THE COMPLAINTS COMMISSIONER'S FINAL REPORT INTO THE FINANCIAL CONDUCT AUTHORITY'S OVERSIGHT OF LONDON CAPITAL & FINANCE (LCF)

15 FEBRUARY 2022

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Complaints Commissioner

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15 February 2022

Final report by the Complaints Commissioner

The complaint

1. I have accepted 440 complaints about the Financial Conduct Authority's (FCA) regulation of London Capital & Finance plc (LCF). The FCA has investigated the majority of these complaints and issued decision letters to complainants, who have exercised their referral rights and sent me their complaints so I can review the FCA's decisions with which they are unhappy. A small number of the 440 complainants sent me their complaint directly without approaching the FCA first. Under the Complaints Scheme to which both the regulators and I operate (details of the Complaints Scheme can be found here: (https://frccommissioner.org.uk/complaints-scheme/) it is the usual practice for each complainant to have their complaint reviewed first by the regulators before approaching me for an independent review. However, I have accepted these complaints directly as they are in time and in respect of issues which the FCA has already investigated in relation to other complaints. It is also the usual practice for an individual preliminary report (copied to the FCA) to be issued to each complainant, who is invited, along with the FCA, to comment on my preliminary findings. Following this, a final report is issued on their complaint.

2. I have read every complaint that has been submitted to me. I have taken them all into account and tried to reflect them all in this report. Many complainants specifically wrote to me to say that they support representations on complaint matters sent to me by law firm Shearman and Sterling LLP. For ease of reference I have attached these as appendices to this report.

3. I received 232 responses to my preliminary report. The length of time taken to finalise my report has been dependent upon the volume, length and complexity

of responses received from both sides which I have considered in full. All responses to my preliminary report have been carefully considered in reaching my decision.

4. Having reviewed the complaints, it is apparent that the reason for most of the complainants' dissatisfaction with the FCA's response on the matters raised centres upon its oversight role of LCF and the fact it will not pay compensation except for, in some cases, a small ex gratia payment for complaint handling delays or small administrative failures on the part of the FCA Complaints Team, which were issues also complained about.

5. I am aware that there are more complaints connected with LCF which the FCA is currently investigating. However, these cover issues separate from the ones outlined above, and if any of them are referred to me in due course I will review them at that point. On 7 January 2022 the FCA set out how it will apply the 12 month time bar within the Complaints Scheme for complaints about its oversight of LCF. Complainants will continue to be able to make complaints to the FCA about its handling of LCF until 17 March 2022. This announcement can be accessed here: https://www.fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints and I have no objection to the FCA implementing the time bar until 17 March 2022 concerning these types of complaints.

6. I do not wish to delay addressing these important issues for so many affected complainants. Therefore, I have taken the decision to issue one final report encompassing the matters in paragraph 2 above, which are interconnected.

7. This is my master final investigation report which follows the same suit as the report The Rt. Hon. Dame Elizabeth Gloster DBE, PC (the Gloster report) issued following her independent investigation into the FCA's oversight of LCF. I have taken the decision to address complainants in this way to ensure efficiency with minimal delays and disruptions caused to complainants. It is important that I have been as efficiently resourceful as possible in order to provide complainants with an answer as quickly as possible. I am grateful to all those complainants who provided me with their comments and responses to my

preliminary report. I have taken these comments and responses into consideration where I have felt it is appropriate to do so.

8. I have summarised the complaints I have received under the following three broad categories.

Element One

Dissatisfaction with the FCA's oversight of LCF and/or

Element Two

A request that the FCA should offer complainants an ex gratia compensatory payment for its regulatory failings in its oversight of LCF. I have been asked to consider the points raised by Shearman & Sterling in a letter dated 25 June 2021 (Appendix 1a) and/or

Element Three

Dissatisfaction with aspects of the FCA's complaint handling process.

Preliminary points:

9. The Compensation (London Capital & Finance plc and Fraud Compensation Fund) Act 2021 was made into law on 20 October 2021. Full details of the Act can be accessed here: https://www.legislation.gov.uk/ukpga/2021/29/enacted For context the Government announced that the scheme will pay 80% of bondholders principal investment in eligible bonds, up to a maximum of £68,000 (80% of the £85,000 FSCS compensation limit). This is specifically for investors who have not already been compensated by the FSCS. The FSCS has started the process of paying compensation to LCF bondholders who are eligible for the governments scheme. I discuss this further on in my report.

10. Many complainants have raised the point as follows, '…the Treasury Compensation Bill means I will be losing out 20% of my investment…' As HM Treasury (HMT) are the body who have put through the proposal for this Bill which has now passed and become an enacted part of legislation, it is a matter that is not within my remit. As such I am unable to investigate this complaint

point. Section 3.1 of the Complaints Scheme provides coverage for complaints against the FCA, Prudential Regulation Authority (PRA) and the Bank of England (the Bank). My role is to investigate complaints only against any of the financial regulators and for that reason, this issue connected to the Government Bill is not something I can comment upon or look at further. In response to my preliminary report, I received several queries about the Government Bill, complainants queried when they would receive payment and what they should do. The Government have provided an information web page answering such queries which complainants may find helpful here: https://www.gov.uk/government/publications/london-capital-finance-lcf-compensation-scheme

11. I am also unable to review any complaints about the actions, or inactions, of the Financial Services Ombudsman (FOS) and the Financial Services Compensation Scheme (FSCS).

My analysis

Element One - the FCA's oversight of LCF

12. The FCA's oversight of LCF and the LCF collapse itself, prompted widespread attention from various individuals and bodies. This has been high profile in nature and included observation and scrutiny from LCF individual investors and their representatives, government departments, law firms, press, media and consumer groups. This accelerated the coverage of LCF in general and its oversight by the FCA. A separate inquiry (resulting in the Gloster report issued on 17 December 2020) offered in depth analysis of the problems which arose. The FCA's own investigation was extensive and thorough and resulted in a further comprehensive analysis of the facts relating to its oversight of LCF. I have studied the Gloster report and the FCA's investigation report. Although I have consulted background documents to check the FCA's analysis, I have not considered it necessary to rehearse all the factual background here. Nonetheless, I set out below a very brief summary of the general background, because without it, it is not possible to explain why the regulator acted as it did,

nor is it possible to assess whether or not its actions or inactions were reasonable. Much fuller explanations of this background are contained in the Gloster report.

13. My office, during its logging and review of the complaints, has noted the impact this has had on individuals. The most common themes included depression, stress, anxiety and exacerbated existing medical conditions. Many complainants have also made me aware of the development of new medical conditions which they believe to have been triggered by the stress they experienced. Aside from the medical impact, complainants have shared the impact this has had on their personal and family lives including homelessness, the breakdown of marriages and the loss of employment. I empathise with all complainants and the detrimental impact this has had on them.

Background to LCF and the FCA's regulation

14. In July 2012 LCF (as it is now known), was initially incorporated on Companies House under the Company name 'South Eastern Counties Finance Limited'. In July 2015 it changed its name to London Capital and Finance Limited.

15. LCF obtained its consumer credit licence from the Office of Fair Trading (OFT) in September 2012 for consumer credit (lending) and consumer hire. On 1 April 2014 the FCA took over the regulation of the consumer credit industry from the OFT. The interim permissions for consumer credit and consumer hire business were carried over from the OFT licence pending LCF obtaining full FCA authorisation.

16. As has been outlined in the Gloster report LCF's main business appeared to have been commercial lending which was funded by it issuing various bonds in its own name to bondholders. LCF bonds were issued for up to five years and at rates of interest that varied depending upon the terms of the bond and the bond issue. For context, just over £237 million was raised by LCF from investment products issued to over 11,000 bondholders.

17. LCF were approved by Her Majesty's Revenue and Customs (HMRC) on 1 November 2017 to manage Individual Savings Accounts (ISAs). Subsequently, LCF started to offer products which it claimed to be ISAs alongside its non-ISA

wrapped products. LCF operated on the basis of a stated business model of raising money from private investors for the purpose of making loans to SME's. Money was raised by issuing 'LCF bonds' and products it claimed to be ISAs to investors for periods of up to 5 years and at rates of interest that varied depending upon the terms of the bond and the bond issue. Much like the Gloster report, some complainants have also made me aware in their response to my preliminary report, that they did not consider that they were investing in 'mini-bonds'. As such, my final report will only make reference to 'mini-bonds' where it is imperative to do so.

Regulated and Unregulated activity

18. In essence, LCF used marketing materials which gave prominence to its FCA authorised status in order to entice consumers, despite the fact that many of the bonds it issued were unregulated. This so called 'halo effect' as described in the Gloster report led a number of the firm's clients to believe they were investing in regulated products when in fact this was not true in all cases.

19. My predecessor has raised similar issues with the FCA previously, this being the matter that regulated firms are not required to advise consumers when a particular product or activity they carry out is not covered by the FOS or FSCS. Understanding what is not covered under the FOS and FSCS has an equal if not greater importance to a consumer than understanding what is covered. So, this has very much been on the radar of the FCA since it was raised in 2016. The specific case my predecessor issued can be accessed here: https://frccommissioner.org.uk/wp-content/uploads/FCA00131-DL-02-02-16.pdf

20. LCF's issuing of its bonds did not constitute regulated activity. In certain circumstances LCF were also carrying out other regulated activities for which it did not have permission. For example, LCF arranged deals in investments such as making arrangements for investors to switch their existing investment from a stocks and shares ISA to an LCF bond, therefore LCF were arranging the disposal of the existing investment. This activity was not an activity for which LCF had permission. Another important factor to note here is the permissions that had been granted to LCF. Although permissions had been granted to LCF

for regulated activities, LCF did not actually carry out some of these regulated activities.

21. LCF's issuing of its bonds - 'mini-bonds' are described by the Treasury and the FCA as an unregulated investment product. Although there is no legal definition of a 'mini-bond', the FCA's description can be accessed here: https://www.fca.org.uk/consumers/mini-bonds. LCF products offered rates of return of between 3.9% and 11% with many of LCF's products offering returns at the higher end of that range (6.5% or higher). LCF held only interim permissions for consumer credit and consumer hire business when the FCA took over the regulation of consumer credit firms from the OFT from 1 April 2014. Later, on 21 October 2015 LCF submitted an application to the FCA for authorisation (the Initial Authorisation Application) under Part 4A of Financial Services and Markets Act 2000 (FSMA) for the following regulated activities:

    i. credit broking

    ii. entering into regulated credit agreements as lender (excluding high-cost short-term credit, bill of sale agreement, and home collected credit agreement) and

    iii. exercising/having right to exercise lender's rights and duties under a regulated credit agreement (excluding high-cost short-term credit, bill of sale agreement, and home collected credit agreement).

22. Discussions took place between the FCA Financial Promotions Team and LCF at the start of 2016. LCF's initial authorisation application regarding credit broking was approved in June 2016. Further discussions took place between the FCA and LCF in September and October 2016 specific to LCF's financial promotions.

23. Later in October 2016 LCF submitted its first Variation of Permissions (VOP) application to carry out corporate finance business.

24. The following year in April and June 2017 the FCA Financial Promotions Team had further contact with LCF. In addition, the VOP was approved by the FCA on 13 June 2017. This gave LCF permissions to carry on corporate finance business as an Exempt CAD firm with new permissions for:

i. Making arrangements with a view to transactions in investments

ii. Arranging (bring about) deals in investments; and

iii. Advising on investments (except on Pension transfers and Pension Opt Outs.) This authorisation also permitted LCF to approve its own financial promotions.

25. The FCA Financial Promotions Team engaged in further dialogue with LCF in August and September 2017.

26. In November 2017 HMRC granted LCF ISA Manager status.

27. Almost a year later in September 2018, LCF submitted its second VOP application for permission to provide investment advice to retail clients.

Inception of the FCA's concerns

28. The FCA's Listing Transactions Team in particular, were the first to highlight their concerns to the Supervision Division within the FCA. As such, information requests were logged with Supervision in August 2018 and in September 2018 which detailed its specific concerns. Equally and within a similar time frame, the Intelligence Team within the FCA realised their concerns in October 2018. These concerns occurred by chance when a member of the Intelligence Team first identified the risk, whilst they were working on a different matter entirely. Subsequently in October 2018, the Intelligence Team raised these concerns with the Supervision Division and the matter was escalated within the FCA.

29. As a result of the concerns raised the FCA decided to intervene. It was on 10 December 2018 when the FCA took part in an unannounced visit to the offices of LCF. A prohibition took place including the issuing of a First Supervisory Notice. This notice banned LCF from using its promotional material, which was deemed as unclear, unfair and misleading.

30. Later in December 2018 the FCA issued a Voluntary Requirements Notice (VREQ). This VREQ was entered into with the following conditions upon LCF:

i. Not to deal with, or dispose of any of its assets

ii. Cessation of its regulated activities and

iii. Not to communicate financial promotions

31. On 17 January 2019 the FCA issued a Second Supervisory Notice. The principal points of this notice stated:

    i. The ISAs sold by LCF were not qualifying investments

    ii. Undue prominence was given by LCF to its FCA authorisation despite the bonds not being regulated or protected by the FSCS protections.

32. Shortly after the second notice was issued, on 30 January 2019 LCF entered into administration. Four administrators of the firm Smith and Williamson LLP were appointed as the administrators.

33. Given the collapse of LCF and the scale of the issues identified, the FCA Chair Charles Randell, requested an independent investigation into LCF. In his letter dated 1 April 2019 https://old.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/Letter-from-Charles-Randell-to-Nicky-Morgan-20190401.pdf, Mr Randell invited HMT to commission an independent investigation pursuant to Section 77 of the Financial Services Act (FSA) 2012. Economic Secretary to the Treasury John Glen MP responded to this letter and agreed that it was in the public interest for HMT to order an independent investigation under Section 77 of the FSA 2012 https://www.parliament.uk/globalassets/documents/commons-committees/treasury/Correspondence/2017-19/EST-to-Charles-Randell-FCA-010419.pdf

34. HMT consequently set out its Direction to the FCA, pursuant to s77 and s78 of the FSA 2012. The purpose of this direction was to '…investigate the events and circumstances surrounding the failure and placing into administration of LCF…' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803967/LCF_Direction_to_FCA.PDF

35. During this time, the FCA also received complaints against it from the investors in LCF, which it deferred until the independent investigation of LCF had been completed. I agreed with the deferral of those LCF complaints about the FCA.

36. The Rt. Hon. Dame Elizabeth Gloster DBE, PC (Dame Elizabeth) was appointed by the FCA on 22 May 2019 as the independent investigator to conduct the investigation. The Gloster report was published by HMT on 17 December 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf The Gloster report set out recommendations for both the FCA and HMT.

The Gloster report

37. Factors such as FCA delays in providing Dame Elizabeth with the information and evidence in a timely manner, impacted when her report would be readily available. This caused a delay in the original timeline for the report to be finalised, which was set for 10 July 2020. The report was not received by the FCA until 23 November 2020, with a revised version published on 10 December 2020. This continuous delay has understandably been frustrating and caused further upset for complainants. I know complainants have also had to wait a considerable amount of time for the finalisation of my final report and thank them for their patience.

38. I welcome the independent report of Dame Elizabeth and its recommendations. My office and my predecessors have made similar recommendations in the past as outlined in Dame Elizabeth's report and the need for change within the FCA.

FCA's investigation into the allegations

39. The Gloster report identified a number of FCA failures in its regulation of LCF. All recommendations set out in the Gloster report specifically for the attention of FCA were accepted. The FCA has also committed to implementing each of the recommendations which can be accessed here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945252/FCA_Response_DIGITAL_final.pdf

40. After the Gloster report was published and the FCA published its own response, the FCA turned to investigating the complaints it had previously deferred about its oversight of LCF. A copy of the FCA's findings about a number of aspects

connected to its authorisation and regulation of LCF is attached at Appendix 2. This provides further information on the events which transpired.

41. The FCA completed a review of 10 complaints which it refers to as 'allegations' about its oversight of LCF and either upheld or partially upheld six complaints, did not uphold two, excluded one and deferred one complaint. Allegation six was deemed out of scope of the Complaints Scheme and allegation eight continues to be deferred as follows:

    i. Allegation Six - The FCA will not provide more information about the investigation. (out of scope of the Complaints Scheme under paragraph 3.5)

    ii. Allegation Eight - Unhappy with the length of time the FCA's Enforcement investigation is taking (allegation remains deferred due to the ongoing Enforcement and Serious Fraud Office (SFO) investigation)

42. I agree with the FCA's reasoning regarding its decision on allegations six and eight above.

43. The allegations which the FCA upheld or partially upheld are as follows:

    i. Allegation One – the FCA should have picked up on LCF's misleading marketing and advertising sooner. If the FCA had acted sooner, it would have prevented people from investing (partially upheld)

    ii. Allegation Two – The FCA was in receipt of intelligence regarding the way that LCF was operating and concerns about the underlying investments in 2015, and in the years since, and did not take any action (upheld)

    iii. Allegation Four - The FCA should not have authorised LCF. The FCA should have identified issues with LCF and its business model at the point of authorisation (partially upheld)

    iv. Allegation Seven - The FCA failed to supervise LCF and as a result you have suffered a loss on your investment (partially upheld)

    v. Allegation Nine - The FCA failed in its authorisation of LCF (partially upheld)

vi. Allegation Ten - You are complaining that the FCA has caused a delay in the Independent Review of the FCA's regulation of LCF (upheld)

44. Both the Gloster report and the FCA investigation of its regulation of LCF identified that there were regulatory failures. I welcome the fact the FCA has upheld and/or partially upheld these complaints about its oversight of LCF and agree with its decision to do so. The FCA has informed me that not all the allegations it investigated were upheld. As can be seen in Appendix 2, allegations three and five provide as follows:

    i. Allegation three – The actions the FCA took under its investigation caused LCF to fail

    ii. Allegation five – The information about LCF on the Financial Services Register was misleading. Consumers believed LCF was a reputable firm and were purchasing a regulated product which offered the associated protections or access to the Financial Ombudsman Service and Financial Services Compensation Scheme

45. Allegation three – the FCA is of the view that the primary cause of LCF's collapse were the actions of LCF and not the FCA's intervention. On the matter of the FCA's intervention, it is important to emphasise that it is not my role to say what I might have chosen to do had I been in the regulators' shoes at the relevant times. The regulators have been given considerable discretion to decide how and when to deploy their regulatory powers: this is right and inevitable, given the scale and complexity of the task which the regulators are expected to perform, and the competing priorities which it faces. The question which I have to address under this Complaints Scheme is not whether the regulators might have done things better, but whether their actions or inactions were of a kind which fall outside the bounds of reasonableness.

46. The FCA states that it is satisfied that its actions and interventions in December 2018 did not cause LCF to fail and having looked at this, I agree with the FCA's stance to not uphold on allegation 3. I also note that the Dame Elizabeth independent report too, did not reach a finding on this particular area.

47. Allegation five – the FCA is of the view that:

> The Gloster Report finds that Bondholders who searched for LCF on the FCA Register found it difficult to use and commented that it was not clear that LCF's bonds were unregulated. While the Register could have been clearer in some respects and easier to use, we do not accept it was misleading.
>
> The information gathered during the course of the investigation shows that the information contained on the FCA Register regarding LCF was accurate regarding the level of permissions LCF had. The Gloster Report also does not make a finding to say the FCA Register was inaccurate.
>
> Because of this, we do not uphold this allegation. Although we accept information could have been clearer, the Register is there as a record of firms, individuals and other bodies that are or have been regulated by the PRA and/or the FCA. It is not designed to be the sole due diligence check a consumer should carry out when making a decision to invest and the ultimate responsibility for deciding on whether to make an investment remains with the consumer.

48. The FCA has not upheld allegation five and does not accept that the Register was misleading. As part of the FCA's decision making with allegation five, there has been a reliance on the Gloster report, in that the Gloster report did not make a finding that the Register was '…inaccurate...' The FCA provides quotes from the Gloster report in connection with the deficiencies and the Register being unintelligible to the public. However, the FCA then does not seem to provide any commentary or decision on these elements in particular, only that the Register could have been clearer in some respects and easier to use. Whilst the Gloster report did not specifically make a finding on the Register being 'misleading', it cannot be ignored the extent to which the Gloster report determined that the Register was deficient and failed to present information in an intelligible manner.

49. The Gloster report provides:

> The Register was deficient. During the Relevant Period, the Register was, however, deficient in two respects: (i) it failed adequately to warn

consumers of the risk of unregulated products sold by authorised firms; (ii) it failed adequately to present information in a manner intelligible to the public.

Unregulated products sold by regulated firms. Bondholders have informed the Investigation that LCF's appearance on the Register contributed to investors' belief that LCF had a badge of respectability deriving from its authorised status, including in respect of its unregulated bond business.

50. In conclusion the Gloster report found that the '…Register and the ScamSmart website do not excuse or mitigate the FCA's failures set out in this report. Such resources did not dissuade investors from investing in LCF…' The Gloster report quoted testimony from investors as follows:

> For example, at the Bondholders' Meeting, one investor said that the Register showed that LCF was FCA registered which led the investor to conclude "therefore they're FCA approved, therefore we are safe."

51. The Gloster report also stated the following in relation to the Register:

> The Register failed to present information in an intelligible manner.
>
> This deficiency was acknowledged in an internal FCA ExCo paper dated 11 September 2017. The paper stated that the "Register does not give potential users, particularly consumers, an intelligible service" and quoted from a January 2015 study which had concluded that "consumers are largely baffled by the Register's language." The paper went on to state that if the Register was maintained as it was "[c]onsumers will continue to find it difficult to understand the language used in the Register which is likely to result in harm." The paper also recorded that the FCA had held workshops with staff from all areas of the FCA and that "[t]here was a general view that the Register as constructed is not a suitable vehicle for conveying information directly to consumers."

52. I have also been provided with evidence and screenshots from the FCA regarding what the Register entry at the time '…would have looked like…' for LCF. I note that commentary provided in relation to the production of these

screenshots state '…I wouldn't be able to say 100% this was the content, but there have been few changes to our previous Register, so it would have been close to this…' As these are not the actual screenshots from the Register at the time, I cannot be certain what the Register would have resembled at the time, although given the FCA's own commentary it is highly likely it would have resembled this as there had been few changes to its previous Register.

53. I also note in the FCA evidence I have been provided with, the screenshots were prepared for the '…(TSC) hearing…' I presume TSC refers to the Treasury Select Committee hearings that took place earlier this year, although I would not want to assume this is the acronym without the FCA clarifying this. In my preliminary report I invited the FCA to provide a response on this for clarity. In the FCA's response (Annex 5) which is also located at Appendix 6 of my report it stated '…We can confirm that 'TSC' stands for the Treasury Select Committee...' So, the FCA have now clarified this. The FCA then go on to state in the document containing the Register screenshots:

> The document prepared for the TSC hearing also said the following regarding the Register finding in Chapter 1 above:
>
> Accept: need to avoid any comments that the Register could mislead; however, may accept that at the time the Register was not simple to use. Now easier to use, etc

54. Based on everything I have looked at specifically the citing of investors' testimony and conclusions reached in the Gloster report, it is difficult for me to see that the Register could not have given investors the wrong impression. If investors were led into thinking they were investing in a safe product because of FCA authorised status (which was not the case) and there were no warnings displayed regarding the risks associated with unregulated products I struggle to see how the Register subsequently could not appear to be misleading. Investors were not warned of the risk associated with unregulated products. It wasn't until September 2019 Charles Randell warned investors about putting all their eggs in one high risk basket using mini-bonds to highlight his remarks. In November 2019 the FCA announced a temporary ban on mass marketing of mini-bonds to

retail investors and in January 2021 the FCA made the temporary ban permanent.

55. The appearance of LCF's Register entry encouraged investors that LCF had a badge of respectability. Information was also not presented in a manner which was intelligible to the public. Considering all the evidence in the round, I disagree with the FCA's stance on allegation five and there could be arguments relevant to the FCA Register being misleading, due to my own analysis and the deficiencies that were identified in the Gloster report.

56. The FCA has stated more recently:

> In July 2020, we relaunched our enhanced Register to include information on consumer protections and actions against individuals and firms to help users avoid scams. Additionally, since March 2021, all firm records on the Register include the following warning: "Firms we regulate may also provide products or services that are unregulated. These may not be covered by the Financial Ombudsman Service (FOS) or the Financial Services Compensation Scheme (FSCS). If you are unsure whether a product or service is regulated by us, then you should ask the firm to clarify this in writing

57. Whilst these developments are welcome, I continue to monitor this and proactively raise subsequent Register issues with the FCA. In my preliminary report I recommended that the FCA uphold allegation five. In the FCA's response to my preliminary report, it has disagreed with my recommendation and considers its decision was appropriate to not uphold allegation five regarding the FCA's Register. I continue to have significant concerns about the FCA's Register, specifically the FCA's stance in its response that, '…the halo effect will continue to pose an unavoidable challenge…' In light of its view, the FCA should seriously consider amending its warning message on its Register by making clearer the risks attached to the halo effect. In response to my preliminary report, I received many responses raising concerns about the Register. An example is the following response from a complainant,

> address the issue of the Register being too involved or complicated for some casual investors to manage, especially those with limited IT

> skills. I looked the other day for a firm and its still difficult to drill into it to find what is, or is not, covered or regulated to do

58. I remain of the view that the warning message on the FCA Register needs to be made even more prominent, making it simple and concise for investors to understand the risks involved. In the FCA's response to my preliminary report located at Appendix 6 it quoted what the FCA Register warning currently reads,

> Firms we regulate may also carry out activities that are not regulated by either the FCA or the Prudential Regulation Authority (PRA). Complaints or claims about these unregulated activities may not be covered by the Financial Ombudsman Service (FOS) or the Financial Services Compensation Scheme (FSCS). If you are unsure whether an activity undertaken by a firm is regulated by us or the PRA, then you should ask the firm to confirm in writing what protections will be available to you if you need to make a complaint or claim compensation.

59. It is my view that this messaging on the FCA Register should be updated as soon as possible, so that it is clearer for the benefit of investors. For example, currently the FCA message gives the impression that claims about unregulated activities '…may not be covered…' by the FOS or the FSCS. Using the term '…may not be covered…' gives the impression that there is a possibility an investor may actually be covered for a claim for unregulated activity if they raised a claim with the FSCS for example. As demonstrated in the response I received from a complainant above - confusion and complications regarding the Register remain. It is important to highlight the FSCS take a different stance on this on its website here: https://www.fscs.org.uk/what-we-cover/investments/ The FSCS messaging on its website provides the following,

> For FSCS to be able to protect you, the PRA or the FCA must have authorised the provider or adviser, as well as regulated the service and product it provided.

60. In comparison I note the FSCS messaging in this area. I am not sure why the FCA will not provide the same clear content in its warning message in its

Register. I urge the FCA to reconsider my recommendation on allegation five. It is important the FCA recognise this and make amendments to its Register.

61. In addition to the reference of the FCA's point that the halo effect, '…will continue to pose an unavoidable challenge…', I have already highlighted the criticisms found in the Gloster report that the Register was (a) unintelligible; and (b) contained insufficient warning. The Register is about provenance and accuracy and the halo effect can be mitigated by the FCA. It does not feel right in my view, that there is an acceptance from the FCA's standpoint that the halo effect will be unavoidable. The FCA must take active steps to mitigate the halo effect happening again - thereby alleviating further risks such as those identified in the case of LCF. The FCA has not adequately addressed these points in its response to my preliminary report and as such I have outlined in my recommendations of this report what I think the FCA ought to do.

Andrew Bailey

62. A few complainants have raised arguments in relation to Andrew Bailey personally. The gist of these particular complaints points is the same, an example of which includes, '…Why did Andrew Bailey knowingly allow illegal financial activity on his watch? This question has never been answered…'

63. Andrew Bailey served as Chief Executive Officer of the (FCA) from 1 July 2016 until taking up the role of Governor of the Bank of England on 16 March 2020.

64. I have not seen any evidence that Mr Bailey (or any FCA staff) knowingly allowed illegal activity under his watch whilst he was the CEO at the FCA. Mr Bailey also gave oral evidence to the Treasury Committee on 24 February 2021 in respect of the FCA's oversight of LCF. As such I do not think it is relevant for me to look at this complaint point any further. For reference viewing of this meeting with the Treasury Committee is still available to watch online as well as the transcript of the meeting here: https://committees.parliament.uk/event/3792/formal-meeting-oral-evidence-session/

Conclusions as to the FCA's oversight of LCF

65. My conclusions in respect of the FCA's oversight of LCF: firstly, I take into consideration the fact that the FCA have decided to uphold certain elements specifically allegations one, two, four, seven, nine and ten. I agree that the FCA should have upheld these allegations and welcome the FCA's approach and its commitment in reviewing these elements on their own merits based on the individual facts of the case.

66. As to allegations six and eight I agree with the FCA's approach of allegation six being out of scope of the Complaints Scheme pursuant to Section 3.5 of the Complaints Scheme and allegation eight continues to be deferred as per Section 3.7 of the Complaints Scheme. The enforcement investigation is ongoing within the FCA and separately at the SFO and I need to consider the underlying reasons for the FCA's decision to defer allegation eight in this case. I am satisfied that the enforcement investigation is still live and that it would be unreasonable to not await the conclusion of the FCA's enforcement investigations regarding allegation eight. As such, I do not think it is appropriate that the FCA begin the complaints investigation into allegation eight before the procedures into the enforcement are completed.

67. As to allegations three and five which have not been upheld by the FCA, I have provided my analysis regarding the FCA's stance on these allegations above in my report. I have taken into account the evidence and facts I have been provided with and I repeat that overall, I agree with the FCA's decision to not uphold allegation three, but I do not agree with the FCA's decision to not uphold allegation five.

68. I also reiterate that I welcome the independent report of Dame Elizabeth and its recommendations, and the fact the FCA has accepted these.

69. It is not in doubt that there were regulatory failings on the part of the FCA in its oversight of LCF. This has been acknowledged by HMT, the Gloster report and the FCA itself as a result of its own investigation into complaints (apart from the allegations referred to above). Complainants have reiterated to me that they are dissatisfied with the FCA's regulation of LCF, and I agree that the FCA was right to uphold and partially uphold allegations six of the investigated allegations

(although I disagree with the decision not to uphold allegation five which I recommend should be upheld). I also agree that the FCA was right to issue an apology to complainants.

70. In response to my preliminary report, I received a response from a complainant as follows,

> HMRC involvement not mentioned enough in the PR as LCF were also approved by HMRC as 'manager' of ISA's. The FCA said these ISA's were not qualifying investments and it was too delayed before the FCA decided to provide advice

71. This is a further issue I have considered more widely. The Gloster report extensively identified this issue and as such, I have decided there is no need for me to explore this further. Dame Elizabeth in her independent review identified these issues and under Recommendation 10 provided as follows,

> HM Treasury should consider addressing the lacuna in the allocation of ISA-related responsibilities between the FCA and HMRC.

72. Any further investigation into these matters would not yield a better remedy for complainants. The Gloster report has appropriately dealt with bringing this to the attention of both HMRC and the FCA.

73. Some complainants have said that their questions about aspects of the FCA's regulation of LCF remain inadequately unanswered and have not been specifically covered by either the Gloster report or the FCA investigation. I appreciate that complainants may continue to have questions about specific actions the FCA undertook during its oversight of LCF, but I do not think that any further investigation into matters connected to the ten allegations above is proportionate given the already extensive investigation of Dame Elizabeth and the FCA. The FCA has accepted that there were regulatory failings on its part and has upheld complaints on these matters. Any further investigation will not have a bearing on this conclusion. Therefore, I am exercising my discretion not to investigate any further matters related to the FCA's oversight of LCF connected to the ten allegations than the ones referred to throughout this final report for reasons of proportionality and in order to use my resources efficiently

during the course of this investigation. For the avoidance of doubt, my decision will not disadvantage complainants.

Element Two – ex gratia payment/compensation

74. Here I assemble all complaints in one and treat these as a compendious complaint about the FCA's failings in relation to LCF and in that context, the FCA's further failings in adopting a particular compensatory test regarding those complaints. Many complainants have asked me to recommend that the FCA award them an ex gratia compensation payment in view of the FCA's regulatory and supervisory failings with respect to LCF and/or to consider the points raised by Shearman and Sterling and, in some cases, Gina and Alan Miller of the True and Fair Campaign, on this issue. I have received a letter from the True and Fair Campaign dated 27 April 2021 (Appendix 3a) and a second letter dated 9 August 2021 (Appendix 3b).

75. There are also complainants who have adopted the position that they accept the FCA's offer of payment for the delay and/or mistake in processing their complaint, but they do not accept this as compensation for the FCA's regulatory failures and/or lack of action against LCF.

76. Finally, there are a set of complainants who received an ex gratia payment from the FCA for delays, but the offer was made either to a group of complainants jointly rather than severally, or the amounts seemed irregular. I queried this with the FCA and it has undertaken to address this. I address this further later in my report and explain the actions both I and the FCA have undertaken and continue to undertake.

77. In order to address the issue of compensation, I first outline the background underpinning the current debate.

78. Provision in relation to ex gratia compensation for complaints about the regulators is made at section 87(5) of Financial Services Act 2012 as follows:

> The Complaints Scheme must confer on the investigator the power to recommend, if the investigator thinks it appropriate, that the regulator to which a complaint relates takes either or both of the following steps
>
> (a) makes a compensatory payment to the complainant, or

(b) remedies the matter complained of.

79. The investigator referred to in the legislation is in fact my role of 'Complaints Commissioner'.

80. The Financial Services Authority ("FSA") (as it then was) carried out a consultation about the details of the Complaints Scheme at its inception in 2000-2001. Following this consultation, it published the Complaints Scheme.

81. The Complaints Scheme can be accessed here: https://frccommissioner.org.uk/complaints-scheme/ On the issue of compensation, paragraph 6.6 of the Complaints Scheme provides:

> Where it is concluded that a complaint is well founded, the relevant regulator(s) will tell the complainant what they propose to do to remedy the matters complained of. This may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an ex gratia basis.

82. Paragraph 7.5 of the Complaints Scheme provides that:

> In deciding what steps they should recommend the regulators to take, the Complaints Commissioner will have regard to matters such as the source of the funds to make the payment as well as the desire of the regulators to be efficient and economic in the use of their resources.

83. And paragraph 7.6 provides:

> The Complaints Commissioner may, if appropriate, recommend that the regulators remedy the matters complained of, as described in paragraph 6.6

84. Paragraph 7.14 provides:

> In deciding how to respond to a report from the Complaints Commissioner, the relevant regulator(s) will normally take into account:
>
> a) the gravity of the misconduct which the Complaints Commissioner has identified and its consequences for the complainant;

b) the nature of the relevant regulator(s)' relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s);

c) whether what has gone wrong is at the operational or administrative level;

d) the impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers.

85. There were then no further significant developments in the parameters of the Scheme until a Remedies Statement was published on the FCA's website on 16 June 2020 which can be accessed here: https://www.fca.org.uk/news/statements/complaints-scheme-our-approach-remedies The FCA contends that the Remedies Statement reflects historic practice. As set out in more detail below, however, in my view it introduces, for the first time, the notion of a 'solely or primarily cause' test of causation.

86. In the FCA Consultation Paper, CP 20/11 (published July 2020), the FCA commenced a consultation exercise with a view to amending the terms of the Complaints Scheme. The Consultation Paper can be accessed here: https://www.fca.org.uk/publications/consultation-papers/cp20-11-complaints-against-regulators-fca-pra-boe The consultation was joint with the Bank of England and the Prudential Regulation Authority. The stated purpose of the consultation was for the three financial regulators to propose a revised version of the Complaints Scheme that is more user friendly, using plain, simple language making it more accessible for consumers, businesses and others.

87. Paragraph 1.4 of the Consultation Paper explains that one of the reasons for the consultation is that '…we are proposing a more detailed description of our approach to ex gratia compensatory payments...to help complainants understand what they can and cannot expect from the Scheme…' Paragraph 1.8 provides that one of the outcomes being sought from the consultation is '…to help users approach the Scheme with realistic expectations of what it can and cannot deliver in terms of remedies, by clearly stating our approach to

compensatory payments…' Paragraph 4.2 explains that '…We are proposing further information on our approach to compensatory payments…'

88. Paragraph 2.2 explains that the context of the Complaints Scheme includes statutory immunity from suit, which allows the FCA to discharge its regulatory functions without the distractions or perverse incentives which might arise from concerns if it were concerned about facing damages claims. It continues:

> While the Scheme allows for compensatory payments to be made, such payments cannot be made in a way which undermines or erodes this exemption under legislation. Compensatory payments under the Scheme are therefore made ex gratia and are not comparable to payments which might be claimed from us if statutory immunity did not apply.

89. Section 4 of CP 20/11 explains the FCA's approach to compensation payments:

> 4.4: We see compensatory payments as an acknowledgment of regulatory shortcomings and of the fact that the complainant has suffered distress or inconvenience and/or financial loss. We believe it is appropriate that payments be modest, for the following reasons:
>
> By law, we are immune from liability in damages unless it is found that we have acted in bad faith or have breached human rights;
>
> The Scheme is not designed to consider complex issues of causation, and our determination of any compensatory payment cannot be made in the same way in which a court or tribunal might calculate an award of compensatory damages; and,
>
> We are funded by the fees paid by the firms we regulate, and therefore the costs will ultimately fall on the firms and, through them, consumers.
>
> In determining the levels of compensatory payment, we would consider how the cumulative impact of payments may affect the fees we levy on the financial services industry and, indirectly through them, consumers. In some cases, we may decide that the levels of

compensatory payments as determined under our proposed Annex A of the Scheme, need to be reduced in light of that impact.

In cases of financial loss, we would consider making a compensatory payment only where adequate documentary evidence of the loss has been provided, and the following further conditions have been met:

We are the sole or primary cause of the loss; and

There has been a clear and significant failure by us

Given the nature and purpose of the Scheme, we would not undertake the kind of detailed analysis of the causes of the loss that a Court would carry out. We also do not interview witnesses or complainants. We would instead carry out a common-sense analysis. For this reason, and because neither regulation nor the Scheme are insurance against failures primarily caused by the actions of others, we expect compensatory payments to be appropriate only where we are clearly the sole or primary cause of the loss. The mere fact that one of us may have been at fault in some way does not mean that the Regulator should be considered to be the sole or primary cause of loss which was the result of the actions of a financial services firm.

In deciding the level of any compensatory payment, we will consider a number of relevant factors to help us to decide the appropriate amount, including:

The seriousness, nature and duration of our failing(s) and its/their consequences for the complainant;

The amount of the complainant's evidenced and foreseeable financial loss;

The complainant's individual circumstances, based on information provided to us and/or that is available to us; and

The extent to which the issue, which has resulted in the complaint, is within our regulatory remit.

We would use these factors to decide the actual level of compensatory payment. Any compensatory payment relating to a

> financial loss will not exceed £10,000, save in exceptional circumstances. Moreover, in most cases we would expect any compensatory payment to be lower than this. (Emphasis added)

90. My predecessor's response to the consultation can be accessed here: https://frccommissioner.org.uk/wp-content/uploads/Response-to-CP20-11-for-publication.pdf

91. The FCA's response to the consultation has not yet been finalised and according to the FCA's website it anticipates publishing a policy statement and revised Complaints Scheme by the end of April 2022. The regulators and I continue to have discussions on the issue of compensation. I share the concerns of my predecessor and I have further concerns of my own.

The HMT Scheme

92. In my preliminary report, I referred to the announcement by HMT of the London Capital & Finance Compensation Scheme. On 19 April 2021, HMT announced the London Capital & Finance Compensation Scheme. The Ministerial Statement by which the scheme was announced is instructive. It includes, amongst other things, the following observations:

> One of the key purposes of regulation is to ensure that investors have the right information to understand their risk. Within this system even a regulator doing everything right will not be able to, and should not be expected to, ensure a zero-failure regime.
>
> That is why statute has established the Financial Services Compensation Scheme (FSCS), which is the compensation scheme for customers of failed financial services firms in the UK.
>
> It is an important point of principle that government does not step in to pay compensation in respect of failed financial services firms that fall outside the FSCS. Doing so would create the wrong set of incentives for individuals and an unnecessary burden on the taxpayer.
>
> However, as I will set out in this statement, the situation regarding LCF is unique and exceptional. After considering the issues in detail,

the government has decided to establish a compensation scheme for LCF bondholders. The scheme I am announcing today appropriately balances the interests of both bondholders and the taxpayer and will ensure that all LCF bondholders receive a fair level of compensation in respect of the financial loss they have suffered.

While I have not seen evidence that would indicate that the regulatory failings at the FCA were the primary cause of the losses incurred by LCF bondholders, they are a significant factor that the government has taken into account when deciding to establish this scheme. Indeed, the government does not ordinarily step in to pay compensation to consumers in relation to allegations of fraud, investment losses, mis-selling or mis-buying of investments. I would, however, like to make it clear that neither the government nor the FCA accepts any legal liability for the failure of LCF or the losses incurred by its bondholders.

In these extraordinary circumstances, the government has decided to establish a compensation scheme. However, it is imperative to avoid creating the misconception that government will stand behind bad investments in future, even where FSCS protection does not apply. That would create a moral hazard for investors and potentially lead individuals to choose unsuitable investments, thinking the government will provide compensation if things go wrong. The ultimate responsibility for choosing suitable investments must remain with individuals.

To avoid creating this misconception, and to take into account the wide range of factors that contributed to the losses that government would not ordinarily compensate for, the government will establish a scheme that provides 80% of LCF bondholders' initial investment up to a maximum of £68k.

Around 97% of all LCF bondholders invested less than £85k and therefore will not reach the compensation cap under either the government scheme or the FSCS."

93. Thus, the view of HMT (which is the FCA's sponsoring department) is that the failure of the regulatory system in the case of LCF was so exceptional as to justify a compensation scheme. Both the existence and the extent of the government scheme thus take into account the government's view of the FCA's degree of culpability. However, in order to reflect: (i) the complex interplay of contributory factors; and (ii) the need to encourage consumer responsibility/avoid moral hazard, the decision has been made to cap compensatory awards at 80 percent up to a maximum of £68,000.

94. Shearman and Sterling read my preliminary report as indicating that the compensation available via HMT should be regarded as a cap on the level of compensation that it is fair to pay in each case. They contend that, rather, it should be treated as a floor rather than a cap.

95. My preliminary report was not intended to convey the impression that payments under the HMT scheme could be treated as a cap. In any event, since my preliminary report was published, the HMT scheme has been finalised. Paragraph 4.3.5 of the scheme rules provides that "no deduction shall be made from the compensation amount in respect of any payments made to the Eligible Bondholder under the FCA Complaints Scheme." This makes it clear that HMT does not necessarily consider its compensation scheme to strike the final balance, or to represent a "cap" on all sources of compensation.

96. However, I also do not agree with Shearman and Sterling that the HMT compensation scheme is intended to act as a floor, either. All that may be said is that the two schemes – HMT and the Financial Services Complaints Scheme – exist in parallel, have different eligibility criteria, and take into account different considerations. The HMT scheme does not have regard to any compensation paid out by the FCA, but the reverse is not necessarily the case: the FCA is not precluded by paragraph 7.14 of the Complaints Scheme from taking into account the existence of the HMT scheme in deciding how it should respond to a complaint. It is a potentially relevant (but not decisive) factor going, for example, to the impact on individuals of a decision to, or to refrain from, making an ex gratia award. At the same time, the existence of the HMT scheme is likely

to be of limited if any relevance to the considerations to which paragraph 7.14 of the Complaints Scheme expressly directs the FCA's attention. Thus, even if the FCA does take the HMT scheme into account, then it must not treat the existence of the HMT scheme as a complete answer to the complaint, but must rather continue to give individualised consideration to the facts of every case.

97. Turning specifically to the FCA's decision-making regarding compensation in the matter of LCF, the FCA Board discussed making ex gratia compensatory payment to LCF investors on 16 April 2021. The FCA Board minutes of this meeting can be accessed here: https://www.fca.org.uk/publication/minutes/fca-board-minutes-16-april-2021.pdf

98. The Board is recorded as having decided as follows :

> 2.2 It was noted that the FCA had received final details of the compensation scheme that HM Treasury intended to put in place for LCF investors, and letters from Gina and Alan Miller, and Shearman & Sterling, a law firm acting for certain LCF investors.
>
> 2.3 The Board was advised that the proposals should be considered in light of the relevant factors in the Complaints Scheme, and the FCA's statutory framework, including (as part of consideration of the consumer protection objective) the role of consumer responsibility. It was noted that, having regard to the public sector equality duty (PSED), final decisions on individual complaints would be considered in light of the PSED.
>
> 2.4 Having considered the analysis of the relevant factors in the Complaints Scheme, the Board agreed:
>
> i. to award payments under the FCA Complaints Scheme to LCF investors who were provided incorrect information by the FCA in direct communications where that information may have led the individual to invest, or to refrain from withdrawing their investment, in LCF. This was subject to a final review as the complaints are individually responded to;

ii. that those payments should be described as "ex gratia compensatory payments" (as opposed to payments specifically for financial loss or distress and inconvenience);

iii. not to award ex gratia compensatory payments to other investors, subject to a final review as the complaints are individually responded to.

2.5 The Board considered different options for calculating the amount of any compensatory payments. The Board concluded that two principles should guide the approach; that investors should not be overcompensated, and they should not receive in total more than Financial Services Compensation Scheme (FSCS) limit of £85k from all sources. The Board discussed various options and agreed the methodology to be applied to calculate the payments.

99. On 19 April 2021, the FCA published a statement setting out its '…broad approach to assessing LCF complaints…'. This can be accessed on the FCA's website here https://www.fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints The statement said that it, '…reflect[ed] what we consider is likely to be appropriate in individual cases in accordance with the approach set out in or Complaints Scheme, our remedies statement, and the statutory framework within which we operate…' It continued:

> As part of this process, we have conducted an initial review of LCF investors' direct communications with the FCA over the period between 1 April 2014 and 10 December 2018, the date of the FCA's first regulatory intervention. As noted in Dame Elizabeth Gloster's report, we have identified investors who were given incorrect information in these direct communications with the FCA which may have led them to conclude their investment would be safer than it was. While we do not believe this was the primary cause of these investors' losses, those direct communications may have been a factor in their decision to invest, or to remain invested. While each case will be given individual consideration, given the exceptional circumstances the FCA intends to offer ex gratia payments to the small number of investors

who fall into this category who have not already been compensated by the FSCS.

We will be contacting those investors directly to discuss the details of the payments and how they will interact with the government compensation scheme and any payments made by the FSCS

Complaints by other investors will be considered individually in accordance with the Complaints Scheme. Whilst we do not expect to make ex gratia compensatory payments to these investors, we will be writing to the majority of complainants, acknowledging the errors we made in relation to LCF, reiterating our apology and ensuring they have full information about the government scheme.

100. In response, the True and Fair Campaign wrote to the FCA Chairman Charles Randell on 27 April 2021. The letter can be accessed here and additionally at Appendix 3a of my report: https://trueandfaircampaign.com/wp-content/uploads/2021/04/Open-Letter-to-Mr-Randell-FCA-From-The-True-and-Fair-Campaign-27-April-2021-1.pdf (trueandfaircampaign.com)

101. Although they are slightly differently expressed, I consider that the Board resolution of 16 April 2021 and the announcement on 19 April 2021 should be treated as both seeking to articulate reasons for the same decision.

102. When the FCA issued its decision letter to complainants who had not had "direct" communications with it, it stated the following:

> The FCA has legal immunity from liability to pay damages (compensation) unless it is found that we have acted in bad faith or have breached a complainant's human rights. Therefore, whilst the Complaints Scheme includes a provision for ex gratia payments, we do not award compensation or damages in the same way a court would do. This approach reflects the longstanding practice of the FCA, the Financial Services Authority ('FSA') before it and the Prudential Regulation Authority ('PRA'), collectively the Regulators, having regard to the intention of Parliament in conferring statutory immunity on the Regulators.

In line with our historical practice, for the FCA to consider it appropriate to offer an ex gratia compensatory payment in respect of financial loss, complainants would normally need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA.

Additionally, we may also consider it appropriate to offer an ex gratia compensatory payment in respect of distress and inconvenience where a complainant has suffered a specific inconvenience or an emotional impact, for example due to delays or poor service, directly caused by our actions. We do not have set amounts that we award in such cases as individual complainants are affected differently depending on their specific circumstances.

We have also considered whether, having regard to the factors in paragraph 7.14 of the Scheme, it would be appropriate to make an offer of an ex gratia compensatory payment. We note that in making this decision we look at the overall effect of the factors in light of the circumstances of the complaint. We acknowledge that, with hindsight, there were errors in the handling of LCF and that you have been indirectly impacted by the decisions we have made in relation to LCF. However, we have concluded that it was the actions of the firm itself, and its senior management, which primarily caused your loss. We also note that your complaint does not relate to any direct dealings with the FCA, and that while there were operational errors, our actions need to be considered in light of the fact that we had to make complex judgements about where to prioritise resources. Making a payment in circumstances where we have only indirectly contributed to a loss would also result in the cost of compensatory payments imposing a disproportionate burden on the firms we regulate and their consumers (who ultimately bear that financial burden) and would not give effect to the policy underlying the regulatory framework established by Parliament (as explained above). For these reasons we have determined it is not appropriate to make an offer of compensation in your case."

103. Complainants have approached me to say they disagree with the FCA not offering compensation.

Shearman and Sterling letter 25 June 2021

104. I received a letter (Appendix 1a) dated 25 June 2021 from the law firm Shearman and Sterling LLP. I received a second letter from Shearman and Sterling dated 3 September 2021 (Appendix 1b). Shearman and Sterling informed me in their letter that they act for certain LCF investors, and I have received a letter from the True and Fair Campaign (Appendix 3a). Many complainants have asked me to consider the points raised in these letters in relation to the issue of ex gratia compensation under the Complaints Scheme.

105. I have identified that many of Shearman and Sterling's points are applicable to all LCF complainants. I say this as my review of the complaints I have received show they bear almost precisely the same arguments and concerns highlighted in the letter, although not all complainants have made express reference to Shearman and Sterling or its letter at Appendix 1a. It is for that reason I find it appropriate to consider the points made in the letter across all complaints and will discuss the main points in my report. The main arguments in the letter are, in summary, that:

    a. To the extent that the LCF decision is in turn based on the approach set out in the remedies statement, that approach has no basis in statute or the Complaints Scheme, it would need to be consulted upon, it does not reflect historic practice, and it has no legal force.

    b. Instead, the correct test under the Complaints Scheme and the one that has been used historically is one of "contributing to" causation. If the FCA is not the sole or primary cause then that has been a reason to reduce ex gratia payments, rather than exclude them altogether.

    c. The "sole or primary cause" test gives excessive weight to the FCA's statutory objective of encouraging consumers to take responsibility for their actions, especially when considered in the light of the particular facts of the LCF cases (in which, for example, generally unsophisticated investors paid into what they were led to believe were low risk schemes).

Further, it gives no or insufficient weight to the FCA's statutory objectives of customer protection or enhancing the integrity of the UK financial system.

d. The FCA has misapplied the factors at paragraph 7.14 of the Complaints Scheme. Insufficient weight has been given to the gravity of the FCA's failings. In singling out the incorrect information investors, the FCA incorrectly gave overriding importance to the nature of the relationship between FCA and consumers. The FCA cannot rely upon the need to allocate finite resources, as the Gloster report rejected that as a reason for the FCA's failings. The financial consequences for investors are significant, and the FCA can use fines received from enforcement action and/or to deplete the FCA's surplus funds in order to pay compensation to affected LCF complainants.

e. Applying a "contributed to" test would, on the findings of the Gloster report as summarised at paragraphs 3.4 to 3.6 thereof, have resulted in the award of substantive compensation to at least some complainants.

FCA letter dated 9 August 2021

106. I then received a letter from the FCA Chair Charles Randell dated 9 August 2021 (Appendix 4) which sets out the FCA's response to Shearman and Sterling's group complaint. The FCA makes the following points:

a. The Complaints Scheme must be considered in its wider regulatory context, which includes for example the FCA's wider role and responsibilities; the role of consumer responsibility; the existence of other schemes such as the Financial Ombudsman Service, the Financial Services Compensation Scheme and, in this instance, the HMT scheme; and the fact that the Complaints Scheme is not intended to be a substitute for a civil court process.

b. Under the sub-heading "the historical approach", the FCA points out that the Complaints Scheme is intended to ensure regulatory accountability, but not to undermine or cut across the statutory immunity conferred upon the FCA. I note, however, that there is no support in the section on the

"historical approach" for the alleged practice of making ex gratia payments only when the FCA is the sole or principal cause of the loss.

c. In deciding whether to make ex gratia payments, the FCA will have regard to the Remedies Statement. The FCA will consider representations as to why ex gratia compensation ought to be paid in circumstances not provided for by the Remedies Statement. The purpose of having a published statement is to assist with ensuring a consistent and fair approach to proposals for compensation based on the individual features of the complaint and the FCA's culpability. The reasons for the approach taken in the Remedies Statement are set out in the first three paragraphs of the Statement itself.

d. Contrary to what is suggested by Shearman and Sterling, the FCA does not have any means to fund compensation payments to bondholders without raising significant further revenue from regulated firms.

My analysis

107. In connection with Element two, I have considered all the representations above, the historical background to the issue of ex gratia compensation in the Scheme, and the additional representations made by complainants in response to my preliminary report.

108. I find that it is appropriate in principle for the FCA to seek to adopt a consistent approach across all LCF cases, given the large number of such cases and the fact that many of them are likely to follow a similar fact-pattern. This is provided, however, that the FCA still considers the individual circumstances of each case and retains the discretion to depart from its published approach where there is good reason to do so.

109. The real question is thus about the appropriateness of the particular approach the FCA has adopted.

110. As I understand it, the FCA's approach to LCF investors was intended to be an application of its published Remedies Statement. That is apparent from the language used in its 19 April 2021 announcement, the reliance which the FCA

letter dated 9 August 2021 seeks to place on the Remedies Statement, and the reasoning contained in individual decision letters which closely follow the language of the Remedies Statement.

111. As set out above, the Remedies Statement provides that the FCA will only provide compensation for financial loss in respect of its actions or inaction where it is the sole or primary cause of the loss. Yet, in its announcement dated 19 April 2021, the FCA stated that:

> While we do not believe this [the FCA's failings] was the primary cause of these investors' losses, those direct communications may have been a factor in their decision to invest, or to remain invested. While each case will be given individual consideration, given the exceptional circumstances the FCA intends to offer ex gratia payments to the small number of investors who fall into this category who have not already been compensated by the FSCS.

112. Thus, the FCA does not accept that it was the sole or primary cause of the losses even of those investors to whom it provided incorrect information via direct communications. It merely considered that the provision of incorrect information via direct communications may have been "a factor" in the decision of individual investors and regards this as an exceptional circumstance. As such, the decision to award compensation to this group of investors, despite purporting to be an application of the Remedies Statement, was in fact a departure from it, on the grounds that having direct communications with the FCA was an '…exceptional circumstance…' It is not clear whether the FCA appreciated this contradiction at the time it made the relevant decisions in that, as just observed above, those decisions purported to be an application of the Remedies Statement. Be that as it may, the FCA appears to accept this logic now: see paragraph 17 of its response to my preliminary report.

113. This serves to demonstrate how narrow the Remedies Statement is. If consumers who were directly provided with incorrect information in the already exceptional circumstances identified in the Gloster Report would not qualify under the Remedies Statement for an ex gratia compensatory payment arising

from regulatory and supervisory failings, then it is difficult to envisage who would.

114. Given the nature of FCA's role as a regulator of businesses, it is likely that it will always, or almost always, be the case that ex gratia compensatory payments for regulatory and supervisory failings, is caused by the default of a third party, such that the FCA is not the "sole or primary cause". As against that, Parliament has concluded that there will be some situations in which the Complaints Commissioner has the power to recommend, if appropriate, the regulator make a compensatory payment : see s.87(5) of the FSA 2012. The FCA's public statements also acknowledge that such payments should be available: see e.g. CP20/11 at paragraph 4.4. The test as currently adopted by the FCA thus appears on the face of it to frustrate the statutory object and purpose underpinning the Complaints Scheme: see *Padfield v Minister of Agriculture* [1968] AC 997.

115. I therefore said in my preliminary report that if the FCA did intend to maintain this test, then I would expect it to be able to clearly identify examples of cases in which the payment of substantive ex gratia payments for financial loss, including in respect of the FCA's regulatory and supervisory failings could qualify under the Remedies Statement.

116. The FCA has responded to the invitation extended in my preliminary report by providing three examples of circumstances in which it has decided to pay compensation within the terms of its Remedies Statement. Strikingly, all three examples provided involved the payment of compensation to a business, not to a consumer. It is also evident that in all three of these examples, no supervisory or regulatory failings had occurred. This is despite the fact that the scheme referred to in s.87(5) of the FSA 2012 makes no distinction between business and consumer.

117. Given that the FCA's first operational objective is consumer protection, and given the lack of any distinction in the primary legislation between business and consumer in relation to the scheme, it is in my view perverse that the FCA when given the opportunity to do so, did not provide examples of circumstances in which it has decided to pay ex gratia compensation within the terms of its

Remedies Statement arising from regulatory and supervisory failings to consumers.

118. Thus, even though the approach taken to LCF investors purports to take account of the factors in paragraph 7.14 of the Complaints Scheme, the de facto position appears to be that the ex gratia compensatory payments arising from regulatory and supervisory failings will never be available in practice. The FCA states that the Remedies Statement is not a bright line and that there may be exceptional circumstances when such ex gratia payments are made. This is a departure from both the statute and from the published scheme itself: there is no fifth factor within paragraph 7.14 requiring the presence of exceptional circumstances.

119. Further, the FCA's stated aim in publishing the Remedies Statement was to assist with ensuring a consistent and fair approach to proposals for compensation based on the individual features of the complaint and the FCA's culpability. But if the FCA will only make payments to consumers in exceptional circumstances which are outside the terms of the policy which is intended to provide consistency, then the policy itself can provide no consistency at all for that group. It therefore does not even meet its own stated aim.

120. In the FCA's letter dated 9 August 2021, the FCA sought (at paragraph [32]) to explain that the first three paragraphs of the Remedies Statement are the reasons for the test set out in the fourth paragraph. As to that purported explanation, however:

    a. The first paragraph of the Remedies Statement refers to FCA's statutory immunity and the fact that the compensation scheme is not intended to undermine that. However, that it is not of itself sufficient justification for a "sole or primary" test of causation. First, the FCA's statutory immunity at section 222 of FSMA 2000 is expressed to be an immunity from "liab[ility] in damages". Nothing the Commissioner is empowered to do renders the FCA liable "in damages". Second, the power of the Commissioner to recommend an award of financial compensation could be seen as designed to counterbalance the possible injustice of a total lack of recourse against an otherwise unaccountable regulator. Third,

the recommendations of the Commissioner are non-binding such that the regulator is in principle free to comply with them or not. My power to make recommendations that the FCA make ex gratia payments, subject to the various considerations described in the published Complaints Scheme, represents a compromise between the various different interests at stake, rather than a means of cutting across the FCA's statutory immunity.

b. The second paragraph of the Remedies Statement seems to be referring to distress and inconvenience, which the FCA considers separately from ex gratia compensatory payments for regulatory and supervisory failings, and so is not of direct relevance to the "sole or primary cause" test.

c. The third paragraph of the Remedies Statement points out that it is often the case that, where a complainant is seeking compensation for financial losses, those losses have been caused by a third party. As observed above, that will presumably always be the case. But in order for section 87(5) of FSA 2012 to have some content, there must be some circumstances in which it is appropriate for the FCA to make an ex gratia payment for supervisory or regulatory failings. The third paragraph thus begs the question of when that will be, i.e. what degree of culpability is required on the part of the FCA before an ex gratia compensatory payment for regulatory and supervisory failings will be appropriate, and why?

121. The FCA contends that the "sole or primary cause" approach reflects historic practice. Such an approach is not self-evident from the face of the complaints scheme itself. Instead, the FCA has sought to refer to a number of what it says are examples of this being the case. Upon review, however, it seems that none of them do support a "sole or primary cause" approach as alleged. The short point to be made about all of them is that, in each case, the fact that the FCA was or was not the sole or primary cause of the loss is just one of several factors that are taken into account in deciding whether an award of ex gratia compensation should be made. None of them is an example of "sole or primary cause" working as a decisive test for decisions as to the payment or non-payment of compensation. Some of them are examples of the opposite. For

example, in complaint FCA000641, upon which the FCA relied at paragraph 25(2) of its August letter, my predecessor expressly rejected (at [164]) the FCA's reliance upon responsibility lying with the bank and its auditors was misplaced, because whilst the FCA was right about the bank's responsibilities, that did not preclude the possibility that the FCA, having been found to have fallen short in its responsibilities, might consider offering an ex gratia sum. And in respect of FCA00503, the FCA referred to a range of factors in declining to offer financial compensation, including the fact that the complainant received sensible guidance from the FCA before investing which was not followed and which, had it been followed, would have meant the investment was not lost in the way that it was. The complainant did not say that they relied on the Register.

122. In any event, even if this were the historic approach of the FCA, then that does not make it correct, for all the reasons already set out above. Further, this is not encapsulated in 7.14 of the Complaints Scheme.

123. I also have concerns about the fact that the FCA initially sought to introduce the "sole or primarily responsible" test by way of amendment to the Complaints Scheme, and decided to introduce it without the benefit of public consultation. This suggests that the FCA originally considered that the adoption of the test would, in effect, amount to a substantive change of the rules. In my view, the FCA's original position, that this was a substantive rule-change requiring consultation, was correct: it represents a departure from historic practice; it establishes a different set of considerations to those contained within paragraph 7.14 of the Complaints Scheme; and as observed above it would in substance seem to exclude all or almost all ex gratia compensatory payments to consumers arising from regulatory and supervisory failings, which is not a position that it would otherwise be possible to infer from the statute or the current iteration of the Complaints Scheme. I observed in my preliminary report that the introduction of the test via a Remedies Statement without the benefit of public consultation, at the time and in the circumstances in which it was introduced, tends to suggest that this may have been an attempt to introduce what amounts to a substantive change to the Scheme via the backdoor, without the proper level of fair scrutiny to which it ought to have been subject. In response the FCA makes the general point that the "sole or primary cause" test

reflects its historic practice but, somewhat surprisingly, did not otherwise seek to refute this inference in its comments on my preliminary report.

124. Thus the "sole or primary cause" test contained in the Remedies Statement frustrates the object and purpose of s.87(5) of the FSA 2012; does not provide the desired consistency of approach; is inadequately reasoned; and its proposed introduction ought to have been subject to public consultation. In light of all of this, to the extent that decisions in individual cases are based on the foundation of the Remedies Statement, that foundation is fundamentally flawed and therefore vitiates the decisions that have been made. The decisions ought to have been based only upon the factors set out in the version of the Complaints Scheme applicable at the relevant time; not on the test set out in the Remedies Statement.

125. Irrespective of the Remedies Statement upon which the LCF approach is purported to be based, I am in any event of the view that the FCA's decision not to award an ex gratia payment for its regulatory failings lacks adequate justification. In my preliminary report, I gave the following reasons for this part of my decision.

126. First, the Gloster report noted a wide number of failings on the part of the FCA. None of these are given any specific consideration in the FCA's reasoning on remedy. I said that the analysis of each of the factors at paragraph 7.14 of the Complaints Scheme was inadequate. There is only the briefest of reasoning in relation to each of those factors. There was also no consideration of whether the FCA regarded its failings as a whole, as identified in the Gloster report, as amounting to exceptional circumstances justifying a departure from the Remedies Statement and, if not, then why not. No express consideration had been given to the gravity of the FCA's failings. I agreed with the points made in the Shearman and Sterling letter about the merits of the FCA's consideration of each of the factors at paragraph 7.14 of the Complaints Scheme.

127. The FCA said in its comments on my preliminary report that it has had regard to the identified failings. However, from its representations it appears that it has only done so in considering whether it was at fault. It still does not appear to have considered whether those failings justify a payment of ex gratia

compensation under the Complaints Scheme, having regard in particular to the factors at paragraph 7.14 of that Scheme. Indeed, given that the FCA has adopted a "sole or primary cause" approach to the payment of compensation, it stands to reason that it has not done so.

128. In my preliminary report, I observed that this problem was exacerbated by the fact that those factors are themselves general and high level, and that the broadness of these factors makes it all the more important that adequate reasons are given as to why it does/does not justify a compensatory award. In its response to my preliminary report, the FCA says it should not be criticised for having regard to the factors at paragraph 7.14 of the Complaints Scheme, which were the subject of detailed consultation and have been a feature of the Scheme since 2001. I agree. I wish to emphasise that my preliminary report did not criticise, and should not be taken as having criticised, the FCA's reliance upon these factors. Indeed, part of the problem that I have identified with the Remedies Statement and the FCA's approach to LCF investors is that it applies a potentially unjustified gloss to the factors-based test set out at paragraph 7.14 of the Complaints Scheme. I was simply making the observation that, given the broad nature of those factors, it will be all the more important to provide an adequate explanation of how they have been applied to the facts of individual cases.

129. As a sub-issue, in relation to paragraph 7.14(b), which is '…whether what has gone wrong is at an administrative or an operational level…', I said that it was not clear (a) where FCA draws the distinction between operational and administrative failures; (b) what happens when (as here) the failures may be seen as a combination of both operational and administrative failures; or (c) which of operational and administrative failures is regarded as stronger justification for a compensatory payment, and why. The FCA has now clarified, by reference to its consultation in November 2000 (CP73), that "operational" or "administrative" failures are to be viewed as linked concepts, to be distinguished from the concept of alleged errors in "matters of policy" which can involve complex value judgements and are therefore not appropriate matters for the Compensation Scheme. I accept this explanation as to the meaning of "operational or administrative". There is no dispute in this case that, subject to

wider questions about the allocation of the FCA's resources, the failings identified took place at the operational or administrative level.

130. I said in my preliminary report that I was also concerned about the way in which the FCA has treated the provision of incorrect information via direct communications as being the determinative factor in deciding whether or not to make an award of compensation. I pointed out in my preliminary report that, amongst the complex interplay of factors, the Gloster report placed particular emphasis on the '…halo effect…' of FCA authorisation. I said that the distinction between reliance by consumers upon direct communications with the FCA, and reliance by consumers upon the halo effect, is indistinct, especially when considered in the context of the factors listed at paragraph 7.14 of the Complaints Scheme. I also found, based on a consideration of how the Register would have appeared at the time, that it gave a misleading impression. Further, the Gloster Report found that the Register was deficient, in that (i) it failed adequately to warn consumers of the risk of unregulated products sold by authorised firms; and (ii) it failed adequately to present information in a manner intelligible to the public

131. The FCA's reasoning contained no analysis of what it was about having direct communications with the FCA that made this group exceptional so as to justify a departure from the Remedies Statement. There was no identifiable explanation as to why other categories of LCF victim were not also regarded as exceptional. Indeed, beyond identification of the direct communications customers, there was no consideration of the relationship between the FCA and complainants at all. This silence was particularly glaring given the prominence given to the "halo effect" in the Gloster report.

132. In its comments on my preliminary report, the FCA has identified that the difference between the two is that the "direct communications" cases involved the giving of reassurance using incorrect information, which might have misled consumers; whereas the Register correctly recorded LCF's authorisations.

133. The FCA contended that the "halo effect" exists in many cases and is a feature of the legislative scheme over which the FCA has no control. However, this fails to give due regard to the findings in the Gloster Report and in my preliminary

report, set out above, about the fitness of the Register. The FCA's approach also fails to give due regard to the catalogue of other regulatory failings which were identified in the Gloster report. Part of the reason that this catalogue of failings was able to have the impact that it did on consumers was the halo effect and the deficiencies in the Register, but these were not, of themselves, the things being complained about. The FCA needs to have regard to the full extent of the failings identified in the Gloster report, by reference to the factors at paragraph 7.14, in order to decide whether this group of consumers should receive an award.

134. Further, paragraph 7.14(b) of the Complaints Scheme provides that one of the relevant factors to which regulators will normally have regard in deciding how to respond to a complaint is:

> the nature of the relevant regulator(s)' relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s).

135. "Direct dealings" is not a precise concept and could mean a range of things, including but not limited to having direct communications with the regulator. Moreover, "direct dealings" is only one aspect of a wider consideration the overall focus of which is upon "the nature of the relationship" between the regulator and the complainant. In my view, "direct dealings" as used within paragraph 7.14(b) of the Complaints Scheme should not be interpreted as referring to a binary question of whether or not the regulator spoke directly with the consumer. Nor should it be regarded as a "test" or "threshold" which needs to be met before a particular type of response will be justified.

136. Rather, paragraph 7.14(b) invites a more nuanced consideration of the nexus, or the proximity of the relationship, between the regulator and the consumer. This should be treated, instead of as a binary question, as a sliding scale, which has regard to all the relevant factors making up the relationship between the regulator and the consumer. The closeness of the relationship may then be weighed in the balance with the other considerations outlined at paragraph 7.14 of the Complaints Scheme. Where the relationship is a close one, it may be that

the other factors need not be as weighty in order to justify, for example, an ex gratia compensatory payment for regulatory and supervisory failings. Conversely, if a complainant is seeking financial compensation for regulatory failings but the relationship was a more distant one, then other factors may need to be correspondingly stronger before such an award may be justified. All will depend on the particular circumstances of each case.

137. Finally, even if the "direct communications" cases can be distinguished from the remainder of the cohort, that is not of itself a reason for excluding the cohort from compensation payments under the scheme. It is still necessary to consider that cohort in its own right, through the prism of each of the factors at paragraph 7.14 of the Complaints Scheme and any other relevant considerations, before deciding whether they should be awarded an ex gratia payment.

138. The FCA relies, in relation to paragraph 7.14(c) of the Complaints Scheme, upon the need to make decisions about the allocation of its resources. The Gloster report clearly rejected this as a reason for the FCA's failings in this case, and I do not understand the FCA to have disagreed with that finding. I said in my preliminary report that if the FCA does disagree with it, then the reasons for doing so needed to be explained in its reasoning on these complaints. The FCA has not disagreed with this finding as such but submits that, even if resource allocation was not an adequate explanation for its regulatory shortcomings, it is nevertheless a factor which should be taken into account in deciding whether it is appropriate to make an award of compensation. I accept that there may be certain specific circumstances in which this is correct. However, I do not accept the point in the general terms in which it has been put by the FCA. As explained above, paragraph 7.14(c) is intended to draw a distinction between operational and administrative matters on the one hand, and policy decisions on the other. All operational and administrative shortcomings are, at one level, the result of a managerial decision about the amount of resources that should be focussed on that area. Paragraph 7.14(c) cannot be interpreted as permitting matters to be looked at it in this way generally because, if it did, then the distinction between administrative and operational matters, and policy matters, would be completely diluted.

139. I said in my preliminary report that the FCA did not appear to have given fair consideration to the Gloster report's view about the possibility of its causative role. The FCA relied upon the Government's view that it had not seen evidence that would indicate that the regulatory failings at the FCA were the primary cause of the losses incurred by LCF bondholders. However, the Gloster report provided as follows at Chapter 1 paragraph 3.5 – 3.6:

> 3.5...the following is, in the Investigation's view, self-evident: had some or all of the FCA's failures in regulation outlined in this Report not occurred, then it is, at the least, possible that the FCA's actions would have prevented LCF from receiving the volume of investments in its bond programmes which it did...
>
> 3.6 The Investigation does not comment on the likelihood that, at any particular point in time, different action by the FCA would have resulted in LCF being prevented from receiving further investor funds with the result that Bondholders' exposure would have been less than it in fact was. Such considerations are best left to those determining compensation in respect of particular investments by Bondholders in the light of the totality of the facts relevant to any particular claim. Nonetheless, the above demonstrates that the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses."

140. In my preliminary report, I said that it was not open for the FCA to rely, without more, upon the Government's statement in this regard over that of the Gloster report. The Government simply said that it has seen "no evidence" that the FCA "caused" bondholders' losses, whereas the Gloster report expressly left open that possibility. There was no suggestion that the Government undertook the kind of exercise that the Gloster report indicated was necessary in determining the causation question. The Gloster report said that such considerations were best left to "those determining compensation in respect of particular investments", i.e. the FCA. There is also no explanation by the Government of what it means by "cause", which is capable of a number of different interpretations. I said that in these circumstances, it was not open to the FCA, without more, to defer its own consideration of the causation issue to that of the

Government. I said that, moreover, when the FCA did give its own consideration to the causation issue, it was necessary for the FCA to consider the provisional views of the Gloster report referred to above and, if it rejected them, to explain why it is doing so.

141. The FCA now appears to accept the possibility left open by the Gloster report that it was at least in part causative of the losses of LCF investors (see paragraph 21(10)-(11) of its comments upon my preliminary report). However, it then goes on immediately to say that this is an inevitable feature of a system of risk-based regulation, and further seeks to subsume the issue back into the question of allocation of resources. But these are not points about causation as such. Moreover, whilst I accept that the Complaints Scheme is not designed to deal with complex questions of causation, the FCA's reliance upon these factors goes too far in the other direction. Even if these points were true at a general level, reliance upon these factors would mean that ex gratia payments would never be made for supervisory and regulatory failings, regardless of any reference to exceptional circumstances, – which is the situation now.

142. Further, at paragraph 21(11), the FCA says that the acceptance of possible causation.

> does not translate into a general entitlement to compensation via the Scheme. We have carefully considered the extent to which the FCA might be said to have caused loss to the LCF investors and have concluded that the FCA was not the sole or primary cause of such loss

143. But this is a false dichotomy. There is no binary choice between "a general entitlement to compensation" on the one hand and "sole or primary causation" on the other. There is a wide range of possibilities between those two extremes. Further, I have already observed above that the sole or primary causation test has no place in the Compensation Scheme in any event. I am grateful to the FCA for, now, accepting the possibility that it might have caused some of the losses complained of. Having done so, however, it now needs to reconsider the question of whether compensation should be awarded, but applying the considerations at paragraph 7.14 of the Rules without regard to the "sole or

primary causation test" and 'direct dealings' test the way the FCA has interpreted it.

144. I said in my preliminary report that the way in which the FCA has invoked the public sector equality duty ("PSED") as part of its reasoning seemed misconceived. The PSED applies whenever a public body is carrying out a public function; this includes both high level policy decisions and decisions in individual cases. In my view, to the extent that the PSED applies in this area, it applied not only to individual cases but also to the overall approach that the FCA has chosen to adopt: it was not difficult to imagine, for example, that the collapse of LCF affected certain protected characteristic groups more than others, depending upon the cross-section of society that invested and the gravity of the impact upon them of the failure of the investment. For example, it may be that there were more elderly investors who were more adversely impacted by the collapse. It could be inferred from the FCA's decision that no consideration was given to the PSED at the stage of deciding to adopt a generic test.

145. The FCA has now provided an equality impact assessment ("EIA") dated 21 May 2021. The first point to note is that this post-dates its decision about how to compensate LCF investors generally. Nevertheless, the case law on the PSED establishes that it is an ongoing duty, and that a decision which did not initially comply with the PSED may be rectified by giving it consideration at a later date. Having said that, the EIA from 21 May 2021 focuses only upon the ability of complainants to access the complaints scheme. It did not take account of the issue I had identified regarding the possibility that different cohorts might have been differentially affected by the collapse of LCF, and by extension by the FCA's approach to compensation.

146. Whilst maintaining that it had correctly discharged its PSED, the FCA nevertheless undertook a further EIA on 12 November 2021, which does specifically seek to address the issue identified above. In that EIA, the FCA notes that it has limited data about the characteristics of people that invested in LCF. It is therefore unable to state whether different groups were differentially affected. I am satisfied that the FCA has made a reasonable attempt to investigate this issue. I also accept that any potential impact is likely to have

been mitigated by the equalities consideration that the FCA undertook to give when determining individual complaints.

147. As to the FCA's consideration of its statutory objectives, I said that the aim of encouraging consumer responsibility as an aspect of the FCA's consumer protection objective is in my view a legitimate factor for the FCA to take into account in deciding its approach. Indeed, HMT (which is the FCA's sponsoring department) has taken this approach in deciding that LCF victims should be provided with less than full compensation. However, I agree that there seems something perverse about singling out one part of one objective, and then turning that against consumers so as to exclude the possibility of compensation in almost every case. No consideration appears to have been given to other aspects of that objective, for example avoiding future regulatory failings. Moreover, even taken on its own terms, it is not clear why meeting that objective should result in a "solely or primarily responsible" test of causation across all cases.

148. In the FCA's comments on my preliminary report, it says that it has revisited this issue, but does not consider that its other statutory objectives outweigh this factor. I accept that the weighing of its various statutory objectives is a matter for the FCA, in which I would be reluctant to interfere. My concern is not so much, however, about the way in which the FCA has weighed up its various statutory objectives. Rather, it is the way in which it has weighed the consumer responsibility objective against all the other factors in the case. My concerns in this area therefore still remain.

149. For all the reasons given above, the FCA's approach to compensation in the LCF cases is unjustified and does not stand up to scrutiny. My decision is limited to the LCF cases that are within scope of this complaint but, given the extent to which the LCF cases rely, at least ostensibly, upon the Remedies Statement, I recognise that my decision also raises wider questions about that policy, as well as the FCA's interpretation of 'direct dealings'. I have also made a number of comments about paragraph 7.14 of the Complaints Scheme, and in particular paragraph 7.14(c) thereof, which may also require further attention in my recommendations below.

150. The FCA has asked me to have regard to the wider implications of an approach to ex gratia compensation which would generally lead to the FCA paying compensation when it is not the primary cause of the loss. My only recommendation is that the "sole or primary cause" test be abrogated, and the position under the Complaints Scheme be restored. That will not necessarily lead to the FCA "generally" paying compensation when it is not the primary cause of the loss; it simply means that decisions about compensation will need to be made in accordance with the terms of the Complaints Scheme. To the extent that this leads to more payments of compensation than has previously been the case, then that is simply the result of an application of the Complaints Scheme which has been in place since 2001.

Element Three: the FCA handling of complaints

FCA ex gratia payments for complaint handling delays:

151. Many complainants have raised complaint points in relation to the FCA's approach to calculating the ex gratia payments it has offered to complainants, for the delay caused in reaching its view on complaints. Some have questioned the lack of clarity of the algorithm used for calculating the ex gratia payments and the basis of the FCA's approach for the ex gratia payments.

152. In such a case I understand why complainants would be curious about the FCA's approach to ex gratia payments for complaint delays. I am aware of and have access to the FCA's approach to ex gratia payments for distress and inconvenience caused as a result of its delay in complaint handling. The FCA has marked this guide as FCA restricted and state that it's approach is not shared publicly.

153. In the interests of transparency and for the benefit of complainants, I believe that this guide is something that should be publicly available, such as on the FCA website – currently it is not. As such, during my investigations I requested that the FCA disclose its approach to ex gratia payments for distress and inconvenience publicly such as on its website, and I also requested sharing this as an appendix to this report, emphasising that this would be helpful for complainants to understand how distress and inconvenience payments for

delays are decided and calculated. Unfortunately, the FCA disagreed with my request and stated that this is something that it does not share publicly and does not agree that it is necessary for me to share this guide in my report either. I disagree. In my preliminary report I highlighted that there was no reason why this guide disclosing the FCA's indicative scale of how ex gratia payments are calculated and assessed should remain confidential. I recommended that the FCA published its guide in the interests of transparency, concerning its approach to distress and inconvenience payments. Despite my requests to the FCA to publish its internal guide for calculations of ex gratia payments for complaint handling delays, the FCA has informed me in its response that it does not propose adding these levels of information to its website. The FCA has stated that the approach it has taken to LCF as outlined in its Annex 4 document located at Appendix 10 of my report, sufficiently covers my recommendation. I disagree. My recommendation covered a widescale gap which was not specific to just LCF complainants. It is in the best interests of the FCA to publish its guide concerning ex gratia payments for complaint handling delays for the benefit of all complainants who would most likely find this helpful. I can only repeat this recommendation and urge the FCA to reconsider its decision to not publish this guide.

154. In the FCA's response to my preliminary report the FCA has agreed that its approach to calculating ex gratia payments for complaint handling delays could have been explained to me in more detail. Annex 4 illustrates examples as to how the FCA approached calculating ex gratia for complaint handling delays in the case of LCF.

155. With reference to the Annex 4 document, the FCA have explained it has not included ex gratia delay for the period between when the notice of deferral was given to LCF complainants up until when the FCA deferral was lifted, which I agreed with. Therefore, I think it is fair and I agree that no ex gratia was due for this deferral period.

156. Understandably prior to the FCA providing its approach, a small number of complainants asked me to investigate the amount of ex gratia that had been offered to them for FCA complaint handling delays. I closely monitored and investigated all of these complaint points and these complainants have been

contacted individually. I did not identify any issues with the amount of ex gratia these complainants had been offered by the FCA. The investigation I conducted considered the approach outlined in Annex 4. I am satisfied therefore, based on what I have seen in the small number of cases, there were no broad based concerns about the amount of ex gratia offered by the FCA for its complaint handling delays.

157. It must also be noted that my office highlighted to the FCA a trend identified concerning ex gratia payments for delays for joint complainants and group complainants. These complainants were expected to share one sum of ex gratia payment amongst them, rather than an individual ex gratia payment. This was unusual given these complainants were separate investors in LCF. My office raised this issue with the FCA and were able to resolve this by making sure it made individual ex gratia payments to those individual investors who had complaints with the FCA.

158. My office continues to monitor this and will investigate issues such as this and we will raise them directly with the FCA.

FCA Decision Letter

159. I have received concerns from complainants regarding the FCA decision letter issued to them. The crux of the issue is complainants feeling the letter was not individual to them and doubts raised about the FCA looking at their case on its own individual merits. Examples of these types of complaints include:

> The tone of the FCA decision letter, it was excessively long and like a cut and paste job. It was not addressed in good faith or on its own merits.

160. I understand why elements of the FCA decision letter are identical to other complainants' letters. Much like this investigation report and the Gloster report, often one report or letter is sufficient in addressing matters such as this. This provides efficiency, avoids delays and overlapping themes can be addressed which coincide with one another. I cannot see the FCA has done anything wrong by issuing similar decision letters to complainants where their complaints overlap.

FCA's complaint handling process

161. There have been a few general complaints and requests for me to review the FCA's entire complaint handling process. In instances such as these, where the request is general and without specific examples or issues raised, I see no justification for conducting a full investigation into the FCA's complaint handling process.

162. I have been closely monitoring and following the FCA's handling of complaints about its oversight of LCF. There have been occasions where I have raised concerns about the FCA's complaint handling process such as the example of ex gratia payments for couples and group complaints and acted on these. I am aware that some complainants have experienced poor customer service when interacting with the FCA complaints team. I have been told that the FCA did not answer the telephone on occasions or respond in a timely fashion to letters. It is a published fact that the FCA Complaints Team has been dealing with extended backlogs of complaints and delays for a long period, as highlighted in the three previous annual reports issued by my predecessor. This inevitably led to poor customer service and was of concern being monitored by both my predecessor and I. Steps have been taken to address this issue as most recently the FCA agreed that it would provide an independent assurance function of its complaints department in order to ensure the good progress it is now making is continued. I welcome the fact the FCA has issued ex gratia payments as appropriate for the deficiencies in its complaints handling process.

The Gloster report: lack of communication on the part of the FCA

163. Select complainants have raised the issue that they found out in the newspaper on two occasions, that the Gloster report was delayed and there was lack of communication from the FCA in this regard. Complainants have asked why the FCA did not send them simple communication about their deferred complaint explaining the current situation and delay. I think this is a very fair question and I put this question to the FCA. The FCA informed me of the following:

We did not update complainants individually; we updated the LCF pages on our website to reflect that the report would be delayed and the Independent Review website was also updated.

164. I struggle to see why the FCA did not think it would be of the upmost importance to keep complainants updated on the progress of the Gloster report. I do not think in this instance updates on the FCA website alone would suffice. This is not good enough and goes against the principles of being as transparent as possible, especially in a case such as this on a mass scale involving several complexities, entities and bodies. From a customer service perspective, the FCA should have reached out to complainants directly using the complainant's preferred method of communication and as a courtesy informed them of the delay with the Gloster report. The FCA could have done this at least once and perhaps included in their communications that updates would be available on their website on a regular basis and complainants were asked going forward, to check the website for updates on a 'monthly basis' for instance. However, this did not happen.

165. The FCA wrote to all complainants on 17 December 2020 making them aware the Gloster report had been published, so I fail to understand why it did not follow this same method when the Gloster report was delayed. There cannot be a presumption that every complainant would regularly check the FCA website for updates on the movement of the Gloster report and the assumption that the complainant has the means to be able to check the website. The complaints I have received in relation to this issue are notably complainants who realised there was a delay on two occasions with the Gloster report from reading the newspaper. Essentially this tells me that these are complainants who may not have easy access to a computer or technology on a regular basis and rely on reading the newspaper for updates.

166. I agree with complainants that the FCA should have kept complainants updated directly on a regular basis with the progress of the Gloster report. If the Gloster report was to be delayed, the FCA had a responsibility to provide adequate communications to complainants explaining this. In my preliminary report I made a recommendation that the FCA recognised the need to alert complainants to updates, in situations regarding important updates such as the

progress of the Gloster report. As opposed to a reliance and/or presumption that complainants should be expected to check its website for important updates. In the FCA's response to my preliminary report the FCA accepted my recommendation that it would have been best practice to have directly informed complainants about the progress of the Gloster report. I am pleased the FCA have accepted this recommendation and note its intention to consider a proactive communications approach in similar circumstances in the future. I will continue to monitor this to ensure the FCA keep this at the forefront of its communications if similar situations arise.

Request for an FCA apology

167. In response to my preliminary report several complainants requested an apology from the FCA. This is a further issue I considered more widely and I investigated these complaint points individually. In all instances I was pleased to see that the FCA had already issued these complainants with a separate apology letter from the FCA Chair Charles Randell. As such I am satisfied the FCA had already dealt with issuing an apology to all these complainants in an appropriate manner and I consider this aspect of the complaint handling element resolved. All those complainants who raised this complaint point have been contacted individually regarding my outcome as this matter being resolved and not requiring the FCA to do anything further.

My decision

Element One the FCA's oversight of London Capital & Finance plc

168. I welcome the fact that the FCA has accepted and agreed to implement the recommendations made in the Gloster report. I **recommend** the FCA keeps me informed of progress of its transformation programme.

169. I agree that the FCA should have upheld and/or partially upheld allegations one, two, four, seven, nine and ten. I agree with the FCA's decision to offer an apology to complainants.

170. As to allegations six and eight I agree with the FCA's approach of allegation six being out of scope of the Scheme pursuant to Section 3.5 and allegation eight

continues to be deferred as per Section 3.7 of the Complaints Scheme. The enforcement investigation is ongoing within the FCA and separately at the SFO and I am satisfied that it would be unreasonable to not await the conclusion of the FCA's enforcement investigations regarding allegation eight.

171. As to allegations three and five which have not been upheld by the FCA, I have provided my analysis regarding the FCA's stance on these allegations earlier in my report. I have taken into account the evidence and facts I have been provided with and I repeat that overall, I agree with the FCA and its decision to not uphold allegation three. I **recommend** that the FCA upholds allegation five. In my analysis in this final report I have extensively touched on the significant problems with the FCA Register. I am concerned the halo effect is left to remain and in turn, investors will not be able to grasp from the FCA Register that whilst a Firm is regulated, the activity to which they are investing in may not be. The FCA should be taking steps to avoid replicating the failures that occurred in its oversight of LCF. I am not convinced the FCA has given proper consideration to the detrimental impact this could have on future investors if the maintenance of its Register is not prioritised and looked into as a paramount consideration. It is important to highlight that the Gloster report identified two criticisms of the Register, that it was unintelligible and contained insufficient warning. The FCA has not adequately addressed these points in its response to my preliminary report. I urge the FCA to reconsider its position and **recommend** that it proactively make every effort to keep up to date with the maintenance of its Register and update me as to the steps it is taking. I **recommend** the FCA take steps to mitigate the halo effect given the inevitability of the halo effect to which it has referred.

172. Given that there has been an extensive separate inquiry (resulting in the Gloster report referenced in paragraph 34 issued on 17 December 2020) which offered in depth analysis of the problems which arose in the FCA's regulation of LCF as well as the FCA's own thorough investigation, I do not propose to conduct any further review of this matter save for what I have covered in this report.

Element Two ex gratia payment/compensation

173. The FCA's approach to compensatory payments on an ex gratia basis in the LCF cases is unjustified and does not stand up to scrutiny.

174. My decision is limited to the LCF cases that are within scope of this complaint but, I recognise that my decision also raises wider questions about policy and interpretation of the Complaints Scheme which I refer to below. In particular, I have noted that de facto, compensatory payments on an ex gratia basis due to supervisory or regulatory failings on the part of the FCA will never be available to complainants despite the FCA saying there are exceptional circumstances where it might be, so long as the FCA relies on:

    a. Its self devised test of 'sole and primary cause' test in its Remedies Statement;

    b. Its binary interpretation of 'direct dealings' in paragraph 7.14 (b) of the Scheme;

    c. Its self devised test that such payments should only be made in 'exceptional circumstances', which is not encapsulated in the Scheme, and not defined in detail by the FCA.

175. In my view, this is inconsistent with the statute and with the published Complaints Scheme, which draws no such distinctions and pursuant to which ex gratia compensatory payments arising from regulatory and supervisory failings should be available in practice.

176. I have also made a number of comments about paragraph 7.14 of the Complaints Scheme and in particular paragraph 7.14(c) thereof, which may also require further attention in my recommendations below.

177. These represent my understanding and views on the correct interpretation of the Complaints Scheme in light of the enabling statute. The FCA may have a different view. However, I accept that, ultimately, questions about the correct interpretation of statute and of published guidance are for the Court rather than for the public bodies concerned.

178. In deciding what remedy to recommend, I noted that this was an unusual case for a number of reasons. It involved a large number of individuals with similar facts. The FCA had decided to respond to the complaints by articulating a

bespoke test (the “direct communications test”) and applying it across all the complaints.

179. I also noted in my preliminary report that HMT had decided to set up a compensation scheme, which reflected at the time what I understood to be the government’s view of where and how the balance should be struck. I also expressed concern that the existence of the scheme might impact upon the effectiveness of any recommendation that I might make: for example, if the HMT scheme allowed for set-off against FCA awards, then a recommendation that the FCA pay compensation would (if accepted) simply have the effect of transferring the burden of making such payments from HMT to the FCA, without any benefit to the victims.

180. For those reasons, I did not consider it appropriate for me to seek to substitute a different test of my own. I said that there were potentially a number of different tests that may legitimately be applied. I therefore proposed to recommend that:

    a. The FCA reconsider the test it had adopted, in line with my observations above, and provide adequate justification for whatever test it adopts. It should then re-decide the LCF cases in line with a new, adequately justified, test.

    b. I expressed no view as to whether that will result in additional compensation being paid in individual cases.

181. In the FCA’s comments on my preliminary report, it sought to respond to my request for further justification of the test adopted and examples in which it would result in compensation being paid to consumers. I have already observed above that, in my view, no adequate justification has been provided and that the examples provided, in that they are limited only to awards to business, undermine rather than assist the FCA’s case. The FCA has also made clear, in my view, that it has no intention of modifying the test in line with my proposed recommendation.

182. In light of the above, I have reached the conclusion that I should **recommend** the abrogation of the FCA’s causation test altogether. The FCA has a published complaints scheme which was the subject of consultation, which has stood for many years, and the consistent application of which is capable of providing

answers in these cases. The Remedies Statement is an unjustified gloss on, or departure from, that scheme. The test as set out in the Complaints Scheme should be restored.

183. The FCA should therefore withdraw its decisions on LCF complaints to which this approach has been applied and re-decide them in accordance with paragraph 7.14 of the Complaints Scheme and in light of my comments above.

184. More generally, the FCA should clarify its position that ex gratia compensatory payments for regulatory and supervisory failings may be available under the Scheme, and it should also abrogate the tests it applies as defined in paragraph 174 (a -c) which, if applied, mean that such payments will never be available in practice.

185. The FCA should also do everything in its power to ensure that the Register is not misleading, in particular by ensuring that it provides adequate warnings to consumers of the risk of unregulated products sold by authorised firms and presents information in a manner intelligible to the public.

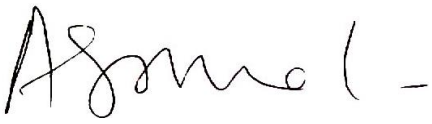
Element Three the FCA's handling of the complaint

186. Ex gratia payments for complaint handling delays: The FCA states on its publicly available information on its website that it sets out to be as open and transparent as possible, so it can be scrutinised by consumers, firms and Parliament. Whilst the FCA have explained its approach to calculating ex gratia for complaint delays in the case of LCF, my view remains the same of that expressed in my preliminary report regarding the FCA's internal guide approach when determining ex gratia payments for complaint delays in general. Whilst I have access to this guide, in the interests of transparency I see no reason why complainants should not be able to see the FCA's guide which the FCA has marked as restricted and assert it is not shared publicly. The purpose of having such a published statement is to assist with ensuring a consistent and fair approach to calculating ex gratia payments for complaint handling delays based on the individual features of the complaint and the FCA's culpability. I therefore ask the FCA to reconsider its position on this and repeat my recommendation, I

recommend that the FCA publish its guide on the FCA website, concerning its approach to ex gratia payments for complaint handling delays.

187. FCA Decision Letter: I cannot see the FCA has done anything wrong by issuing similar decision letters to complainants where their complaints overlap.

188. FCA's complaint handling process: I have considered making a recommendation about the need for systemic improvement in the FCA's complaints function, but I have decided to give the FCA a further period to convince me that its promises are in fact being delivered through operational improvements.



Amerdeep Somal
Complaints Commissioner
15 February 2022

Appendix 1a

SHEARMAN & STERLING LLP

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Thomas.Donegan@shearman.com
[redacted]

25 June 2021

By email complaints@frccommissioner.org.uk

Financial Regulators Complaints Commissioner
23 Austin Friars
London
EC2N 2QP

Dear Sirs

London Capital & Finance Plc (in administration) (FRN: 722603) ("LC&F") – Complaint regarding (i) lack of compensation to LC&F investors for regulatory failures and (ii) the Financial Conduct Authority's incorrect reliance upon a purported "solely or primarily responsible" causation test for *ex gratia* compensation payments, which has no basis

Introduction

We act for certain investors[1] in the above authorised firm (which is in administration) on a *pro bono* basis. We have previously corresponded with the Financial Conduct Authority ("**FCA**") in relation to LC&F for certain of these clients in our letters to the FCA dated 9 April 2021 (the "**S&S April Letter**", pp. 1-13 of the exhibit), the FCA's letter to us dated 27 April 2021 (the "**FCA April Letter**", pp. 14-25 of the exhibit), our emails to [redacted] of the FCA dated 17 and 19 May 2021 (the "**S&S Emails**") (pp. 28-30 of the exhibit) and [redacted] email to us dated 26 May 2021 (the "**FCA Email**") (pp. 26-27 of the exhibit).

Our clients have each submitted complaints to the FCA regarding, *inter alia*, failures in the FCA's authorisation and supervision of LC&F. Five of our clients, [redacted] have received written responses to their complaints from the FCA complaints handler (pp. 31-90 of the exhibit) in which the FCA

[1] [redacted]

declined to compensate them on the basis that the FCA was not the "*primary*" cause of LC&F investors' losses. The FCA has offered a token amount of compensation for the FCA's delay in responding to their complaint. We understand that these responses are based upon a *pro forma* letter that many of the more than 1,000 LC&F investors who raised complaints with the FCA are now receiving. [redacted] have accepted the FCA's compensation regarding delay in dealing with their complaints, but have not accepted the FCA's explanation or offer regarding the regulatory and supervisory failures of the FCA, which they have chosen to escalate by means of this letter (pp. 297-298, 305-306, 308, 310, 313 and 314 of the exhibit). The FCA has confirmed receipt of [redacted] acceptance of compensation for delay, has acknowledged that these individuals will be referring the FCA's decision to the Complaints Commissioner and has agreed to fully co-operate with regards to their complaints (pp. 296, 301 and 308-309 of the exhibit)[2]. [redacted] are still awaiting a response to their communications with the FCA.

We are submitting this complaint on behalf of [redacted] following these written responses and also on an anticipatory basis in respect of all our other clients,[3] without prejudice to the rights of some of them (and in particular [redacted]) as "direct communication" investors within the meaning of the FCA's announcement dated 19 April 2021[4] regarding the application of the FCA's Complaints Scheme to LC&F investors (the "**LC&F Compensation Statement**").

Our clients do not dispute the modest amounts offered for the delay in processing their complaints, but now complain to the Financial Regulators Complaints Commissioner about the offer of zero compensation for FCA regulatory failures and the asserted basis for those decisions, for the reasons set forth below. This complaint essentially relates to the complaints process itself for UK financial regulators, established pursuant to the Financial Services Act 2012 ("**FS Act**"). This letter constitutes a formal referral to the Complaints Commissioner for purposes of paragraph 6.8 of the FCA's complaints scheme rules (the "**Scheme Rules**").[5]

Summary

Our clients' complaint concerns:

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[2] [redacted] has already raised a complaint with the Complaints Commissioner regarding the FCA's response (reference [redacted]) (p. 308 of the exhibit) and has received an acknowledgement from the Complaints Commissioner (p. 307 of the exhibit), but requests that the FCA also takes account of the matters raised in this letter when considering his complaint.

[3] We note paragraph 3.7 of the existing FCA Complaints Scheme allows complaints to be referred prior to the conclusion of the regulators' action in some circumstances, which would seem appropriate as regards those of our clients who are yet to receive a *pro forma* response, in the circumstances in which the FCA is part way through sending such responses to over a thousand complaints by LC&F investors, where the FCA has already made its Board Resolution, the LC&F Compensation Statement is expressed to be of general application and the matters at issue are of such public interest.

[4] The FCA, *FCA sets out broad approach to assessing LCF Complaints* (19 April 2021) (FCA sets out broad approach to assessing LCF Complaints | FCA).

[5] The FCA and PRA, *Complaints against the Regulators The Scheme* (March 2016), p. 10, ¶ 6.8, (The Complaints Scheme (fca.org.uk)) (the "**Scheme Rules**").

(i) the purported introduction by the FCA of a previously unseen and narrow test of causation – a "*solely or primarily responsible*" test – for purposes of determining whether compensation should be paid by the FCA to investors who are victims of malfeasance by FCA-regulated firms, under the regulatory complaints scheme established pursuant to section 84 of the Financial Services Act 2012 ("**FS Act**"); and

(ii) the purported application of this new narrow test of causation to LC&F bondholders in particular pursuant to the LC&F Compensation Statement and related board resolution dated 16 April 2021 (the "**Board Resolution**" and the decision made therein, the "**Decision**"),[6] by which the FCA decided only to offer compensation to a small subset of LC&F investors who received incorrect information via "direct communications" from the FCA.

Pursuant to the FS Act, a detailed complaints process is established which may be used by persons with grievances relating to the actions or omissions of the UK's financial regulators, such as the FCA. This regime is governed by the FS Act itself and by the Scheme Rules.[7] The Scheme Rules are made and amended from time to time pursuant to a consultation process administered jointly by the UK's financial regulators, in accordance with the FS Act.[8] The FS Act and Scheme Rules provide for complaints (where not settled to the complainant's satisfaction by the FCA itself) to be considered by an independent commissioner. *Ex gratia* payments can be recommended by the commissioner in circumstances where the commissioner "*thinks it appropriate*",[9] based upon a finding that a complaint is "*well founded*". The established test of causation under the complaints regime is whether the "*actions of the FCA contributed to the complainants' financial loss*".[10]

Dame Elizabeth Gloster was commissioned under section 77 of the Financial Services and Markets Act 2000 ("**FSMA**") to produce a report, (the "**Gloster Report**") into the FCA's regulation of LC&F.[11] The Gloster Report concluded that the FCA was culpable for multiple and serious regulatory failings. The Gloster Report sets out details as to why the investigation found that, had the FCA's failures in regulation not occurred, it was possible that at least some LC&F investors would not have suffered losses, including in the context of the causation test

[6] See FCA Board Minutes dated 16 April 2021 (FCA Board minutes: 16 April 2021) (the "**April Board Minutes**").

[7] The Scheme Rules are available at The Complaints Scheme (fca.org.uk) dated March 2016.

[8] Section 86, FS Act.

[9] Section 87(5), FS Act.

[10] Office of the Complaints Commissioner, *Annual Report 2018/2019*, p. 13, ¶ 5.5 (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk) (the "**2018/2019 OCC Report**") and Office of the Complaints Commissioner, *Annual Report 2019/2020*, p. 13, ¶ 5 5 (https://frccommissioner.org.uk/wp-content/uploads/OCC-Annual-Report-2019-2020.pdf) (the "**2019/2020 OCC Report**").

[11] The Gloster Report (23 November 2020) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf) (the "**Gloster Report**").

applicable to the regulatory complaints regime.[12] The FCA's submissions that it did not cause LC&F investor losses were discussed in detail and rejected or criticised in the Gloster Report.

Our clients consider that:

1. **The FCA's supposed "*solely or primarily responsible*" test of causation has no basis**. The causation test now invoked by the FCA is not found in the FS Act, the Scheme Rules or any other statutory FCA rule or FCA guidance.[13] It first appeared in an informal statement published by the FCA on 16 June 2020 (the "**Remedies Statement**"). The FCA has asserted that the "*solely or primarily responsible*" test reflects its "*long-standing*" practice but has adduced no evidence of it being used or referred to in any materials prior to June 2020. The Remedies Statement is at most the FCA's statement of its own point of view with no legal force, and that point of view is demonstrably incorrect for the reasons stated in the next section.

2. **The established test of causation is whether the FCA "*contributed to*" investor losses.**[14] The applicable causation test is significantly less stringent than the FCA's proposed "*solely or primarily responsible*" test. The "*contributed to*" test of causation has been regarded by the Complaints Commissioner as reflecting Parliament's intention in establishing the scheme and has been discussed and applied consistently by Complaints Commissioners for over a decade. For example, in complaint Case FCA00459, the FCA argued that it should not pay a victim of wrongdoing by a firm on the basis that "*principal responsibility for the complainant's losses lay with … fraudsters*".[15] The Commissioner rejected the FCA's proposed causation test and concluded that the FCA's offer was "*wholly inadequate*", recommending compensation on the basis that the FCA had "*contributed to*" the complainant's financial loss and ought therefore to pay compensation. This same test of contributory causation was also essentially that applied in the Gloster Report when analysing the causation by the FCA of LC&F investor losses.[16] For over a decade, neither the FCA nor its predecessor the FSA has taken issue with or disputed the "*contributed to*" test of causation until the June 2020 Remedies Statement. In the Decision, the FCA has adopted an overly

[12] The Gloster Report, Chapter 1, ¶3 5: "*…had possible irregularities by LCF been detected (and their significance appreciated) by the FCA sooner than late 2018, then the FCA should, in the Investigation's view, have intervened (or taken other regulatory action) earlier. On any basis, it is, at the least, possible that the FCA would have intervened sooner than it in fact did. Such earlier intervention may, in turn, have prevented LCF from receiving investments in its bond programme sooner, thereby reducing the exposure of investors to LCF's collapse*".

[13] See the FCA Email, in which [redacted] commented, "[t]*he remedies statement is not, and was not intended or stated to be, FCA guidance under section 139A of the Financial Services and Markets Act 2000 or an FCA rule. The statement is instead a statement of the FCA's general approach or policy* […]" (p. 26 of the exhibit).

[14] See the 2018/2019 OCC Report and the 2019/2020 OCC Report.

[15] The 2018/2019 OCC Report, p. 15.

[16] The Gloster Report, para 3.6: "*the above demonstrates that the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses.*".

stringent causation test, thereby under-compensating complainants who are investors in LC&F.

3. **The FCA has failed to further its statutory objectives**. The purported introduction and application of the "*solely or primarily responsible*" test is not in accordance with the FCA's statutory duties or objectives. The FCA has cited the consumer protection objective under FSMA – which is defined as "*securing an appropriate degree of protection for consumers*"[17] – as a basis for its Decision. One of the factors relevant to this test, which the FCA cited as the basis for its Decision, is that "*consumers should take responsibility for their actions*". However, it is inappropriate for the FCA to elevate this one factor to such an extent that it over-rides the wording of the statutory objective itself, least so to excuse liability for FCA regulatory failures. In doing so, the FCA has failed to further the integrity objective under FSMA: "*protecting and enhancing the integrity of the UK financial system*". By virtue of the Decision, the FCA has diminished confidence in the ability of the UK's regulators to protect consumers where they are let down by regulatory failure and .diminished the standing of the UK regulatory system and its regulators by abandoning basic principles of fairness.

4. **The FCA has acted irrationally in misapplying the factors under the Scheme Rules and attempting to apply instead the "*solely and primarily responsible*" causation test, despite this not being made as Scheme Rules.** In its detailed reasons for the Decision under the Scheme Rules criteria, the FCA relies upon its lack of "*direct dealings*" with investors, ignoring for such purposes investors who relied upon LC&F's FCA regulated status and the FCA register. It also relied upon the FCA's need *"to make complex judgements around where to prioritise its resources*", a proposition that the FCA also made submissions upon to Dame Elizabeth Gloster, but which were rejected resoundingly in the Gloster Report. Further, the FCA cites "*The impact of the cost of compensatory payments on firms*". However, of the £237m of LC&F investor losses, £60m are already compensated by the FSCS, £120m will be covered by the government's *ad hoc* compensation scheme and £6m has been returned by LC&F's administrators, leaving a maximum FCA exposure of *c*.£50m. This amount represents less than half of the "surplus assets" on the FCA's balance sheet or approximately one eighth of the *fines* (not fees) levied by the FCA on authorised firms during 2018-2019 for breaking the FCA's rules. In contrast, the first criterion under the Scheme Rules is: "*The gravity of the misconduct and its consequences for the complainant*", which for many LC&F investors are stark, proven by the Gloster Report and yet ignored by the FCA in favour of other irrelevant or inappropriately applied criteria. The FCA has therefore failed to act in accordance with the Scheme Rules. Instead, by relying upon the supposed "*solely or primarily responsible*" test of causation, the FCA has acted irrationally, failing to administer the complaints scheme in accordance with the FS Act and the Scheme Rules.

[17] Section 1C(1), FSMA.

It is of particular concern that the FCA sought formally to introduce the "*solely or primarily responsible*" causation test to the Scheme Rules via Consultation Paper No. 20/11[18] (the "**Consultation Paper**"), in July 2020. The FCA was forced to postpone introducing the amended rules proposed in the Consultation Paper following public pressure[19] (including from politicians and NGOs and also our clients in their consultation response dated 8 October 2020,[20] the "**Consultation Response**", pp. 91-104 of the exhibit). The new and narrower "*solely or primarily responsible*" test and its proposed retrospective application were a particular focus in political and press criticism, which would unlikely have arisen were the test to have been a simple restatement of existing policy, as the FCA now asserts. The FCA has essentially therefore ploughed on as if it had introduced the "*solely or primarily responsible*" causation test into the Scheme Rules, in disregard for its failure so to do.

5. **The FCA has been found to have contributed to LC&F investor losses for the reasons set out in detail in the Gloster Report**. On the basis of the correct test of causation, it is appropriate for the FCA to pay *ex gratia* compensation to LC&F investors. This is supported by the Treasury Select Committee's report, *The Financial Conduct Authority's Regulation of London Capital & Finance plc: Fourth Report of Session 2021-22*, published on 24 June 2021 (the "**Treasury Select Committee Report**")[21] which points to the FCA's complaints scheme as a source of compensation for bondholders and expects the FCA to coordinate with the Treasury to, "*prevent any detriment to customers*".[22]

Quantum. Our clients acknowledge that the *ad hoc* compensation scheme recently announced by the UK government, which will compensate LC&F investors for 80% of their losses, subject to a cap of £68,000, would mean that any FCA compensation under the complaints regime would be significantly reduced.[23] However, our clients believe that the proposed FCA

[18] Consultation paper, "*Complaints against the Regulators (The Financial Conduct Authority, the Prudential Regulation Authority and the Bank of England CP20/11*" (July 2020) (https://www.fca.org.uk/publication/consultation/cp20-11.pdf) (the "**Consultation Paper**").

[19] See, for example: the Gloster Report, part A, ¶ 3.1, fn 34: "*Although Dame Elizabeth did not formally respond to the consultation, she wrote to the Chair of the FCA in September 2020 to express her concern about the potential for the proposals set out in the consultation paper adversely to impact on any complaints which might be made by Bondholders after publication of this Report.*"; a letter from Rt Hon. Mel Stride MP, Chair of the Treasury Committee to Chris Woolard, Interim Chief Executive of the Financial Conduct Authority dated 11 September 2020 (Correspondence (parliament.uk)) (the "**Mel Stride Letter**"): "*Given the interest in the consultation expressed to the Committee, and elsewhere, I ask that serious and urgent consideration be given to extending the consultation period, as an 8-week period may no longer be sufficient.*"; and contemporaneous press reports: International Adviser, "*FCA complaints scheme changes 'unfair, immoral and illegal'*" (12 October 2020) (https://international-adviser.com/fca-complaints-scheme-changes-unfair-immoral-and-illegal/); the Financial Times, "*UK MPs urge financial regulators not to rush changes to complaints scheme*" (11 September 2020) (https://www.ft.com/content/51af062f-87f4-4438-89bb-756049734c11) (the "**Press Reports**").

[20] Response of [redacted] to the Consultation Paper on Complaints against the Regulators (the FCA, the Prudential Regulation Authority and the Bank of England) (CP20/11) (pp. 91-104 of the exhibit).

[21] https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902.htm

[22] The Treasury Select Committee Report (24 June 2021), p. 39, ¶ 159
https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902.htm

[23] This complaint does not address the proposed overall cap on FCA compensation for LC&F investors, which the FCA has tied to the maximum amount of compensation that would have been available from the FSCS. The FCA in adopting this cap cited a "public equality

compensation level of £0 for the overwhelming majority of LC&F investors is inappropriate. The underlying FCA Decision not to make compensation awards results from a failure by the FCA to act in accordance with its statutory duties or the Scheme Rules, irrational FCA actions and an incorrectly applied causation test. The Decision further sets a worrying precedent for the FCA in dealing with other recent regulatory scandals on which it is yet to make a final complaints decision (e.g. for investors in [redacted]). Our clients make this complaint not only to secure fair and just compensation for themselves and other LC&F investors, but on a point of principle in solidarity with victims of other financial scandals who may not benefit from such detailed investigation as was carried out under the Gloster Report or from FSCS protection or an *ad hoc* compensation scheme.

Our clients therefore now ask that the Complaints Commissioner issues a recommendation that:

- the FCA reissues the Remedies Statement, retracting the reference to the "*solely or primarily responsible*" test therein; and

- the FCA's Decision in the Board Resolution dated 16 April 2021 as communicated in the LC&F Compensation Statement be revoked and reconsidered by the FCA Board, by applying the causation test of whether the "*actions of the FCA contributed to the complainants' financial loss*"[24] and therefore offering a reasonable amount of compensation to LC&F investors (recognising the contribution of FCA regulatory failure to the losses in question, but taking into account the *ad hoc* government scheme and the maximum amount available under the FSCS regime).

In this letter, we:

(i) provide background on the LC&F case, the FCA's complaints scheme, the FCA's unsuccessful attempt to introduce a new "*solely or primarily responsible*" test of causation via public consultation into the Scheme Rules;

(ii) set out the basis for our clients' complaint, in particular the FCA's reliance upon a narrow test of causation, with no basis, in connection with the Decision;

(iii) explain our clients' view that the Decision cannot be justified in light of the factors established under the Scheme Rules or as furthering the FCA's statutory objectives;

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duty". Our clients do not accept the general principle, proposed in the Consultation Paper, that the FCA's *ex gratia* compensation payments should be capped at £10,000 or another figure, nor the apparent underlying principle that LC&F investors should not be "over-compensated" or have their losses capped at £85,000 in this case. Where the FCA is responsible for significant investor losses, it should pay appropriate compensation, as recommended by the Commissioner without any cap prejudging that matter. In the Consultation Paper, we suggested that guidelines, not caps, could be developed, and that the FSCS regime caps would be a useful non-determinative point of reference in relevant cases. Any guidelines in this regard would also need to take into account the flexibility which exists within the FSCS regime under the Temporary High Balances ("**THB**") scheme (See Temporary high balances | Check your money is protected | FSCS), which typically protects balances in bank accounts, building society accounts or credit union accounts of up to £1,000,000 for up to 6 months (albeit this would not be applicable to LC&F investors given the minimum 1 year term of its bonds).

[24] See the 2018/2019 OCC Report, p. 13, ¶ 5 5 and the 2019/2020 OCC Report, p. 13, ¶ 5.5 .

(iv) rebut certain other points made in an FCA April Letter, which purported to justify the Decision (in the Schedule); and

(v) describe the actions we would like the Complaints Commissioner to take in response to this complaint.

Background

The FCA Complaints Team will be aware that LC&F is in administration. The FSCS has declined to compensate the majority of LC&F investors.[25] The former principals of LC&F appear to have misappropriated almost all of the £237 million of mostly retail investor deposits that it raised[26] with only a 2.5% distribution having been made by the administrators to date.[27] It is expected that the administration will "*still take a number of years to achieve and finalise*",[28] with no further distributions expected in 1-2 years. An *ad hoc* government compensation scheme has been announced, that will provide LC&F investors with 80% of the compensation they would have received had they been eligible for FSCS protection.[29]

Dame Elizabeth Gloster was commissioned under section 77 of FSMA to produce a report (the "**Gloster Report**") into the FCA's regulation of LC&F.[30] The Gloster Report concluded that the FCA was responsible for several regulatory failures concerning LC&F. It found that: "*the FCA did not discharge its functions in respect of LCF in a manner which enabled it effectively to fulfil its statutory objectives*"[31] and that "*there were in fact serious underlying issues with LCF's business, of which the FCA was aware, which were not pursued adequately or at all by the FCA*."[32] It also noted that, "*the FCA's failures may be relevant to arguments that the FCA*

[25] FSCS has announced that it will compensate investors who: (i) transferred into LC&F ISA bonds from existing stocks and shares ISAs; and (ii) received regulated "*advice*" (under article 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001). This has so far led to compensation for roughly 24% of investors (see https://www fscs.org.uk/failed-firms/lcf/). In *R (Donegan and ors) v Financial Services Compensation Scheme Limited* [2021] EWHC 760 (Admin), our clients, a group of LC&F bondholders, brought a claim against FSCS's decision not to compensate a wider group of investors. However, while the Judge agreed with many of the key aspects of the claimants' submissions, including that the non-transfer clauses which LC&F purported to rely upon to avoid more stringent regulation were unfair and unenforceable, he declined to find that the bonds were regulated and therefore declined to set aside the FSCS's decision on compensation. The Judge has since granted the claimants permission to appeal that decision and our clients have filed their appeal with the Court. Our clients reserve all their rights in this regard.

[26] See the Gloster Report, Ch. 1, ¶ 1 3.

[27] See Administrators Report of Smith & Williamson dated 25 February 2021 (the "**2021 Administrators' Report**"), p. 14 (pp. 191-235 of the exhibit).

[28] *Ibid.*, p. 3 (p. 195 of the exhibit).

[29] John Glen, "*Written Ministerial Statement – London Capital & Finance"* (19 April 2021) (WMS - LCF CS - final 003 .pdf (publishing.service.gov.uk)). The second reading of the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill, which will implement the compensation scheme, took place on 8 June 2021 and passed with cross-party support.

[30] The Gloster Report.

[31] See the Gloster Report, Ch. 2, ¶ 1 1.

[32] See the Gloster Report, Ch. 6, ¶ 1.4.

in some real sense "caused" Bondholders' losses"[33]. The Gloster Report expressly doubted and criticised submissions by the FCA that it was not a cause of investor losses and that it should not compensate investors under its complaints scheme.[34]

The FCA has reported that 1,062 investors in LC&F have submitted complaints to the FCA. Those complaints were deferred by the FCA whilst the Gloster Report was unpublished.[35] According to the latest Financial Regulators Complaints Commissioner's Annual Report, the number of open complaints in the FCA scheme for the period 2019/2020 was "*around 50% higher than the historic norm*", with much of the backlog related to LC&F investors.[36] Some of our clients have now received responses to their complaints from the FCA and have had sight of several other responses from the FCA to other bondholders. These responses are *pro forma*, denying FCA responsibility on the basis of the supposed "*solely or primarily responsible*" test and offering £50-100 in compensation in respect of the delays in handling the complaint but not in respect of FCA failures.

The FCA Complaints Scheme

Pursuant to paragraph 25 of Schedule 1ZA to FSMA, the FCA enjoys a statutory immunity from liability for damages, subject to limited exceptions. Under Part 6 of the Financial Services Act 2012 (the "**FS Act**"), a complaints scheme is established. The FCA (and its sister regulator, the Prudential Regulation Authority, the "**PRA**", which has no involvement in LC&F) are obliged to make arrangements for the investigation of complaints relating to the exercise of their functions, known as the complaints scheme (section 84(1), FS Act). The complaints scheme must allow for reference of complaints to an independent investigator (in this case, the Complaints Commissioner) to investigate complaints without favouring the regulators (section 84(5)(b) and 86(2), FS Act). The investigator must have powers to recommend that a compensatory payment be made (section 86(5) FS Act). The FCA and PRA acting together were required to publish the Scheme Rules of the complaints scheme in accordance with section 86 of the FS Act 2012. The Scheme Rules are entitled: "*Complaints against the regulators: the Scheme*".[37] Any amendment to the Scheme Rules must be preceded by a public consultation made by both authorities (section 86(10) FS Act).

The established test of causation for the award of *ex gratia* compensation for these purposes, which has been repeatedly referred to by the Complaints Commissioner, is whether the "*actions of the FCA contributed to the complainants' financial loss*".[38] In line with this causation test,

[33] See the Gloster Report, Ch. 1, ¶3.6.

[34] See the Gloster Report, Ch. 1 ¶ 3.4-2.6

[35] See the Financial Times, "*UK MPs urge financial regulators not to rush changes to complaints scheme"* (11 September 2020) (https://www ft.com/content/51af062f-87f4-4438-89bb-756049734c11).

[36] The 2019/2020 OCC Report, p. 16.

[37] The Scheme Rules.

[38] The 2019/2020 OCC Report, p. 13.

the Complaints Commissioner has previously recommended that the FCA make material compensation payments to investors on several occasions, including in situations where the FCA did not have "*principal responsibility*" for the loss.[39] This will often be the case, since if an authorised firm was engaged in misconduct which the FCA failed to address, the firm will be the main cause of the loss. The FCA may however be responsible for failures which contributed to the loss, precisely as is the case for LC&F investors according to the conclusions of the Gloster Report.[40] In such situations where there is also a regulatory failure, the FCA will have "contributed to" the investors' loss and compensation at an appropriate level would be recommended by the Complaints Commissioner. However, the FCA will not be liable for the full amount of the loss.[41]

FCA Consultation on Scheme Rules

On 20 July 2020, the FCA published a wide-ranging set of proposals in a Consultation Paper to amend the Scheme Rules.[42] Its proposals included that: the FCA would make *ex gratia* payments under the complaints scheme to investors only if the regulator was "*the sole or primary cause of the loss; and there has been a clear and significant failure by [the FCA]* ".[43] This consultation caused considerable controversy, not least in light of the timing of the consultation and the fact that so many LC&F complaints (and complaints relating to other recent scandals such as those relating to FCA-regulated firms such as [redacted]) were open and that apparently some or all investors in these scandals would be affected by the proposed changes.

The apparently retrospective nature of the FCA proposals in the Consultation Paper was widely criticised.[44] In the FCA April Letter, the FCA highlighted that the new rules would not have applied to "*complaints made before the revised Scheme comes into force*", as was stated in the Consultation Paper itself. However, that does not affect the retroactive effect of the FCA's proposals as regards the prospect of compensation for actions or omissions of the FCA which took place before the revised Scheme came into force, for example where the complaint related to the period before the proposed rules were introduced but the complaint was submitted after

[39] See the 2018/2019 OCC Report, p. 15.

[40] See the 2018/2019 OCC Report, p. 15.

[41] See, for example, the Complaints Commissioner's decision in Case [redacted]: "*While I do not consider that the FCA should be held responsible for the totality of your loss, in my preliminary report I recommend that it should make a substantial contribution towards it to acknowledge the extent of their failings*" (Final Report by the Complaints Commissioner – Complaint number F[redacted], para 14 (FCA00459-FR-18-06-18-publication-version.pdf (frccommissioner.org.uk)) ("**Case [redacted]**").

[42] See the Consultation Paper.

[43] *Ibid*, ¶ 4.10.

[44] The *True and Fair Campaign*, a group whose mission is to "*to achieve better customer outcomes and restore trust in the Financial Services sector*", has described the FCA proposals to cap its own liability and change the basis for its liability (including its proposed primary liability test) to be "*unfair, immoral and illegal*", True and Fair, "*CP20/11 Complaints against the Regulators (The Financial Conduct Authority, the Prudential Regulation Authority, and the Bank of England) Submission from The True and Fair Campaign*" (12 October 2020) (pp. 236-243 of the exhibit) (the, "**True and Fair Campaign Response**"). See also the Consultation Response (pp. 91-104 of the exhibit) and the Press Reports (International Advisor and Financial Times).

the proposed rules were introduced. Notably, 9,000-10,000 LC&F investors have not to date made a complaint to the FCA and would have risked falling foul of the retroactive nature of the proposed FCA rulemaking in this regard, since the rules would have come into effect not from the date of the actions or omissions of the FCA but from the date of submission of the complaint.

The publication of the Consultation Paper led to considerable and noteworthy controversy.[45] Our clients, and several public figures, asked that the FCA at least delay implementation of the amended Scheme Rules or not apply them to existing cases or complaints concerning matters arising prior to the date the Scheme Rules are to be amended.[46] Gina Miller, co-founder of the True and Fair Campaign, commented that the FCA's proposals, "*amount to the FCA blatantly attempting to close the door on all future compensation for financial loss suffered by victims where regulatory failure by the FCA has contributed to their loss*" and "[t]*he rush to undertake and conclude this consultation before publication of three major independent reviews, likely to detail the FCA's failures…is highly suspect*.[47] Mel Stride, Chair of the Treasury Select Committee, received "*several representations*" regarding the length of the consultation and asked the FCA to give "*serious and urgent consideration*" to extending the consultation period.[48] Before the consultation was launched, the Complaints Commissioner had informed the FCA that it could see no justification for curtailing the usual 12-week consultation and, in its consultation response, stated that, "*there are some significant policy issues raised by the revisions to the Scheme, issues which affect potentially vulnerable people and involve restrictions upon a statutory scheme*".[49] The matter was widely discussed and commented upon in the press, as was our clients' Consultation Response.[50] The FCA bowed to this and other public pressure and outcry, including comments from Dame Elizabeth who, "*wrote to the Chair of the FCA in September 2020 to express her concern about the potential for the proposals set out in the consultation paper adversely to impact on any complaints which might be made by Bondholders after publication of this Report.*"[51] As a result, the FCA announced in December 2020 that it would be delaying the implementation of the proposals on the basis of concerns raised by respondents to the Consultation Paper.[52]

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[45] See the Gloster Report, Ch. 1, ¶ 3 1, fn 34, the Mel Stride Letter, the Consultation Response (pp. 91-104 of the exhibit), the True and Fair Campaign Response (pp. 236-243 of the exhibit) and the Press Reports (International Advisor and Financial Times).

[46] See the Gloster Report, Ch. 1 ¶ 3.1, fn 34.

[47] See International Advisor.

[48] The Mel Stride Letter.

[49] The Complaints Commissioner, *Complaints Commissioner's response to Consultation Scheme consultation CP20-11* (Response-to-CP20-11-for-publication.pdf (frccommissioner.org.uk)) (the "**Commissioner's Consultation Response**").

[50] See the Press Reports (International Advisor and Financial Times), the Consultation Response (pp. 91-104 of the exhibit) and the True and Fair Campaign Response (pp. 236 -243 of the exhibit).

[51] See the Gloster Report, Ch. 1, ¶ 3.1, fn 34.

[52] See the Consultation Paper.

Remedies Statement

Although the FCA and PRA were forced to postpone amending the Scheme Rules (and have still not published their policy statement or final rules related to the Consultation Paper), this took place too late to have any effect on the FCA's earlier publication of the Remedies Statement[53] on 16 June 2020, an online "*approach document*" on its own dedicated page within the FCA website concerning the complaints scheme. This document does not have the status of statute, Scheme Rules, other FCA rules or FCA guidance. The Remedies Statement was not apparently subject to any public consultation or cost-benefit analysis, as would be required under section 86(10) of the FS Act for Scheme Rules or section 138I(2) of FSMA for FCA rules or guidance. It is merely a published viewpoint of the FCA as to its own liability. In the FCA Email dated 26 May 2021, the FCA confirmed this status of the Remedies Statement, commenting that it "*simply explains the FCA's general approach to remedies when it agrees that a complaint made about the FCA under the Complaints Scheme (the Scheme) is well founded*". The Remedies Statement is of particular concern because it referred – apparently for the first time in any official sector document – to the "*solely or primarily responsible*" causation test.

In the FCA Email, the FCA has confirmed that the publication of the Remedies Statement was approved in an FCA board meeting on 21 May 2021[54], which authorised the LC&F Compensation Statement, whilst the Consultation Paper process progressed "*that in the interim a statement, clarifying the current approach to paying compensation and the intention to consult, be issued*".

The Decision

The Decision of the FCA relating to compensation for LC&F investors is evidenced by board minutes dated 16 April 2021. These minutes mention the S&S April Letter and other material correspondence received by the FCA which were apparently presented to the FCA board, presumably to draw attention to the controversial nature of the subject matter under consideration. The FCA board decision refers to "*the relevant factors in the Complaints Scheme, and the FCA's statutory framework, including (as part of consideration of the consumer protection objective) the role of consumer responsibility*".[55] There is no mention of the "*solely or primarily responsible*" test. The reference to "*consumer responsibility*" presumably refers to a limb of the consumer protection objective under section 1C of FSMA. The consumer protection objective itself is defined as "*securing an appropriate degree of*

[53] See the FCA, "*Complaints Scheme our approach to remedies*" (https://www.fca.org.uk/news/statements/complaints-scheme-our-approach-remedies).

[54] See the FCA Board Minutes dated 21 May 2020 (the "**May Board Minutes**") (FCA Board Minutes: 21 May 2020).

[55] See the April Board Minutes, ¶ 2.3

protection for consumers".[56] In section 1C(2)(d) of the Financial Services and Markets Act 2000, one of the factors relevant to this objective is: "*the general principle that consumers should take responsibility for their actions*". The minutes also refer to the "*public sector equality duty*" when assessing final decisions on individual complaints, presumably in purporting to justify the FCA's stated aim in the Decision of ensuring that no individual LC&F investors would receive more compensation overall than that prescribed under the FSCS regime.[57]

The operative part of the decision for present purposes reads as follows:

> *"2.4 Having considered the analysis of the relevant factors in the Complaints Scheme, the Board agreed:*
>
> *i. to award payments under the FCA Complaints Scheme to LCF investors who were provided incorrect information by the FCA in direct communications where that information may have led the individual to invest, or to refrain from withdrawing their investment, in LCF. This was subject to a final review as the complaints are individually responded to;*
>
> *ii. that those payments should be described as 'ex gratia compensatory payments' (as opposed to payments specifically for financial loss or distress and inconvenience);*
>
> *iii. not to award ex gratia compensatory payments to other investors, subject to a final review as the complaints are individually responded to.*
> *…*
>
> *2.6 The Board noted that the decision in this case reflected the exceptional circumstances of LCF.*
>
> *2.7 The Board agreed that the final communications on this subject should be signed off by the Chair and Chief Executive."*

LC&F Compensation Statement

The LC&F Compensation Statement was also published online on the FCA website and noted that:

> "*Today we are confirming our broad approach to assessing complaints made specifically to the FCA in relation to LCF, reflecting what we consider is likely to be appropriate in individual cases in accordance with the approach set out in our Complaints Scheme, our remedies statement, and the statutory framework within which*

[56] Section 1C(1), FSMA.

[57] See the April Board Minutes, ¶ 2.3; FSCS is then referred to in ¶ 2.5 of the Board Minutes.

> *we operate.*" [Emphasis added. Links to the Scheme Rules and the Remedies Statement were included.].

Although the Remedies Statement was not referred to in the Decision, it was referred to in the LC&F Compensation Statement, which would have been signed off by the Chair and Chief Executive of the FCA, pursuant to paragraph 2.7 of the Decision.

The LC&F Compensation Statement announced that compensation would be paid to LC&F investors "*who were given incorrect information in these direct communications with the FCA which may have led them to conclude their investment would be safer than it was*". However, in relation to the vast majority of LC&F investors, it said that: "*Complaints ... will be considered individually in accordance with the Complaints Scheme. Whilst we do not expect to make ex gratia compensatory payments to these investors, we will be writing to the majority of complainants, acknowledging the errors we made in relation to LCF, reiterating our apology and ensuring they have full information about the government scheme.*"

The "*solely or primarily responsible*" test and the FCA's citation of and reliance upon it in connection with the Decision

As above, the Remedies Statement was the first published FCA or other official sector document of which we are aware in which the "*solely or primarily responsible*" test of causation is asserted. Further evidence of the Remedies Statement being relied upon for purposes of the Decision can be found in the evidence of Charles Randell, the FCA chairman, to the Treasury Select Committee presaging his reasons as to why the FCA would not be compensating LC&F investors on 1 March 2021 (the "**TSC Evidence**", p. 105-147 of the exhibit). In the TSC Evidence, Charles Randell said that: "[o]*ur current complaints scheme* […] *envisages that in cases where there are complaints against the regulators* […] *in cases where we are the primary cause of the loss, we will* […] *make compensatory payments*" (p. 139 of the exhibit).

The "*solely or primarily responsible*" test was further mentioned in a letter from Mr Randell to Rt Hon Mel Stride MP, the chair of the Treasury Select Committee, dated 23 March 2021 (the "**23 March Letter**", p. 148-149 of the exhibit), which was delivered in connection with the TSC Evidence. The 23 March Letter states that: "[w]*here we conclude that a complaint is well founded, we will decide what remedy is appropriate taking into account the factors set out in the Complaints Scheme…complainants would normally need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA. Any such payment made would not, typically, cover the full loss*." (pp. 148-149 of the exhibit).

In the FCA April Letter, the FCA chose to explain its incorrect view as to why the "*solely or primarily responsible*" test was applicable, rather than to take the view that it was not used. The FCA April Letter stated (at paragraphs 2, 7 and 14) that:

> "*The LC&F Compensation Statement reflects what the FCA considers is the appropriate general approach, having regard to the terms of the "Complaints against the regulators: the Scheme", published by the FCA and Prudential Regulation Authority ("PRA") (the "Scheme"), and the FCA's statement "Complaints Scheme: our approach to remedies" (the "Remedies Statement")*". …
>
> *The Remedies Statement explains that in order for the FCA to consider it appropriate to offer an ex gratia payment, a complaint would be expected to provide "evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA".*
>
> *Accordingly, …. we consider that it is in general appropriate to limit compensation offers to cases where the FCA is solely or primarily responsible for the loss suffered.*"

Although the Board Resolution does not refer directly to the "*solely and primarily responsible*" test, a Court, in assessing an administrative decision, will look beyond the mere formal minute documenting the decision to the "*contemporaneous correspondence, Board minutes, decision logs, memoranda and statement of reasons*"[58] and will consider "*the path*"[59] to the decision. The path to the FCA's decision is evidenced by the 23 March Letter, TSC Evidence, LC&F Compensation Statement and the FCA April Letter. All these materials clearly bring into scope the "*solely or primarily responsible*" test set forth in the Remedies Statement, even though they are not cited expressly in the Decision.

Basis for Complaint

Our clients are submitting this complaint on the basis that the FCA has erred in its Decision not to make more widespread and higher *ex gratia* payments to LC&F investors, by limiting these to investors who received misleading direct communications with the FCA and in making pay-outs only in respect of the delays in processing complaints, not for its regulatory failures.

This section sets out the detailed basis for our complaint. Some references are included to the relevant correspondence. However, the next following section will analyse in greater detail why our clients disagree with the points made in the FCA April Letter.

1. ***The "solely or primarily responsible" test has no basis, since the Remedies Statement is neither Scheme Rules, FCA rules nor FCA guidance***

For the reasons set out above, the Remedies Statement is the first time that the "*solely or primarily responsible*" test appeared in an official FCA communication asserting a general policy. The subsequent TSC Evidence, FCA April Letter and LC&F Compensation

[58] *Mountstar (Plc) Ltd v Charity Commission for England and Wales* [2013] 10 WLUK 555, at ¶ 106.

[59] *The Queen on the Application of Dr Hans-Christian Raabe v Secretary of State for the Home Department* [2013] EWHC 1736 (Admin) at ¶ 152.

Announcement, all after March 2021, invoke this test in the specific circumstances of LC&F investors. It is therefore critical first to consider the legal status of the Remedies Statement.

The Remedies Statement is not Scheme Rules, as has been acknowledged by the FCA in the FCA Email.[60] Section 86 of the FS Act allows the FCA and PRA to jointly make the Scheme Rules but requires the regulators to "*publish a draft of the proposed scheme in the way appearing to them to be best calculated to bring it to the attention of the public*".[61] Under section 86(10) of the FS Act, the same process applies to proposals to alter or replace the complaints scheme. This process was not followed as regards the Remedies Statement dated June 2020. The current version of the Scheme Rules remains dated 2016.

The Remedies Statement is not statutory rules or guidance under FSMA either; the FCA has agreed with this proposition in the FCA Email which explained: "[t]*he remedies statement is not, and was not intended or stated to be, FCA guidance under section 139A of the Financial Services and Markets Act 2000 or an FCA rule. The statement is instead a statement of the FCA's general approach or policy* […]". The FCA Email goes on to state that the Remedies Statement is "*a statement of the FCA's general approach to deciding what it does when it agrees that a complaint made about the FCA under the Scheme is well founded. It was published in the interests of transparency, and with the aim of applying a consistent and fair approach to ensure remedies are appropriate and proportionate, based on the individual features of the complaint and what went wrong.*"

The Remedies Statement therefore has no legislative authority under the FS Act or FSMA and is ineffective as the sole asserted source of authority for a novel test of causation as regards the compensation scheme under the FS Act. Section 84(1) of the FS Act requires the FCA to make a complaints scheme to govern the investigation of complaints in connection with failures in the exercise of regulators' relevant functions. In particular, it was wrong for the LC&F Compensation Statement to "have regard" to the Remedies Statement (at least insofar as it relates to the "*solely or primarily responsible*" causation test) since this test has no basis and it is incorrect, for the reasons discussed in the following section.

In the S&S April Letter (pp. 1-13 of the exhibit), we observed that the Remedies Statement, "*referred favourably – apparently for the first time in any official sector document – to the interpolated concept of the FCA making* ex gratia *payments only where it has sole or primary*

[60] In an email from a partner of our firm [redacted], a partner of our firm, to [redacted] of the FCA dated 19 May 2021 (pp. 28-29 of the exhibit), we queried whether the FCA had followed the consultation and publication process under section 86(10) of the FS Act if it had purported to amend the Scheme Rules via the Remedies Statement. In the FCA Email, being his response of 26 May 2021 (pp. 26-27 of the exhibit), [redacted] for the FCA stated that it was not necessary for the FCA to follow the consultation and publication process because: "*Section 86(10) of the Financial Services Act 2012 ("FS Act") states that where regulators propose to alter or replace the complaints scheme certain requirements relating to consultation, set out in sections (1) to (5) and (9)(a), apply. The remedies statement did not alter or replace the complaints scheme, the statement simply explains the FCA's general approach to remedies when it agrees that a complaint made about the FCA under the Complaints Scheme (the Scheme) is well-founded. Furthermore, as the statement makes clear, in deciding what remedy is appropriate the FCA takes into account the factors set out in paragraph 7.14 of the Scheme. In the circumstances, therefore, it was not necessary for the FCA to follow the consultation and publication process set out under section 86(10) of the FS Act* ".

[61] Section 86(1), FS Act.

responsibility"[62]. The FCA failed to provide any evidence refuting the novelty of the causation test in June 2020, merely asserting without any support that this causation test reflected their "*longstanding approach to the offer of* ex gratia *payments in recognition of financial loss*"[63]. The "*solely or primarily responsible*" test has no basis in any written or published document of which we are aware; it is found in no published FCA document or website, prior to the Remedies Statement in June 2020.[64] To the extent the FCA has sought to rely on similar causation tests (e.g. a "principal liability" test in referred complaint Case FCA00459) from time to time in an attempt to avoid paying compensation to certain investors under the complaints scheme, this has been rejected by the Complaints Commissioner, as discussed in the next section.

The timing of the Remedies Statement, which was approved while Dame Elizabeth Gloster's investigation was ongoing and at a time when complaints against the FCA were at an historically high point following the breaking of an unusual high number of financial scandals, is noteworthy and concerning.

The FCA board resolution of 21 May 2020 approved only a statement of the FCA's "*current approach*" to paying compensation. There is no reference in that board resolution to the "*solely or primarily responsible*" test being introduced, nor to any approval by the Board for the FCA to amend the Scheme Rules in order to introduce this approach or to change the causation test for compensation payments under the complaints scheme. The "*solely or primarily responsible*" test of causation was a novel innovation of the FCA as at June 2020, and cannot under any analysis properly be regarded as describing any "current approach" to paying compensation. The purported introduction for the first time of the "*solely or primarily responsible*" test in the Remedies Statement therefore does not even appear to have been approved by the FCA board resolution which the FCA now cites as grounds for making the Remedies Statement.

If the "*solely or primarily responsible*" test were in fact applicable, then there would be no need for the FCA to amend the Scheme Rules to introduce such a test. However, the FCA attempted to do just that, by means of the Consultation Paper – and was later forced to postpone the proposals following public outcry about the unfair nature of the proposals.[65] Our clients acknowledge that the Consultation Paper itself also sought to characterise the changes to Scheme Rules in general as a "*clarification of our approach to compensatory payments*" which would not "*substantially change the proportion of cases in which we make such payments, nor*

[62] S&S April Letter, p. 7 (p. 7 of the exhibit).

[63] FCA April Letter, p. 3, ¶ 7 (p. 16 of the exhibit).

[64] See the May Board Minutes: "*When considering the treatment of existing complaints, the Board recognised the benefits of providing transparency on the current approach. The Board therefore welcomed the publication of a statement clarifying this approach and the intention to consult. The Board* ***agreed*** *i. to consult on revising the Scheme ii. that in the interim a statement, clarifying the current approach to paying compensation and the intention to consult, be issued.*

[65] See the Gloster Report, Ch. 1, ¶ 3.1, fn 34, the Mel Stride Letter, the Consultation Response (pp. 91-104 of the exhibit), the True and Fair Campaign Response and the Press Reports (International Advisor and Financial Times).

the amounts paid in general."[66] However, the level of public outcry and press attention which resulted from the proposals, and in particular the proposals to change the causation test, would unlikely have occurred if the FCA's proposals were merely to codify previously-established processes, which they clearly are not. The Scheme Rules have not to date been so amended. It is not open to the FCA to act as if the Scheme Rules had been amended pursuant to the consultation process commenced via the Consultation Paper, when it has been unable to make those changes and when those changes form no part of the Scheme Rules.

2. *The applicable test of causation is whether the FCA "contributed to" the investor losses*

Under section 87 of the FS Act, the investigator of a complaint against one of the regulators must have the power to recommend, "*if the investigator thinks it appropriate*", that the relevant regulator either makes a compensatory payment to the complainant in question or remedies the matter complained of.[67] Such a payment would be voluntary and *ex gratia*, in light of the FCA's statutory immunity (paragraph 6.6, Scheme Rules). If a complainant is dissatisfied with the handling of a complaint by the independent investigator, the complaint may be referred to the Complaints Commissioner, who has similar powers to make findings and recommendations (paragraph 6.8, Scheme Rules).

Where the investigator "*has reported that the complaint is well-founded*" or "*has criticised the regulator in a report*", the complaints scheme must require the relevant regulator to inform the investigator and complainant of the steps it proposes to take in response to the investigator's report.[68]

The Complaints Commissioner has adopted a contributory test of causation for more than a decade:

- In the two most recent reports of the independent Complaints Commissioner, it is stated that the applicable test of causation is whether or not the FCA "*contributed to*" the losses of the investor.[69]

- The published report on complaint Case FCA00459[70] applies the "*contributed to*" test, and has several parallels with LC&F. There, alleged fraudsters were the primary cause of the investor's loss, but the losses would not have happened or would not have been so extensive, were it not for certain serious regulatory failures of the FCA as a contributing factor. The FCA refused to pay material compensation on the basis that

[66] See the Consultation Paper, p. 10.

[67] Section 87(5), FS Act.

[68] Section 87(6), FS Act.

[69] See the 2018/2019 OCC Report, p. 13, ¶ 5.5 and the 2019/2020 OCC Report, p. 13, ¶ 5 5 .

[70] The 2018/2019 OCC Report, p. 15 and Case FCA00459.

the regulator did not have "*principal responsibility*" for the loss. This proposition was rejected by the Complaints Commissioner, whose report on this case notes as follows: "*The FCA's serious failings contributed to* [the complainant's] *financial loss. While I do not consider that the FCA should be held responsible for the totality of your loss, in my preliminary report I recommended that it should make a substantial contribution towards it to acknowledge the extent of their failings. The FCA has accepted my recommendation*". The Commissioner's decision in Case 00459 expressly rejected the FCA's submissions that the complainant should not be compensated where the FCA was not the "*principal cause*" of the complainant's loss. In reaching this decision, the Complaints Commissioner even acknowledged that, "*Parliament has protected the FCA from claims for 'lack of care', and there is no evidence that the FCA acted in bad faith, so I do not think the FCA is legally liable for your loss*".[71] This is consistent with the *ex gratia* nature of the complaints regime and the statutory immunity enjoyed by the FCA. However, the Commissioner still found it appropriate in this case that it be recommended that the FCA offer "*an ex gratia payment representing 50% of your loss*".[72] In the FCA April Letter, the FCA entirely misunderstands and mis-states the interaction between the statutory immunity regime and the *ex gratia* compensation regime; the latter is intended to be a separate regime with its own processes, whose validity and force is not negated by the former.

- The test of causation for the purposes of the complaints scheme was analysed in detail in the 2009-2010 Annual Report of the Officer of the Complaints Commissioner.[73] Although this report was made under the former Financial Services Authority ("**FSA**") and FSMA 2000 regime which predated the creation of the PRA and the FS Act 2012, the relevant operative provisions governing the complaints and compensation regime remain materially similar for all present purposes. The relevant passage makes two express references to what "*Parliament ... intend[ed]*" in establishing the scheme. It concludes by noting that:

  "*where an award is requested consideration will always be given to 'causation' and where there is a clear break in causation then an award will either be reduced or not made at all"* (emphasis added).

  The FCA's "*sole or primarily responsible*" test addresses very similar situations to the guidance on addressing a "*clear break in causation*", since the actions of a regulated firm which is a malfeasor would typically involve another person who is primarily responsible, as well as a potential break in causation for the regulator's responsibility. Critically, the "*solely or primarily responsible*" test would ride roughshod over the long-standing Complaints Commissioner position on this topic, since it denudes the

[71] See Case FCA00459, ¶ 15.

[72] *Ibid.*

[73] Office of the Complaints Commissioner, "*Annual Report for 2009/10*" (https://frccommissioner.org.uk/wp-content/uploads/AnnualReport_2010.pdf), pp 11-12.

words "*reduced or*" of all force. The Complaints Commissioner will clearly consider the alternatives of *either* a reduction in compensation *or* no award at all. In contrast, the "*solely or primarily responsible*" causation test of the Remedies Statement results in a binary outcome for investors of 0% compensation ("no award at all") with no scope for "reduced" compensation (as required under this important and historical guidance) whatsoever.

- In its response to the Consultation Paper,[74] the Complaints Commissioner accepted that if the FCA is the sole or primary cause of a complainant's loss, then as a general rule it *should* compensate investors and there should be no arbitrary cap on the compensation available. However, it did not accept that if the FCA is *not* the sole or primary cause of loss then it should pay no compensation at all to investors. The FCA's position invokes a test that could reasonably be used as a presumption to identify cases where payouts should generally be recommended but turns this incorrectly and inappropriately on its head as a defence.

- Dame Elizabeth Gloster herself took the view that the Complaints Commissioner's contributory causation approach is the correct one in the Gloster Report, where she presents a series of failings by the FCA[75] (discussed in further detail below) and concludes that, "*the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses*."[76] The Gloster Report post-dates the Remedies Statement, in which the FCA attempted to establish the "*solely or primarily responsible*" test, making no reference to it or use of it as the current approach.

For over a decade until June 2020, neither the FCA nor its predecessor the FSA has ever challenged principles underlying the Complaints Commissioner's interpretations of or application of the contributory causation test under the *ex gratia* compensation scheme. Moreover, the FCA accepted, in full and without reservation, the recommendations in the Gloster Report. Despite it having been invited to do so, the FCA has provided no evidence that the "*solely or primarily responsible*" test represents a "*long-standing*" approach to the handling of compensation claims, as it now asserts.

The Remedies Statement is also grossly misleading to consumers in stating in such definitive terms that: "*In order for us to consider making an ex gratia payment in respect of financial loss, complainants would need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*" [emphasis added]. A consumer reading this guidance would understand that the "*solely or primarily responsible"* test was a gateway to any compensation payment. However, neither the Scheme Rules nor the FS Act support such a proposition, for the reasons set out above. The FCA is an unfair terms

[74] See the Commissioner's Consultation Response.

[75] See the Gloster Report, Ch. 1, ¶ 3.4 - 3.6

[76] See the Gloster Report, Ch. 1, ¶ 3.6

regulator under the Consumer Rights Act 2015 and it upholds the "*treating customers fairly*" principles under PRIN 2.1.1R of its Handbook when regulating authorised firms, namely that: "*A firm must pay due regard to the interests of its customers and treat them fairly*" and "*A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading*". The FCA should adopt such principles in its own communications with investors, especially complainants.

3. The purported introduction and application of the "solely or primarily responsible" test is not in accordance with the FCA's statutory duties and objectives

The FCA has not acted in accordance with its statutory objectives in purporting to introduce the "*solely or primarily responsible*" test. Under section 1B of FSMA, the FCA, "*in discharging its general functions, must, so far as reasonably possible, act in a way which* […] *advances one or more of its operational objectives*". Under section 1A(6) of FSMA, any reference to the FCA's "*functions*" under FSMA include those under the FS Act, which therefore includes the complaints scheme and Scheme Rules. In discharging its functions in relation to the complaints scheme under sections 86 and 87 of the FS Act, the FCA must therefore act in a way that advances its operational objectives.

The FCA's operational objectives are the consumer protection objective, the integrity objective and the competition objective, described under sections 1C-1E of FSMA. The competition objective is not discussed further here since it is not relevant.

Consumer protection objective

The consumer protection objective is "*securing an appropriate degree of protection for consumers*".[77] The FCA appears to have lost sight of the statutory definition of the consumer protection objective in relation to its processing of LC&F complaints, relying instead upon and giving undue weight to a directional interpretation of two of the several "factors" which the FCA must have regard to in determining the degree of protection, namely: "*the general principle that consumers should take responsibility for their decisions*"[78] (this being cited expressly in the Decision).

The weight given to this factor overlooks the way in which LC&F products were sold to generally retail investors, many of whom were low-to-modest income individuals with few assets who now find themselves in serious financial hardship. Many investors found LC&F via advertising on major search engines, mainstream press advertising and price comparison websites, in which the cash ISA products of high street banks were directly compared to the ISA products of LC&F.

[77] Section 1C, FSMA.

[78] Section 1C, FSMA.

LC&F investments were not sold as high-risk products and they were not sold as "mini-bonds" but as secured bonds or income bonds.[79] The FCA's guidance on "mini-bonds" was first dated 17 May 2019[80] entirely post-dating the breaking of the LC&F scandal. The Gloster Report instead highlighted the "halo effect" that FCA authorisation gave to LC&F's investments. The FCA (and FSCS) have continually sought to pass off LC&F investments as high-risk "mini-bonds",[81] which many LC&F investors have taken an unfair and brazen *ex post facto* rewriting of history on the part of the FCA, whose underlying objective is to blame LC&F investors for seeking out a labelled category of high-risk product. The FCA now, entirely inappropriately, seeks to rely upon this concept even further, in invoking "*the general principle that consumers should take responsibility for their decisions*" to avoid compensating those whom it has failed

Reliance on the consumer responsibility factor is incorrect in the case of LC&F because it invokes a derogatory regulatory categorisation which was: (i) not subject to any significant FCA communication or investor warning at the time of the investments; and (ii) not used in any meaningfully prominent way in the LC&F marketing materials. LC&F's advertising materials were in fact found to be misleading, unfair and unclear by the FCA in its notices of 10 December 2018, and on 13 December 2018. In those notices, the FCA required LC&F to cease communicating with or approving any financial promotions, invitations or inducements to engage in investment activity. In the judicial review case of *R v FSCS*, the non-transfer provisions which characterise the supposedly unregulated bond product sold by LC&F have been found to be unfair and unenforceable. This highlights further the FCA's failure in its capacity as a statutory unfair terms regulator under the Consumer Rights Act 2015, having allowed misleading product advertising and products whose key attributes rely upon unenforceable contractual terms to be so widely distributed. The FCA now seeks to avoid compensation on the grounds that investors knew they were getting themselves into high risk "mini-bond" investments, ignoring the facts underlying the LC&F scandal, the FCA's own enforcement notices against LC&F, the lack of regulatory pronouncements on mini-bonds at the time of same and the findings of the Gloster Report.

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[79] LC&F marketed its bonds on its website as "secured bonds" or "income bonds" (see pp. 244-247 of the exhibit) and in the information memoranda which described the bonds. By contrast, the phrase "*mini-bond*" appears on merely 6 pages out of a total of 573 pages of the LC&F brochures and information memoranda that we have reviewed. The wording is used only in small print without any emphasis and there is no explanation of the consequences in terms of the financial regulatory regime from which these bonds are typically exempt. The phrase does not appear in any of LC&F's information memoranda or bond instruments. Furthermore, in a survey of bondholders prepared for the purposes of our judicial review case, only 2% of investors surveyed thought they were purchasing a "mini-bond" (see p. 248-250 of the exhibit).

[80] The FCA, *Mini-bonds* (Mini-bonds | FCA). The FCA did provide information with respect to mini-bonds specifically with reference to LC&F on a separate webpage entitled *London Capital and Finance Plc enters administration*, but that page was also published after LC&F's collapse on 28 December 2018 and appears to have now been replaced by a separate webpage, *London Capital and Finance plc*, first published on 15 August 2019 (London Capital and Finance plc | FCA).

[81] See Treasury Committee formal meeting (oral evidence session), "*The Financial Conduct Authority's Regulation of London Capital & Finance plc*", HC 1191 (1 March 2021), responses to Qs 192, 223, 226, 227, 234 (https://committees.parliament.uk/oralevidence/1825/pdf/). In response to Q.234, Mr Randell commented that, "[i]*t would be inappropriate for me to engage in what might be called victim shaming by saying that people who bought LCF mini-bonds should have paid heed to the warnings that they were not covered by the Financial Services Compensation Scheme*" but then appeared to do just that, stating, "*we see consumers taking decisions that are not always calm, rational and well-informed*." A reference to mini-bonds is also found in the FCA April Letter (pp. 22 of the exhibit), as well as the FCA and FSCS's published materials on LC&F, e.g., FCA, *London Capital and Finance plc (*London Capital and Finance plc | FCA) and FSCS, *London Capital & Finance plc*, updates dated 10 May 2019 and 1 May 2019 (London Capital & Finance (LCF) failure - latest update | FSCS).

By reducing or limiting the circumstances in which it may make *ex gratia* compensation payments under the regime established by Parliament (by purporting to introduce and rely upon the "*solely or primarily responsible*" test of causation), the FCA has failed to promote the customer protection objective. This is particularly the case in the situation of LC&F where: (i) an independent investigation under FSMA, the Gloster Report, has found the FCA culpable of multiple regulatory failings and to be a contributory cause of investors' losses; (ii) the FCA has determined *ex gratia* compensation payments other than in accordance with the applicable causation test; and (iii) there is no basis in FSMA for giving such weight to the need for customers to take responsibility for their decisions when they were so badly misled by non-complaint unfair terms and false advertising, to such an extent that it excuses liability for regulatory failures of the FCA. Such actions clearly prioritise the FCA's desire to limit compensation payments over the need to provide an "appropriate degree" of protection for consumers.

The "*solely or primarily responsible*" test of causation therefore fails to advance any of the FCA's objectives and in fact the Decision and this causation test actively undermine two out of the three objectives.

Integrity objective

The second FCA objective, the integrity objective is "*protecting and enhancing the integrity of the UK financial system*".[82] "Integrity" in this case is defined to include the soundness, stability and resilience of the financial system, its not being used for a purpose connected with financial crime and the orderly operation of the financial markets. In failing to apply the Scheme Rules, circumventing the statutory consultation process laid out in the FS Act 2012 (on which, see the following section) and attempting to introduce a causation test which contradicts the approach advocated by the independent Complaints Commissioner, the FCA does not enhance the integrity of the financial system. In fact, the FCA has caused serious harm to the integrity of the system in its Decision. People invest on the basis of the legal and regulatory regime applicable at the time of their investment and expect the UK regulators to stand up to their obligations and duties, not that the regulatory regime to change unpredictably, capriciously and retrospectively to their detriment when they most need to rely upon it.

4. The FCA has acted irrationally in misapplying the factors under the Scheme Rules in coming to the decision and attempting to apply the "solely and primarily responsible" test despite this not being made as Scheme Rules

In making the Decision, the relevant minutes dated 16 April 2021 state that the FCA considered the factors set out in §7.14 of the Scheme Rules.[83] In the FCA April Letter, the FCA explained

[82] Section 1C and 1D(1), FSMA.

[83] The April Board Minutes, ¶ 2.4.

the conclusions it had drawn on this basis, as follows. Each of the factors, and the FCA's viewpoints on these as expressed in the FCA April Letter is discussed below:

(a) The gravity of the misconduct and its consequences for the complainant

The FCA effectively appears to accept the "gravity" of its misconduct, acknowledging that "*there were errors in its handling of LC&F and better judgements could have been made*" (paragraph 25(1) of the FCA April Letter (pp. 14-25 of the exhibit). The Gloster Report details these failings in full, as discussed below.

This is of course the first-listed, and most important factor in determining recommended compensation under the Scheme Rules.

(b) The nature of the FCA's relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the FCA

The FCA determined on the basis of this factor that only investors who received incorrect information about LC&F via direct communications by either telephone or in writing (the "**Incorrect Information Investors**") should be eligible for compensation. The FCA argues that for other investors, "*the complaints do not relate to any direct dealings between investors and the FCA. Rather, an investor may allege that they suffered a loss indirectly attributable to the FCA's failures*."

The second factor is just one of five factors. In essentially giving this factor a full weighting and ignoring the first-listed factor for other investors, the FCA has given less importance to the FCA's misconduct and the conclusions of the Gloster Report in assessing the appropriate remedy for investors. Moreover, the FCA communicates with investors not only via email or telephone but also via the FCA Register. The FCA itself places significant weight on the information conveyed by the Register and authorisation process, including in its advertising and awareness campaigns.[84]

The FCA's decision to compensate only the so-called Incorrect Information Investors (i.e. those who contacted the FCA directly by telephone or in writing) is perverse and may lead to negative policy outcomes. In paragraph 27 of the FCA April Letter (pp. 14-25 of the exhibit), the FCA stated that, "*for the avoidance of doubt, we do not consider that it would be appropriate to make* ex gratia *payments to investors who consulted the Register. The Register did not contain any incorrect information regarding LC&F and there was a lack of direct interaction with investors. There were also warnings on the Register which outlined that the customer should not invest based on the Register alone*." The FCA has however disseminated mass public awareness advertising campaigns, including on national radio and television and

[84] The FCA, *Financial Services Register* (1 April 2021): "*Always check the firm you're dealing with is listed on the Register* […] *It shows whether a firm you're using, or plan to use, is regulated by the PRA and/or the FCA* […] *Make sure the firm you're dealing with has permissions for the regulated activities you need. Always check that the permissions/activities of the firm match the services it's providing for you.*"

in the press highlighting that investors in financial products should check the Register.[85] Many LC&F investors accordingly did so, relying upon both the FCA-regulated status of LCF and the FCA Register itself. One of our clients even has a print-out of the FCA Register entry for LC&F from the time of her investment.

The FCA's Decision in disregarding investors who relied upon the FCA Register or LC&F's regulated status more generally. LC&F gave high prominence to its FCA-regulated status in advertising, listing its FCA-authorised and regulated status first among six ticked reasons to invest in LC&F.[86] Many investors diligence that aspect before investing. It is a perverse outcome that those investors who follow the FCA's advertising campaigns and guidance, checking the Register, will not be compensated, whilst those who use up valuable FCA resources by calling the FCA directly and who received essentially equal information, perhaps with limited related commentary reflecting FCA mass public awareness advertising campaigns that firms on the register are a protected investment, will be compensated. The Decision is damaging in diminishing the value of the Register.

If the FCA adheres to this position, it should now be recommended to commence a corrective mass public awareness advertising campaign informing investors that investors should no longer check the FCA Register, but should instead contact the FCA directly via telephone or in writing to see whether a firm is regulated. This would likely have significant resourcing and costs consequences.

(c) Whether what has gone wrong is at the operational or administrative level

In the FCA April Letter, the FCA argued that "*some of the FCA's actions need to be viewed in light of the fact that it had to make complex judgements around where to prioritise its resources*" and that "*the FCA's errors in respect of the Incorrect Information Investors were operational, as opposed to being one where the FCA's judgement and actions had to reflect a balance of conflicting and complex issues*" (paragraph 25(3) of the FCA April Letter (pp. 14-25 of the exhibit). Similar submissions were apparently made by the FCA to Dame Elizabeth Gloster in the course of her investigation. The Gloster Report rejected these arguments, finding that, "*significant additional resource would not have been required to prevent many of the failings described* [in the Gloster Report]"[87] and that, "*many of the failures in respect of the supervision of LCF identified in* [the Gloster Report] *did not arise owing to a lack of resource*."[88] Indeed, the Gloster Report points to the fact that "*LCF* […] *used its FCA-authorised status in its marketing material, often in breach of FCA financial promotion rules,*

[85] See pp. 251-257 of the exhibit. The FCA stresses that consumers should "*Always check the firm you're dealing with it listed on the* [FCA] *Register*" and explains that "*If you deal with a firm…that's not regulated, you may not be covered by the Financial Ombudsman Service or the Financial Services Compensation Scheme*" (Financial Services Register | FCA).

[86] LC&F Investor Journey, p. 258-291 of the exhibit.

[87] See the Gloster Report, Ch. 6, ¶ 7 2.

[88] See the Gloster Report, Ch. 6, ¶ 7.4.

to promote investment in its bond business thereby achieving an unmerited halo effect"[89] as an example of activity for which "*resource should have been available*".[90]

The Gloster Report rejected any argument that LC&F was operating outside the FCA's remit, finding that "*from the documents the Investigation has reviewed, it does not appear that FCA staff failed to act in respect of LCF because they considered they were not entitled to do so.*"[91] The FCA received multiple tip offs that LC&F may have been operating a fraud or a Ponzi scheme, and failed to take any action in response to these, as detailed in the Gloster Report.[92] The Gloster Report was evidently not persuaded that the FCA's "*judgement and actions*" were based on a "*balance of conflicting and complex issues*", as had been submitted by the FCA. Instead, the Gloster Report found that, "*there was a lack of operational awareness and/or consideration of such risks at the lower levels of the organisation which dealt with LCF*",[93] suggesting that all investors were impacted by the FCA's operational failings, not just the Incorrect Information Investors.

The FCA's conclusions in this regard are therefore based entirely upon propositions which have been found to be without any foundation, discredited and rejected by an independent former high court judge in the Gloster Report.

(d) The impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers

The FCA has highlighted the need to conduct regulation proportionately and "*without imposing an undue burden on those whom it regulates*" (paragraph 9 of the FCA April Letter (p. 16 of the exhibit). In the FCA April Letter, the FCA argues that, "[m]*aking a payment to every investor that complains is likely to impose a disproportionate financial burden on the firms and issuers we regulate and their consumers (who would ultimately bear that financial burden*" (paragraph 25(d) of the FCA April Letter (pp. 14-25 of the exhibit). This presumably refers to the need on the part of the FCA to control its own budget.

This insensitive conclusion can be compared with the impact of LC&F's failure on LC&F investors, which has been life changing. The 20% loss still suffered even after the application of HM Treasury's *ad hoc* compensation scheme (which rises to 60%+ losses for investors who invested £100,000-200,000)) are life changing for many investors. LC&F's promotional activities attracted investors who were members of the general public, many of whom were elderly or vulnerable. Many bondholders invested their whole life savings, a redundancy payment or a sum they had inherited. Some were persuaded to invest lump sums

[89] See the Gloster Report, Ch. 6, ¶ 7.6.

[90] See the Gloster Report, Ch. 6, ¶ 7.6.

[91] See the Gloster Report, Ch. 6, ¶ 7.8.

[92] See the Gloster Report, Ch. 2, ¶ 4.3.

[93] See the Gloster Report, Ch. 6, ¶ 8 2

from their pensions, following introduction of the new pension freedoms. High street banks and building societies have been offering savings rates below the rate of inflation for a decade, and many investors were concerned about the creeping erosion in the real value of their savings. Therefore, LC&F offered an attractive product, with interest rates competitive with but not materially higher than, other more mainstream providers. Most investors have now lost life-changing sums of money earned or saved over many years, which has often affected their health and emotional well-being.

The following investors' stories are typical of many whose lives have been devastated by the LC&F collapse:

a) 

b) 

Further examples of investors' stories are set out at pp. 150-162 of the exhibit (Selection of Bondholder Personal Impact Statements) and pp. 163-190 of the exhibit (LCF Impact Assessment).

The FCA discounts these harrowing experiences and life-changing losses for investors, prioritising instead the "*disproportionate financial burden*" on regulated firms and issuers, i.e. a concern about increased FCA fees for regulated firms. The weight given to this factor fails to take into account appropriately the devastation that LC&F's collapse has wrought on the lives of thousands of individuals investors who have been let down by the FCA's regulatory failings.

The FCA's approach to payouts to LC&F investors is inconsistent with how it regulates authorised firms. The FCA recently made a high-profile intervention in the [redacted] case.[94] There, a scheme of arrangement was before the High Court, which would reduce complaints pay-outs of this firm to customers as part of a restructuring of the firm's debt with a view to saving the firm from entering into an insolvency process. The FCA argued, and the Judge agreed, that the Court should not reduce a firm's liability to customers in this way. However, when it comes to a risk of the FCA increasing its expenses (with no evidence that this would cause financial hardship), the FCA now prioritises its own P&L management over investor losses, inappropriately. Our clients are concerned by the double-standards currently being perpetuated by the FCA in this area (i.e. as between its own liability and its expectations for firm liability), a concern which also applies to other aspects of the Consultation Paper proposals.

The argument that the financial burden on firms would be "disproportionate" in any event has no factual basis. The FSCS has paid approximately £60m in compensation to LC&F investors, while HM Treasury's compensation scheme will cover an additional £120m. The LC&F administrators have to date paid out £6m in administration distributions. Of the £237 million total losses relating to LC&F, just over £50m remain uncompensated. This is the maximum amount which the FCA could potentially contribute.

According to its 2019-2020 accounts, the FCA had an annual income of £632m, annual expenses of £591 million and surplus assets of £121 million. Moreover, at 17 June 2020, the FCA had collected £104,717,600 in income by fining regulated firms for misconduct, with over six months of the year left to run. In 2019, the total amount of fines collected for the full year was £392,303,087. The FCA's "finite resources" for 2020/2021 are likely to exceed at least £200m and may be substantially more as a result of fines.

In short, an appropriately fuller pay-out to LC&F investors of up to the remaining £50 million of uncompensated investments would result in less than half of the FCA's surplus assets being applied, causing no liquidity issues and having no impact upon the fees charged to authorised firms. In its Annual Report and Accounts 2019/2020 (the Annual Report), the FCA noted that "*As at 31 March 2020, there are a number of open complaints and claims made against the FCA. However, the FCA does not expect the ultimate resolution of any of the claims to have a significant adverse effect on its financial position, performance or cash flows*".[95] This statement pre-dates the publication of the "solely or primarily responsible" test in the Remedies Statement of June 2020. There is no indication that the FCA's financial position has to date rendered it unable to fund complaints under the existing Complaints Scheme.

All the evidence therefore points to more generous *ex gratia* compensation payouts for all LC&F investors not imposing a "disproportionate" burden on the FCA. The impact for

[94] [redacted]

[95] See FCA 2019/2020 Annual Report and Accounts, p. 153 (Annual Report and Accounts 2019/20 (fca.org.uk)).

investors of receiving this compensation would, on the other hand, be very significant to many of them personally. Some investors stand to lose tens or even hundreds of thousands of pounds to LC&F even after the application of the HM Treasury and FSCS schemes. For some of those whose losses are more moderate in pure monetary terms, losing 20% of their entire lifetime savings is devastating, particularly as many of LC&F's investors are vulnerable and struggle with physical and/or mental health conditions.[96]

(e) Limited ability for FCA to deviate from Scheme Rules

The only instance in which the FCA is expressly granted authority not to act in accordance with the FS Act regime and complaints Scheme Rules is if it reasonably considers that a complaint would be more appropriately dealt with in another way, for example by referring the matter to the Upper Tribunal or by the institution of legal proceedings (section 87(1), FS Act). The FCA did not choose to take either of these options as regards the complaints made by LC&F investors and it is therefore bound to investigate and deal with the complaints of LC&F investors in accordance with the Scheme Rules and the FS Act regime.

(f) FCA's attempt to amend the Scheme Rules

It is of particular concern that the FCA sought formally to introduce the "*solely or primarily responsible*" causation test expressly into the Scheme Rules via the Consultation Paper[97] in June 2020, but failed to achieve this; it now ploughs on as if it had made rules that it apparently decided initially to drop following a public outcry about their contents and timing. [98]

The widespread criticism provoked by the amended rules proposed in the Consultation Paper would unlikely have arisen were this simply to have been a statement of existing law and policy, as the FCA now asserts. By attempting to apply the "*solely or primarily liable*" test of causation when it had failed to introduce this new test via the appropriate statutory consultation process, the FCA has failed to follow the due process set out in the FS Act and, by extension, has not acted fairly in its decision making. The consequences of its reliance on the "*solely or primarily responsible*" test of causation is that the FCA has attempted to reduce the compensation which it would pay on an *ex gratia* basis, a matter in which it has a clear self-interest.

Conclusions

For the reasons set out above, the FCA has failed to apply the applicable criteria in the Scheme Rules correctly. By supplanting those criteria with an inapplicable causation test which has no basis in either the Scheme Rules or the FS Act regime, the FCA has acted irrationally in making the Decision and the LC&F Compensation Announcement.

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[96] Examples of investors' stories are set out at pp. 150-162 and pp. 163-190 of the exhibit.
[97] See the Consultation Paper.

[98] See p. 11 and footnotes 43-48 above.

5. The FCA did contribute to LC&F investor losses

As stated in the Gloster Report, the FCA, "*did* not *discharge its functions in respect of LCF in a manner which enabled it effectively to fulfil its statutory objectives*".[99] LC&F bondholders were, "*entitled to expect, and receive, more protection from the regulatory regime in relation to an FCA-authorised firm (such as LCF) than that which, in fact, was delivered by the FCA*"[100].

The Gloster Report also commented on how the FCA contributed to investors' losses, including as follows:

> *"3.4 … the Investigation has concluded that:*
>
> *(a) the failure of the FCA senior management to implement and embed operational change at the lower levels of the organisation contributed to the FCA's failures of regulation in respect of LCF;*
>
> *(b) the FCA's failure to respond appropriately to information provided by third parties regarding LCF occurred because of deficiencies in the relevant FCA policies;*
>
> *(c) the FCA Case Officer's inadequate training was one of the reasons for the FCA's deficient handling of LCF's first Variation of Permission application submitted in October 2016 (the "First VOP Application"); and*
>
> *(d) had the FCA acted more timeously in late 2018, further Bondholders' funds would not have been invested in the products offered by LCF.*
>
> *3.5 Furthermore, the following is, in the Investigation's view, self-evident: had some or all of the FCA's failures in regulation outlined in this Report not occurred, then it is, at the least, possible that the FCA's actions would have prevented LCF from receiving the volume of investments in its bond programmes which it did. For instance, had possible irregularities by LCF been detected (and their significance appreciated) by the FCA sooner than late 2018, then the FCA should, in the Investigation's view, have intervened (or taken other regulatory action) earlier. On any basis, it is, at the least, possible that the FCA would have intervened sooner than it in fact did. Such earlier intervention may, in turn, have prevented LCF from receiving investments in its bond programme sooner, thereby reducing the exposure of investors to LCF's collapse. This is particularly so in circumstances where the FCA's actions in late 2018/early 2019 did result in LCF not receiving further investments from investors in its bond issues.*

[99] See the Gloster Report, Ch. 2, ¶ 1 1

[100] See the Gloster Report, Ch. 2, ¶ 1.1

> *3.6 The Investigation does not comment on the likelihood that, at any particular point in time, different action by the FCA would have resulted in LCF being prevented from receiving further investor funds with the result that Bondholders' exposure would have been less than it in fact was. Such considerations are best left to those determining compensation in respect of particular investments by Bondholders in the light of the totality of the facts relevant to any particular claim. Nonetheless, the above demonstrates that the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses.*"[101]

The FCA relied upon the ongoing investigation which culminated in the Gloster Report as reason for its delays in processing LC&F-related complaints, stating in its notices to LC&F investors[102]:

> "*Paragraph 3.6 of the Complaints Scheme states:*
>
> *The regulators will not investigate a complaint under the Scheme which they reasonably consider could have been, or would be, more appropriately dealt with in another way (for example by referring the matter to the Upper Tribunal or by the institution of other legal proceedings).*
>
> *We will not be investigating your complaint because the matter you have raised will likely be included as part of the independent review and it is more appropriate for it to be dealt with in that way. We will conduct a review of complaints and will consider the findings of the independent review once they have been published.*"

Now that the Gloster Report has been published, and found that the FCA was responsible for regulatory failings which did contribute towards the losses of LC&F investors, it is inappropriate and contrary to its previously stated policy for the FCA now to manoeuvre away from what should be the clear consequences of that report.

The Treasury Select Committee Report[103] on the FCA's Regulation of LC&F reinforces this, stating:

> "*We note that there are other ongoing discussions and channels by which LCF bondholders can seek compensation, such as through the FCA complaints scheme and through LCF administrators. The Treasury and the FCA should ensure that these discussions and channels are coordinated to the best extent possible, in order to prevent any detriment to customers. The Government should ensure that it is satisfied that the FCA's complaint scheme is working appropriately. In our work scrutinising the FCA, we will consider the results of the ongoing consultation on the regulators'*

[101] See the Gloster Report, Ch. 1, ¶ 3.4-3.6

[102] FCA notice to [redacted] dated 23 January 2020 (pp. 292-295 of the exhibit).

[103] The Treasury Select Committee Report (24 June 2021). https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902 htm

> *complaints scheme. The FCA should provide us with an update on its resolution of LCF complaints by 30 September 2021.*"[104]

In our clients' view, the Gloster Report is sufficient to demonstrate that LC&F bondholders have a "*well founded*" complaint against the FCA. The Treasury Select Committee's report make clear that the Government expects redress under the FCA's complaints scheme to involve more than *de minimis* awards beyond a handful of investors, as is currently being rolled out by the FCA.

Exhibit

The attached exhibit includes materials relevant to this complaint. Certain personal information or confidential information has been redacted. Our clients would be prepared to share this directly with the Commissioner, as necessary.

Conclusions

Our clients ask that the Complaints Commissioner reviews our clients' complaint herein regarding the FCA's Decision not to pay *ex gratia* compensation to the majority of investors on the basis that it was not "*solely and primarily responsible*" for investors' losses.

We ask that the Complaints Commissioner issues a recommendation that:

- the FCA reissues the Remedies Statement: (i) retracting the reference to the "*solely or primarily responsible*" test as a gateway to the payment of any compensation; and/or (ii) confirming instead that if the FCA is "*solely or primarily responsible*" for a complainant's losses, there is a presumption that the FCA will pay compensation (in accordance with the Complaints Commissioner's proposed approach)[105]; and

- the FCA's Decision in the Board Resolution dated 16 April 2021 as communicated in the LC&F Compensation Statement be revoked and reconsidered by the FCA Board, by applying the applicable causation test of whether the "*actions of the FCA contributed to the complainants' financial loss*"[106] and therefore offering a reasonable amount of compensation to LC&F investors, recognising the contribution of FCA regulatory failure to the losses in question as found in the Gloster Report.

Our clients reserve all of their rights. In particular and without limitation, some of our clients have filed their appeal in the judicial review case *R (Donegan and ors) v Financial Services Compensation Scheme Limited* (CO/1176/2020). Nothing in this letter shall affect or be taken to affect the claimants' position in that case or any appeal from it.

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[104] Ibid, p. 39, ¶ 159-160.

[105] See the Commissioner's Consultation Response.

[106] See the 2018/2019 OCC Report, p. 13, ¶ 5.5 and the 2019/2020 OCC Report, p. 13, ¶ 5.5.

Yours sincerely,

Shearman & Sterling (London) LLP

Cc:
Financial Conduct Authority (FAO: [redacted]
[redacted]
Charles Randell, Chairman, FCA
Rt Hon Mel Stride MP
Treasury Select Committee
John Glen MP
HM Treasury
Dame Elizabeth Gloster
[redacted]
True and Fair Campaign (FAO: Alan and Gina Miller)

Schedule: FCA April Letter – other issues

Following the publication of the LC&F Compensation Statement, the FCA sent the FCA April Letter in response to the concerns raised in the S&S April Letter. Subsequent email correspondence included the FCA Email. We are also aware of a letter sent by the True and Fair Campaign to the FCA dated 1 April 2021 (the "**True and Fair Campaign Letter**") and of the FCA's response to that dated 27 April 2021 (the "**FCA T&F Letter**") and the True and Fair Campaign's rejoinder to that dated 15 June 2021. Both the FCA April Letter and the FCA T&F Letter are substantially similar and make a series of propositions, which our clients do not accept as correct. Only extracts from the FCA April Letter are discussed here.

The FCA April Letter is only discussed in this section to the extent that relevant points are not addressed elsewhere.

- The FCA dedicates large parts of the FCA April Letter to discussing irrelevant counterpoints from the FOS regime for adjudicating firm-customer disputes and the FSCS regime for investor compensation (paragraphs 11-12 of the FCA April Letter). For example, paragraph 11 states that, "*Parliament has not expressed any intention that the FCA ought to make payments to investors in respect of losses primarily caused by others/firms. Indeed, the contrary intention is clear from the FCA's exemption from liability in damages referred to in paragraph 10 above.*" However, neither of the FOS or FSCS regimes are relevant comparators.

  Parliament established the FCA complaints scheme under the FS Act, which provides a mechanism for consumers to have redress and compensation in respect of their complaints against financial regulators. The scheme has been used in the past when regulatory failures have contributed to losses of investors, including where malfeasors at a firm are the primary cause of a loss.[107] Our clients have never doubted in correspondence that the FCA has statutory immunity nor that the FS Act establishes an *ex gratia* scheme.

  The FS Act regime is not however entirely discretionary and open-ended. Detailed Scheme Rules have been developed and published, an independent third party complaints commissioner is required to be appointed by statute under the FS Act, bringing rigour and consistency to the processing of complaints and requiring the publication of decisions and recommendations. The "*contributed to*" test of causation applied in statutory complaints proceedings under the FS Act is a well-established part of this framework, subject to extensive non-judicial commentary from the Complaints Commissioner going back over a decade. The compensation scheme cannot simply be

[107] Complaint number [redacted] related to the Financial Services Authority's and FCA's failures to "*act on issues arising from complaints notified to it in 2013 by the Financial Ombudsman Service (FOS) or to consider allegations of fraud by one of Firm A's directors. As a result Firm A had been able to default on its obligations, declare bankruptcy and sell its assets to another FCA-authorised firm*" (¶ 2). In that case, the Complaints Commissioner determined that, "*a compensatory payment under the Scheme should be made because, after serious delays, the FCA's complaints process failed to provide you with a fully substantiated response to your concerns.*" (FCA00535-for-publication-FR-13-5-19.pdf (frccommissioner.org.uk)).

cast aside as a voluntary arrangement by the FCA on the basis that the regime as a whole results only in an *ex gratia* recommendation rather than an obligation to pay.

- Although the FCA April Letter refers extensively to and distinguishes the very different FSCS regime for compensation losses of investors in firms in administration, the letter does not refer at all to the regime for complaints against the FSCS. The FSCS has its own complaints regime, established under section 213 of FSMA and COMP 2.2.8R[108] of the FCA Handbook, for FSCS users who have grievances with the FSCS.[109] The FSCS complaints regime has various parallels with that of the FCA, granting recourse to an assessment process by an independent person, involving the making of recommendations and the publication of information about whether or not the recommendations were followed in annual reports and an *ex gratia* payments regime. The FCA is responsible for drafting the rules governing the FSCS complaints scheme. In doing so, it has declined to impose any equivalent test of causation on the FSCS's liability to that which the FCA now asserts to take the benefit of as regards its own complaints scheme. The FSCS itself does not assert any such causation test in its own complaints procedures either (to the extent that they are published) nor has this matter been commented upon in any reports of the FSCS complaints commissioner.

- Neither does the FCA discuss or compare the very similar complaints regimes applicable to recognised bodies, such as exchanges and clearing houses, under Part XVIII of FSMA. These entities also have statutory immunity under section 291 of FSMA and section 184 of the Companies Act 1989 on similar terms to that enjoyed by the FCA, in light of the market regulatory functions of exchanges and other recognised bodies. These bodies must also establish a complaints regime including provision for the recommendation of *ex gratia* awards by an independent complaints commissioner, pursuant to paragraphs 9 and 23 of the schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges, Clearing Houses and Central Securities Depositories) Regulations 2001 and REC 2.16 of the FCA Handbook. Relevantly (to the extent, for example, that the FCA might assert this to be less relevant to the FSCS), recognised bodies are at risk of contributing towards investor losses, for example since regulatory failures by such bodies could result in trading losses or losses in value of assets by investors trading the relevant markets operated by the exchange.

  The relevant FCA rules on complaints against recognised bodies provide for compensatory payments to be recommended by an independent commissioner. However, the FCA has not been concerned so as to require any test of causation for complaints proceedings – never mind one so narrow as that which it seeks itself to assert. There is no reference to any equivalent test of causation or exclusion of liability

[108] COMP 2.2.8R states that, "*The FSCS must put in place and publish procedures which satisfy the minimum requirements of procedural fairness and comply with the European Convention on Human Rights for the handling of any complaints of maladministration relating to any aspect of the operation of the compensation scheme*".

[109] See further the FSCS website, *Complaints* (Complaints | FSCS).

in the London Stock Exchange's complaints scheme[110] or in the complaints rules of ICE Futures, which operates the London oil market and the leading market for several other commodities.[111] The latter does however include several references to the potential for compensation to be offered on an *ex gratia* basis. The London Metal Exchange's complaints procedure[112] requires provision of evidence to, "*(if relevant) establish the basis for any alleged loss or other detriment suffered by the complainant*". There is a liability disclaimer only for the complaints process itself, not for other losses. The approach of the FCA to liability is therefore wholly inconsistent with that of other bodies with regulatory functions which operate under an essentially identical statutory complaints regime whose remedy is *ex gratia* payments under FSMA.

- In the FCA April Letter, the FCA stated that, "*There can be no question (absent bad faith or violation of the Human Rights Act) of any action in the Courts against the FCA"* (paragraph 14(2) of the FCA April Letter). However, this is incorrect. The FCA can be subject to judicial review when it acts irrationally, as it has done here. There may also be complaints proceedings against the FCA under the FS Act, in which the process is prescribed by the FS Act and Scheme Rules and in which compensatory remedies can be recommended by an independent third party. If the FCA refuses to make a recommended payment, there is a disclosure process which results in the discrepancy being publicised and the regulator being criticised. This can also result in actions being taken in the political realm – and the FCA will be aware that the issue of LC&F compensation from the FCA has now arisen several times in Treasury Select Committee proceedings, including in the TSC Evidence.

- The FCA responded to the points made in the S&S April Letter that the FCA was anticipating resiling from its acceptance of the Gloster Report. In its formal response to the Gloster Report, the FCA stated that "[i]*t is vital that we learn the lessons set out in the LCF Review. We are determined to do so to enable us to better drive higher standards in the vital consumer investment market*."[113] It also accepted the recommendations of the Gloster Report, stating that "*We accept and will implement each of the 9 recommendations made to the FCA*"[114]. No qualifications or reservations are alluded to, despite there clearly being an opportunity for these in the FCA's response. In the S&S April Letter, we noted that "[T]*he FCA made no reservations or comment in respect of the passages cited above. Our clients therefore assume that the FCA accepted the above conclusions. The FCA should not now resile from accepting the conclusions of the Gloster Report*". In particular, the Gloster Report found that, "*had*

[110] Rules and regulations Trade - Resources | London Stock Exchange.

[111] Complaints_Resolution_Procedures.pdf (theice.com).

[112] Appendix H LME Complaints Procedure clean.pdf.

[113] The FCA, "*Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc - The FCA Response"* (December 2020) (Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc – The FCA Response) (the "**FCA Gloster Report Response**"), p. 24, ¶ 7 3.

[114] The FCA Gloster Report Response, p. 7, ¶ 1.1.

some or all of the FCA's failures in regulation outlined in this Report not occurred, then it is, at the least, possible that the FCA's actions would have prevented LCF from receiving the volume of investments in its bond programmes which it did."[115] By unreservedly accepting the recommendations of the Gloster Report and not commenting further on such an important and prominent matter as the FCA's causation of investor losses, the FCA must be taken to have accepted the Gloster Report's findings in this regard. As stated in the S&S April Letter, the FCA should not now resile from accepting the conclusions of the Gloster Report, least so on the matter of causation, which relates directly to LC&F investor compensation, on which topic it is so clearly subject to conflicts of interest and self-interest. The FCA has now argued that, with respect to its acceptance of the Gloster Report's findings, "*the FCA did not seek in its public response to go line by line through the report making "reservations" as to individual findings or comments that it might take issue with (as* [S&S] *imply it ought to have done at page 9 of* [the S&S April Letter]" (paragraph 18 of the FCA April Letter). Our clients do not accept this.

[115] See the Gloster Report, Ch. 1, ¶ 3.5

[4] The FCA, *FCA sets out broad approach to assessing LCF Complaints* (19 April 2021) (FCA sets out broad approach to assessing LCF Complaints | FCA).

[5] The FCA and PRA, *Complaints against the Regulators: The Scheme* (March 2016), p. 10, ¶ 6.8, (The Complaints Scheme (fca.org.uk)) (the "**Scheme Rules**").

[6] See FCA Board Minutes dated 16 April 2021 (FCA Board minutes: 16 April 2021) (the "**April Board Minutes**").

[7] The Scheme Rules are available at The Complaints Scheme (fca.org.uk) dated March 2016.

[10] Office of the Complaints Commissioner, *Annual Report 2018/2019*, p. 13, ¶ 5.5 (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk) (the "**2018/2019 OCC Report**") and Office of the Complaints Commissioner, *Annual Report 2019/2020*, p. 13, ¶ 5.5 (https://frccommissioner.org.uk/wp-content/uploads/OCC-Annual-Report-2019-2020.pdf) (the "**2019/2020 OCC Report**").

[11] The Gloster Report (23 November 2020) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf) (the "**Gloster Report**").

[12] The Gloster Report, Chapter 1, ¶3.5: "…*had possible irregularities by LCF been detected (and their significance appreciated) by the FCA sooner than late 2018, then the FCA should, in the Investigation's view, have intervened (or taken other regulatory action) earlier. On any basis, it is, at the least, possible that the FCA would have intervened sooner than it in fact did. Such earlier intervention may, in turn, have prevented LCF from receiving investments in its bond programme sooner, thereby reducing the exposure of investors to LCF's collapse*".

[14] See the 2018/2019 OCC Report and the 2019/2020 OCC Report.

[15] The 2018/2019 OCC Report, p. 15.

[16] The Gloster Report, para 3.6: "*the above demonstrates that the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses.*".

[18] Consultation paper, "*Complaints against the Regulators (The Financial Conduct Authority, the Prudential Regulation Authority and the Bank of England CP20/11*" (July 2020) (https://www.fca.org.uk/publication/consultation/cp20-11.pdf) (the "**Consultation Paper**").

[19] See, for example: the Gloster Report, part A, ¶ 1 3.1, fn 34: "*Although Dame Elizabeth did not formally respond to the consultation, she wrote to the Chair of the FCA in September 2020 to express her concern about the potential for the proposals set out in the consultation paper adversely to impact on any complaints which might be made by Bondholders after publication of this Report.*"; a letter from Rt Hon. Mel Stride MP, Chair of the Treasury Committee to Chris Woolard, Interim Chief Executive of the Financial Conduct Authority dated 11 September 2020 (Correspondence (parliament.uk)) (the "**Mel Stride Letter**"): "*Given the interest in the consultation expressed to the Committee, and elsewhere, I ask that serious and urgent consideration be given to extending the consultation period, as an 8-week period may no longer be sufficient.*"; and contemporaneous press reports: International Adviser, "*FCA complaints scheme changes 'unfair, immoral and illegal'*" (12 October 2020) (https://international-adviser.com/fca-complaints-scheme-changes-unfair-immoral-and-illegal/); the Financial Times, "*UK MPs urge financial regulators not to rush changes to complaints scheme"* (11 September 2020) (https://www.ft.com/content/51af062f-87f4-4438-89bb-756049734c11) (the "**Press Reports**").

[21] https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902.htm

[22] The Treasury Select Committee Report (24 June 2021), p. 39, ¶ 159 https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902.htm

[23] This complaint does not address the proposed overall cap on FCA compensation for LC&F investors, which the FCA has tied to the maximum amount of compensation that would have been available from the FSCS. The FCA in adopting this cap cited a "public equality duty". Our clients do not accept the general principle, proposed in the Consultation Paper, that the FCA's *ex gratia* compensation payments should be capped at £10,000 or another figure, nor the apparent underlying principle that LC&F investors should not be "over-compensated" or have their losses capped at £85,000 in this case. Where the FCA is responsible for significant investor losses, it should pay appropriate compensation, as recommended by the Commissioner without any cap prejudging that matter. In the Consultation Paper, we suggested that guidelines, not caps, could be developed, and that the FSCS regime caps would be a useful non-determinative point of reference in relevant cases. Any guidelines in this regard would also need to take into account the flexibility which exists within the FSCS regime under the Temporary High Balances ("**THB**") scheme (See Temporary high balances | Check your money is protected | FSCS), which typically protects balances in bank accounts, building society accounts or credit union accounts of up to £1,000,000 for up to 6 months (albeit this would not be applicable to LC&F investors given the minimum 1 year term of its bonds).

[24] See the 2018/2019 OCC Report, p. 13, ¶ 5.5 and the 2019/2020 OCC Report, p. 13, ¶ 5.5 .

[25] FSCS has announced that it will compensate investors who: (i) transferred into LC&F ISA bonds from existing stocks and shares ISAs; and (ii) received regulated "*advice*" (under article 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001). This has so far led to compensation for roughly 24% of investors (see https://www.fscs.org.uk/failed-firms/lcf/). In *R (Donegan and ors) v Financial Services Compensation Scheme Limited* [2021] EWHC 760 (Admin), our clients, a group of LC&F bondholders, brought a claim against FSCS's decision not to compensate a wider group of investors. However, while the Judge agreed with many of the key aspects of the claimants' submissions, including that the non-transfer clauses which LC&F purported to rely upon to avoid more stringent regulation were unfair and unenforceable, he declined to find that the bonds were regulated and therefore declined to set aside the FSCS's decision on compensation. The Judge has since granted the claimants permission to appeal that decision and our clients have filed their appeal with the Court. Our clients reserve all their rights in this regard.

[26] See the Gloster Report, Ch. 1, ¶ 1.3.

[29] John Glen, "*Written Ministerial Statement – London Capital & Finance"* (19 April 2021) (WMS_-_LCF_CS_-_final__003_.pdf (publishing.service.gov.uk)). The second reading of the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill, which will implement the compensation scheme, took place on 8 June 2021 and passed with cross-party support.

[30] The Gloster Report.

[31] See the Gloster Report, Ch. 2, ¶ 1.1.

[32] See the Gloster Report, Ch. 6, ¶ 1.4.

[33] See the Gloster Report, Ch. 1, ¶3.6.

[34] See the Gloster Report, Ch. 1 ¶ 3.4-2.6

[35] See the Financial Times, "*UK MPs urge financial regulators not to rush changes to complaints scheme"* (11 September 2020) (https://www.ft.com/content/51af062f-87f4-4438-89bb-756049734c11).

[36] The 2019/2020 OCC Report, p. 16.

[37] The Scheme Rules.

[38] The 2019/2020 OCC Report, p. 13.

[39] See the 2018/2019 OCC Report, p. 15.

[40] See the 2018/2019 OCC Report, p. 15.

[41] See, for example, the Complaints Commissioner's decision in Case FCA00459: "*While I do not consider that the FCA should be held responsible for the totality of your loss, in my preliminary report I recommend that it should make a substantial contribution towards it to acknowledge the extent of their failings*" (Final Report by the Complaints Commissioner – Complaint number FCA00459, para 14 (FCA00459-FR-18-06-18-publication-version.pdf (frccommissioner.org.uk)) ("**Case FCA00459**").

[42] See the Consultation Paper.

[44] The *True and Fair Campaign*, a group whose mission is to "*to achieve better customer outcomes and restore trust in the Financial Services sector*", has described the FCA proposals to cap its own liability and change the basis for its liability (including its proposed primary liability test) to be "*unfair, immoral and illegal*", True and Fair, "*CP20/11: Complaints against the Regulators (The Financial Conduct Authority, the Prudential Regulation Authority, and the Bank of England) Submission from The True and Fair Campaign*" (12 October 2020) (pp. 236-243 of the exhibit) (the, "**True and Fair Campaign Response**"). See also the Consultation Response (pp. 91-104 of the exhibit) and the Press Reports (International Advisor and Financial Times).

[45] See the Gloster Report, Ch. 1, ¶ 3.1, fn 34, the Mel Stride Letter, the Consultation Response (pp. 91-104 of the exhibit), the True and Fair Campaign Response (pp. 236-243 of the exhibit) and the Press Reports (International Advisor and Financial Times).

[46] See the Gloster Report, Ch. 1 ¶ 3.1, fn 34.

[47] See International Advisor.

[48] The Mel Stride Letter.

[49] The Complaints Commissioner, *Complaints Commissioner's response to Consultation Scheme consultation CP20-11* (Response-to-CP20-11-for-publication.pdf (frccommissioner.org.uk)) (the "**Commissioner's Consultation Response**").

[50] See the Press Reports (International Advisor and Financial Times), the Consultation Response (pp. 91-104 of the exhibit) and the True and Fair Campaign Response (pp. 236 -243 of the exhibit).

[51] See the Gloster Report, Ch. 1, ¶ 3.1, fn 34.

[52] See the Consultation Paper.

[53] See the FCA, "*Complaints Scheme: our approach to remedies*" (https://www.fca.org.uk/news/statements/complaints-scheme-our-approach-remedies).

[54] See the FCA Board Minutes dated 21 May 2020 (the "**May Board Minutes**") (FCA Board Minutes: 21 May 2020).

[55] See the April Board Minutes, ¶ 2.3

[57] See the April Board Minutes, ¶ 2.3; FSCS is then referred to in ¶ 2.5 of the Board Minutes.

[64] See the May Board Minutes: "*When considering the treatment of existing complaints, the Board recognised the benefits of providing transparency on the current approach. The Board therefore welcomed the publication of a statement clarifying this approach and the*

*intention to consult. The Board **agreed**: i. to consult on revising the Scheme ii. that in the interim a statement, clarifying the current approach to paying compensation and the intention to consult, be issued.*

[65] See the Gloster Report, Ch. 1, ¶ 3.1, fn 34, the Mel Stride Letter, the Consultation Response (pp. 91-104 of the exhibit), the True and Fair Campaign Response and the Press Reports (International Advisor and Financial Times).

[66] See the Consultation Paper, p. 10.

[69] See the 2018/2019 OCC Report, p. 13, ¶ 5.5 and the 2019/2020 OCC Report, p. 13, ¶ 5.5 .

[70] The 2018/2019 OCC Report, p. 15 and Case FCA00459.

[71] See Case FCA00459, ¶ 15.

[73] Office of the Complaints Commissioner, "*Annual Report for 2009/10*" (https://frccommissioner.org.uk/wp-content/uploads/AnnualReport_2010.pdf), pp 11-12.

[74] See the Commissioner's Consultation Response.

[75] See the Gloster Report, Ch. 1, ¶ 3.4 - 3.6

[76] See the Gloster Report, Ch. 1, ¶ 3.6

[80] The FCA, *Mini-bonds* (Mini-bonds | FCA). The FCA did provide information with respect to mini-bonds specifically with reference to LC&F on a separate webpage entitled *London Capital and Finance Plc enters administration*, but that page was also published after LC&F's collapse on 28 December 2018 and appears to have now been replaced by a separate webpage, *London Capital and Finance plc*, first published on 15 August 2019 (London Capital and Finance plc | FCA).

[81] See Treasury Committee formal meeting (oral evidence session), "*The Financial Conduct Authority's Regulation of London Capital & Finance plc*", HC 1191 (1 March 2021), responses to Qs 192, 223, 226, 227, 234 (https://committees.parliament.uk/oralevidence/1825/pdf/). In response to Q.234, Mr Randell commented that, "[i]*t would be inappropriate for me to engage in what might be called victim shaming by saying that people who bought LCF mini-bonds should have paid heed to the warnings that they were not covered by the Financial Services Compensation Scheme*" but then appeared to do just that, stating, "*we see consumers taking decisions that are not always calm, rational and well-informed*." A reference to mini-bonds is also found in the FCA April Letter (pp. 22 of the exhibit), as well as the FCA and FSCS's published materials on LC&F, e.g., FCA, *London Capital and Finance plc (*London Capital and Finance plc | FCA) and FSCS, *London Capital & Finance plc*, updates dated 10 May 2019 and 1 May 2019 (London Capital & Finance (LCF) failure - latest update | FSCS).

[83] The April Board Minutes, ¶ 2.4.

[85] See pp. 251-257 of the exhibit. The FCA stresses that consumers should "*Always check the firm you're dealing with it listed on the* [FCA] *Register*" and explains that "*If you deal with a firm…that's not regulated, you may not be covered by the Financial Ombudsman Service or the Financial Services Compensation Scheme*" (Financial Services Register | FCA).

[87] See the Gloster Report, Ch. 6, ¶ 7.2.

[88] See the Gloster Report, Ch. 6, ¶ 7.4.

[89] See the Gloster Report, Ch. 6, ¶ 7.6.

[90] See the Gloster Report, Ch. 6, ¶ 7.6.

[91] See the Gloster Report, Ch. 6, ¶ 7.8.

[92] See the Gloster Report, Ch. 2, ¶ 4.3.

[93] See the Gloster Report, Ch. 6, ¶ 8.2

[95] See FCA 2019/2020 Annual Report and Accounts, p. 153 (Annual Report and Accounts 2019/20 (fca.org.uk)).

[97] See the Consultation Paper.

[99] See the Gloster Report, Ch. 2, ¶ 1.1

[100] See the Gloster Report, Ch. 2, ¶ 1.1

[101] See the Gloster Report, Ch. 1, ¶ 3.4-3.6

[103] The Treasury Select Committee Report (24 June 2021). https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14902.htm

[105] See the Commissioner's Consultation Response.

[106] See the 2018/2019 OCC Report, p. 13, ¶ 5.5 and the 2019/2020 OCC Report, p. 13, ¶ 5.5.

[107] Complaint number FCA00535 related to the Financial Services Authority's and FCA's failures to "*act on issues arising from complaints notified to it in 2013 by the Financial Ombudsman Service (FOS) or to consider allegations of fraud by one of Firm A's directors. As a result Firm A had been able to default on its obligations, declare bankruptcy and sell its assets to another FCA-authorised firm*" (¶ 2). In that case, the Complaints Commissioner determined that, "*a compensatory payment under the Scheme should be made because, after serious delays, the FCA's complaints process failed to provide you with a fully substantiated response to your concerns.*" (FCA00535-for-publication-FR-13-5-19.pdf (frccommissioner.org.uk)).

[109] See further the FSCS website, *Complaints* (Complaints | FSCS).

[110] Rules and regulations Trade - Resources | London Stock Exchange.

[111] Complaints_Resolution_Procedures.pdf (theice.com).

[112] Appendix H LME Complaints Procedure clean.pdf.

[113] The FCA, "*Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc - The FCA Response"* (December 2020) (Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc – The FCA Response) (the "**FCA Gloster Report Response**"), p. 24, ¶ 7.3.

[114] The FCA Gloster Report Response, p. 7, ¶ 1.1.

[115] See the Gloster Report, Ch. 1, ¶ 3.5

Appendix 1b

Appendix 1b

Thomas.Donegan@shearman.com
[redacted]

3 September 2021

By email: complaints@frccommissioner.org.uk

Financial Regulators Complaints Commissioner
23 Austin Friars
London
EC2N 2QP

Dear Sirs

London Capital & Finance Plc (in administration) (FRN: 722603) ("LC&F") – Response to points raised in the letter of Charles Randell, Chair of the Financial Conduct Authority ("FCA") to the Financial Regulators Complaints Commissioner ("FRCC") regarding complaint from Shearman & Sterling LLP ("S&S") on behalf of bondholders

Introduction

We refer to the letter of Charles Randell, Chair of the FCA, to the FRCC dated 9 August 2021 (the "**FCA Letter**"), which responds to certain of the points made in the complaint that we submitted on behalf of our clients to the FRCC dated 25 June 2021 (the "**S&S Letter**").

In this letter, we respond on behalf of our clients to certain of the points raised in the FCA Letter. However, we do not address all the points in the FCA Letter. Many of the FCA's observations (for example in paragraphs 7-24, which involve comparative analyses with other, dissimilar statutory regimes) are not germane, were previously made in the FCA's letter to us dated 27 April 2021 and were addressed on pp. 9-11 and 18-21 of the S&S Letter. Our clients would note that once again that the FCA did not compare its complaints regime to any of the other statutory regimes for *ex gratia* compensation from bodies that have been granted statutory immunity under the Financial Services and Markets Act 2000 ("**FSMA**") (such as exchanges and clearing houses). None of those contain the "sole or primary cause" test upon which the FCA's position entirely rests, as discussed on pp. 35-36 of the S&S Letter.

To recap:

a) The FCA sought to amend the Scheme Rules[1] governing the complaints scheme for the UK's financial regulators, including to introduce a cap of £10,000 and preclude any claim where the FCA was not the "*sole or primary cause*" of financial loss, via a consultation paper published in July 2020. The FCA had to abandon or postpone implementing these proposals following the controversy that they generated (described on pp. 10-12 of the S&S Letter).
b) At around the same time, the FCA introduced a Remedies Statement on 16 June 2020[2] asserting that in cases where the FCA did not "*solely or primarily*" cause a loss, this would negate any payment under the scheme. This test is stated in the Remedies Statement as a hard precondition to any payment being made. The FCA stated at paragraph 31 of the FCA Letter that the "*solely or primarily*" causation test represents the FCA's "longstanding" approach to offering *ex gratia* payments for financial loss (see pp. 16-17 of the S&S Letter).
c) The FCA, based on its Remedies Statement, has determined to pay zero compensation to LC&F bondholders for its regulatory failures, despite the Gloster Report deciding "*the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses*".[3] Since the FRCC has stated that it does not get into complex matters of causation,[4] we ask that the FRCC considers carefully what the relevant passages of the Gloster Report have to say on this matter.
d) As set forth on pp. 15-18 of the S&S Letter, the FCA has provided no evidence for the "*solely or primarily*" test representing any sort of "long-standing" position or existing prior to June 2020. The FCA Letter purports to respond to that allegation but the FCA has still failed to adduce any evidence of the "*solely or primarily*" causation test dating prior to June 2020.

It is now apparently the FCA's position, as per the Remedies Statement and reinforced by the FCA Letter, that it should not pay any compensation as a result of its regulatory failures to victims of wrongdoing by firms, even where losses are caused in part by the FCA's regulatory failures. This is even the case where, as for LC&F investors, the FCA's regulatory failures have been found by an independent, Government-appointed investigation to exist, to have been serious and numerous, and to have caused losses to investors. Our clients remain of the view that the FCA's position simply cannot be correct. Our clients repeat their request, expressed in more detail on p. 32 of the S&S Letter, that the FRCC recommends the FCA: (i) reissues the Remedies Statement, retracting the reference to the "*solely or primarily responsible*" test as a conditional gateway to payment of any compensation; and (ii) revokes the decision reached in

[1] The FCA and PRA, *Complaints against the Regulators: The Scheme* (March 2016) (The Complaints Scheme (fca.org.uk)).

[2] See the FCA, "*Complaints Scheme: our approach to remedies*" (Complaints Scheme: our approach to remedies | FCA).

[3] See the Gloster Report, Ch. 1, ¶ 3.6.

[4] See, for example, [redacted]

the LC&F Compensation Statement, so that LC&F investors may be offered a reasonable amount of compensation by the FCA, for the reasons set forth in the S&S Letter and herein.

The historical approach

In our view, nothing in the FCA Letter supports the proposition that the FCA should not pay any compensation for victims of wrongdoing by regulated firms, where the losses have been caused in part by regulatory failures for which the FCA is responsible. Moreover, the FCA Letter provides no evidence for the "*solely or primarily*" test representing the "long-standing" position.

The correct test of causation – whether FCA "contributed"

Past guidance and case commentary from the FRCC and its predecessors has been consistent and clear that in cases where losses arise from the conduct of regulated firms, it has not been recommended that the FCA pay full compensation to investors for all their losses. As set forth in paragraph 24 of the FCA Letter, our clients accept that the FCA is not an insurer of last resort. However, it *has* consistently been recommended by the FRCC that the FCA pay an appropriate proportion of investor losses by way of *ex gratia* awards where the losses are caused at least in part by regulatory failures. The 2009-2010 Annual Report of the Office of the Complaints Commissioner explains that "*each complaint should be treated on its own merit and* […] *the scale and impact of the alleged 'maladministration' should ultimately decide upon whether a financial award should be made*".[5] According to the FRCC's two most recent annual reports, the appropriate test for an FCA *ex gratia* payment is whether the FCA "*contributed to the complainant's loss*" (emphasis added).[6] In cases where there is a "*clear break in causation*" between the FCA's maladministration and the loss in question, the amount of compensation will "*either be reduced or not made at all*"[7] (emphasis added), not automatically eliminated to zero as the FCA and its Remedies Statement would now have it. In the case of LC&F, there was no "*clear break in causation*" between the FCA's actions and investors' losses; the FCA's failures were one of several relevant causes of losses. However, even if there were such a clear break, the FCA would still be expected to provide compensation to victims of the LC&F scandal.

Therefore, the asserted precondition in the Remedies Statement underlying the FCA's decision on awarding *ex gratia* compensation to LC&F investors,[8] that the FCA must be the "*sole or*

[5] Office of the Complaints Commissioner, "*Annual Report for 2009/2010*" (3768 ann rep FINAL (frccommissioner.org.uk)), p. 12. See further pp. 19-20 of the S&S Letter.

[6] See the OCC 2018/2019 Annual Report (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk)) and he OCC 2019/2020 Annual Report (OCC-Annual-Report-2019-2020.pdf (frccommissioner.org.uk)).

[7] Ibid, p. 12.

[8] The FCA's decision is set out in the FCA Board Minutes dated 16 April 2021 (https://www fca.org.uk/publication/minutes/fca-board-minutes-16-april-2021.pdf) and further described in its

primary" cause of the losses, is not supported by the FRCC, including in its most recent written position on the subject.

Cited complaints cases

In attempting to justify the "*solely or primarily responsible*" test of causation, the FCA Letter cited two previous complaints cases. However, neither of them supports the FCA's position and, on the contrary, they support our clients' position that the FCA should pay compensation even where the FCA's conduct is not the only cause of investor losses.

In the first case relied upon by the FCA (designated [redacted]), the Commissioner addressed the report to the complainant, stating that: "*Ultimately, you have lost your investment to fraud. However, it appears the failures of the regulator have been a facilitator to the criminal activity, and contributed to your decision to make your investment.*", referring to "*the FCA's woefully inaccurate Register*" of authorised firms. The Commissioner found that "*The principal cause of your ... losses appears to be the actions of firm X*". In this case, since the principal causes were related to the firm, the FCA actions or inactions were clearly not the sole or primary cause of those losses. Nonetheless, it was still recommended by the Commissioner that the FCA pay 50% of the investor's losses. In case F[redacted], an award was indeed recommended even though the Commissioner also found that: "*There can be no certainty about what, if any, difference it would have made to your clients' position if the FSA had acted differently*".

The position of LC&F investors is therefore stronger than the successful claimant in case [redacted]. That is because Dame Elizabeth Gloster has found that the FCA's regulatory failures did in a "real sense" cause investor losses and had they not occurred, it is possible that investor losses would have been reduced i.e. the regulatory failures did make a difference for investors. The relevant passage from the Gloster Report is set forth on pp. 30-31 of the S&S Letter but repeated below for convenience:

> "*(a) the failure of the FCA senior management to implement and embed operational change at the lower levels of the organisation contributed to the FCA's failures of regulation in respect of LCF;*
>
> *(b) the FCA's failure to respond appropriately to information provided by third parties regarding LCF occurred because of deficiencies in the relevant FCA policies;*
>
> *(c) the FCA Case Officer's inadequate training was one of the reasons for the FCA's deficient handling of LCF's first Variation of Permission application submitted in October 2016 (the "First VOP Application"); and*

statement, "*FCA sets out broad approach to assessing LCF Complaints*" (19 April 2021) (https://www fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints).

> *(d) had the FCA acted more timeously in late 2018, further Bondholders' funds would not have been invested in the products offered by LCF.*
>
> *3.5 Furthermore, the following is, in the Investigation's view, self-evident: had some or all of the FCA's failures in regulation outlined in this Report not occurred, then it is, at the least, possible that the FCA's actions would have prevented LCF from receiving the volume of investments in its bond programmes which it did. For instance, had possible irregularities by LCF been detected (and their significance appreciated) by the FCA sooner than late 2018, then the FCA should, in the Investigation's view, have intervened (or taken other regulatory action) earlier. On any basis, it is, at the least, possible that the FCA would have intervened sooner than it in fact did. Such earlier intervention may, in turn, have prevented LCF from receiving investments in its bond programme sooner, thereby reducing the exposure of investors to LCF's collapse. This is particularly so in circumstances where the FCA's actions in late 2018/early 2019 did result in LCF not receiving further investments from investors in its bond issues.*
>
> *3.6 The Investigation does not comment on the likelihood that, at any particular point in time, different action by the FCA would have resulted in LCF being prevented from receiving further investor funds with the result that Bondholders' exposure would have been less than it in fact was. Such considerations are best left to those determining compensation in respect of particular investments by Bondholders in the light of the totality of the facts relevant to any particular claim. Nonetheless, the above demonstrates that the Investigation considers that the FCA's failures may be relevant to arguments that the FCA in some real sense "caused" Bondholders' losses.*"

The FCA Letter (at p. 6) seeks to downplay this passage, by citing a quote made by a minister in oral exchanges concerning the Gloster Report. The minister appears to contradict the findings of Dame Elizabeth's report by remarking that the Government had not seen evidence suggesting the regulatory failings at the FCA caused losses for bondholders. This conflicts with the passage of Dame Elizabeth's report quoted above, which the very same minister described as an "*excellent report*" (see p.6, para 14(1)(a) of the FCA Letter). We would invite the Commissioner to simply read the relevant sections of the Gloster Report itself (including the passages above) rather than rely upon such secondary materials.

The second case relied upon by the FCA in support of its "longstanding approach" is [redacted], which relates to the failure of the [redacted]. The substantive complaint was rejected on the facts, it being found that there was no unreasonable action by the financial regulators (albeit a small amount was awarded for the FCA's delay in handling the complaint). As a result, the case is of little relevance to the present situation, where the FCA has been found responsible for multiple and serious regulatory failings. The FCA Letter in any event omits the following section, including the crucial underlined sentence, from the passage that it quotes:

> "*The FCA's explanation for refusing your request for an ex gratia payment – that the responsibility for the financial statements rested with the Bank and its auditors – seems*

to me misplaced, since while the FCA is right about the Bank's responsibilities, that does not preclude the possibility that the FCA, having been found to have fallen short in its responsibilities, might consider offering an ex gratia sum."

The FCA cited additional cases in Footnote 9 of the FCA Letter in support of its assertion that: "*the concept of "sole or primary" cause encapsulates the FCA's longstanding approach*". However, none of these cases support the proposition; in fact, they undermine it:

- In case [redacted], the Complaints Commissioner found that, "*the FSA's serious failings contributed to your loss*" and that, "*it should make an ex gratia payment to you of 50% of your loss*". Again, the Commissioner relied on the "contribution" test, as referred to in the S&S Letter. This case cannot be relied upon to support any proposition that the FCA should not be the subject of a recommended award, less still on the present facts.

- In case [redacted], the Commissioner did not find any evidence that the FCA had failed in its duties, so the complainant was not eligible for compensation. The case is also irrelevant and distinguishable from that of LC&F, where, as we say, the FCA has been found responsible for multiple and serious regulatory failures.

Since even the cases that the FCA now cites in favour of its position either are entirely against it on the "*solely or primarily responsible*" test or are simply irrelevant in the sense that no regulatory failures occurred in those cases, the FCA in citing these cases merely highlights its own divergence from the Complaints Commissioner's recommendations. However, the Complaints Commissioner is not bound to follow the FCA's behaviour in this regard as setting a precedent, particularly if that behaviour directly contradicts the Commissioner's findings.

Past FCA Consultation papers

Also in support of its position, the FCA cites statements made by its predecessor, the Financial Services Authority, in a consultation paper and policy statement from 2000-2001. At their strongest, these include the statement that: "*compensatory payments would be unlikely to be appropriate for consumers who may complain that the Authority could and should have acted to prevent the failure of a regulated firm*" (emphasis added). Our clients would observe that:

- At most, the relevant test asserted here involves *likelihood*, not the hard precondition to an *ex gratia* award that the "*solely or primarily responsible*" test would constitute under the Remedies Statement, which purports to preclude any remedy whatsoever in respect of LC&F.
- This statement is relevant to situations where the regulator "*failed to prevent the failure of a firm*". In the case of LC&F, the main issue is not around whether the firm's failure should have been prevented. It concerns the authorisation and supervision processes which allowed an alleged Ponzi scheme to be operated as an FCA-authorised and regulated firm from the outset. The FRCC is therefore addressing a very different situation from the hypothetical situation addressed in that consultation paper. In the

case of LC&F, the FCA failed to act on multiple tip-offs that the firm might have been operating fraudulently, failed to take appropriate action to stop misleading advertising, failed to assess LC&F's applications for variations of permission, allowed it to become registered as a provider of Investment Savings Account ("**ISA**") products (which HM Treasury has described as, "*a popular and trusted savings product*" and a "*trusted savings vehicle*"[9]), allowed it to expand its regulatory permissions, allowed it to hold just £50,000 of capital against a £200m+ book of worthless financial exposures, failed to intervene earlier and failed to spot the unusual and high-risk nature of LC&F's activities, all of which are detailed in the Gloster Report.

- There is no reference in any of the passages cited in the consultation paper to any "*solely or primarily responsible*" test of causation. Moreover, such a test has never existed in the Scheme Rules, as is detailed further in pp. 4, 9-10 and 15-18 of the S&S Letter.
- A "*solely or primarily responsible*" test of causation would be inconsistent with several prior complaints cases and Commissioner statements, for the reasons set out on pp. 18-21 of the S&S Letter and above.
- The FCA sought to amend the Scheme Rules in 2020 to introduce such a test of causation, which they would not have needed to do if it was already in force and a "longstanding approach".

Other complaints regimes

As discussed in the S&S Letter, under Part XVIII of FSMA, exchanges and clearing houses also have statutory immunity pursuant to section 291 of FSMA and section 184 of the Companies Act 1989 on similar terms to that enjoyed by the FCA. Those bodies are also obliged to establish complaints regimes which provide for the recommendation of *ex gratia* compensation payments by an independent complaints commissioner.[10] The FCA's own rules on complaints against these recognised bodies provide for compensatory payments to be recommended by an independent commissioner but do not require any test of causation for complaints proceedings, let alone one so narrow as that which the FCA seeks itself to asset. There is no reference to any equivalent test of causation or exclusion of liability in the London Stock Exchange's complaints scheme[11] or in the complaints rules of ICE Futures, which operates the London oil market and the leading market for several other commodities.[12] The FCA's approach to its own liability is therefore wholly inconsistent with that of other bodies

[9] See e.g. HM Treasury consultation entitled "ISA qualifying investments: consultations on including shares traded on small and medium-sized enterprise equity markets" dated March 2013, at ¶¶2.4 and 3.7 (ISA qualifying investments: consultation on including shares traded on small and medium-sized enterprise equity markets (publishing.service.gov.uk)).

[10] See paragraphs 9 and 23 of the schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges, Clearing Houses and Central Securities Depositories) Regulations 2001 and REC 2.16 of the FCA Handbook.

[11] Rules and regulations Trade - Resources | London Stock Exchange.

[12] Complaints_Resolution_Procedures.pdf (theice.com).

with regulatory functions which operate under an essentially identical statutory complaints regime whose remedy is *ex gratia* payments under FSMA.

The FCA's changing or inconsistent position

We refer to a letter by Charles Randell of the FCA to Alan and Gina Miller of the True & Fair Campaign dated 29 June 2021 which was shared with our clients, in which it was asserted that nothing in the Remedies Statement (which includes the "sole or primary causation" test), "*fetters the FCA's discretion to make payments in other circumstances, were it considered appropriate to do so*". This is inconsistent with the Remedies Statement itself, which asserts the "*solely or primarily*" causation test as a hard precondition to any claim, as follows: "*In order for us to consider making an ex gratia payment in respect of financial loss, complainants would need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*". With respect, the FCA's stated "thinking" on this topic has shifted, been inconsistent and appears ultimately to be self-serving. It also leaves investors with little clarity on precisely what approach the FCA actually intends to take.

"High risk unregulated investments"

The FCA Letter at p. 2, paragraph 3(1), uses the term "high risk unregulated investments" to describe LC&F investments, apparently with the objective of blaming investors for their losses. This insensitive approach is not founded in the way in which LC&F sold its investments to the public. LC&F was an FCA-regulated investment firm, registered with HM Revenue & Customs as a provider of ISAs. Its products were sold via price comparison websites (often being compared against the ISA products of high street banks), search engines and mainstream newspapers, in which the FCA-regulated status of LC&F and ISA status were highlighted, as described on pp. 21 and 25 of the S&S Letter.

The similarly-loaded "mini-bond" label for the products sold by LC&F was first "deployed" by the FCA in public communications only after the LC&F scandal broke.[13] It should also be remembered that many LC&F investors were unsophisticated retail investors whose lives have been decimated by regulatory failure and who believed they were investing in a safe product comparable to the ISAs of high street banks. See further the Selection of Bondholder Personal Impact Statements, LCF Impact Assessment and LC&F advertising materials in the annexes to the S&S Letter and pp. 21-22 and 26-27 thereof for more information on these aspects.

The level of damages

[13] See the FCA, "*Mini-bonds*" (Mini-bonds | FCA)) (17 May 2019), which was published months after LC&F's collapse into administration on 30 January 2019. The FCA did provide information with respect to mini-bonds specifically with reference to LC&F on a separate webpage entitled *London Capital and Finance Plc enters administration*, but that page was also published after LC&F's collapse on 28 December 2018 and appears to have now been replaced by a separate webpage, *London Capital and Finance plc*, first published on 15 August 2019 (London Capital and Finance plc | FCA).

The FCA Letter at pp. 15-16 makes various assertions about the FCA's resources, giving the impression that it could not afford a pay-out to LC&F investors. The FCA argues that, "*the FCA's current liabilities more than match available cash balances at 31 March 2021 and the existing fixed assets are not convertible into cash*". It also seeks to characterise our clients' demand as one for full compensation, referencing our clients' supposed "*mistaken premise that the FCA has at its disposal some £121 million of "surplus assets"*" (p. 15, paragraph 35 of the FCA Letter). However, it was acknowledged in the S&S Letter that in cases where the relevant firm and the FCA each contribute to an investor's losses, the established approach under the ex gratia compensation regime is for the relevant level of compensation to "*either be reduced or not made at all*".[14] We have respectfully submitted in the S&S Letter that, in the case of LC&F investors, the Complaints Commissioner should consider generous compensation. In doing so, we explained what the total overall losses of LC&F investors are expected to be (after various other compensation sources have been allocated) and we have commented upon the FCA's financial resources. Many LC&F investors have had their lives and savings decimated as a result of regulatory failure and clearly cannot afford their losses, in contrast to the FCA which is funded amply and despite the assertions in the FCA Letter would not appear to have any present threats to its solvency even if a generous scheme were recommended.

Conclusion

Our clients' position remains unchanged by the FCA Letter and we urge the FRCC to consider what the letter says in the light of the points made above.

Our clients have become aware from the FRCC's website that around 1000 other LC&F bondholders have now made formal complaints to the FCA of whom over 400 have made referrals of their complaint to the FRCC.[15] We believe that this is an unprecedented situation, reflecting widespread displeasure at the way in which the FCA has conducted itself. We understand that many of these complaints make reference to the S&S Letter (although please note that we only act for the named persons identified in the S&S Letter). Our clients ask that the FRCC gives this case the proper and prompt attention and serious consideration that it warrants, in light of the volume of complaints that the FRCC has received (which reflects widespread dissatisfaction at the way in which the FCA regulated and supervised LC&F and its response to the scandal), the perilous financial situation facing many LC&F investors and the broader policy implications for other victims of regulatory failure.

[14] See the OCC 2018/2019 Annual Report (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk)) and he OCC 2019/2020 Annual Report (OCC-Annual-Report-2019-2020.pdf (frccommissioner.org.uk)).

[15] See the Complaints Commissioner's notice of 19 August 2021: LETTER 1 – (frccommissioner.org.uk).

Yours sincerely,

Shearman & Sterling (London) LLP

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Cc:
Financial Conduct Authority (FAO: [redacted]
Rt Hon Mel Stride MP
Treasury Select Committee
John Glen MP
HM Treasury
Dame Elizabeth Gloster
[redacted]
True and Fair Campaign (FAO: Alan Miller and Gina Miller)

[1] The FCA and PRA, *Complaints against the Regulators: The Scheme* (March 2016) (The Complaints Scheme (fca.org.uk)).

[2] See the FCA, "*Complaints Scheme: our approach to remedies*" (Complaints Scheme: our approach to remedies | FCA).

[5] Office of the Complaints Commissioner, "*Annual Report for 2009/2010*" (3768 ann rep FINAL (frccommissioner.org.uk)), p. 12. See further pp. 19-20 of the S&S Letter.

[6] See the OCC 2018/2019 Annual Report (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk)) and he OCC 2019/2020 Annual Report (OCC-Annual-Report-2019-2020.pdf (frccommissioner.org.uk)).

[8] The FCA's decision is set out in the FCA Board Minutes dated 16 April 2021 (https://www.fca.org.uk/publication/minutes/fca-board-minutes-16-april-2021.pdf) and further described in its statement, "*FCA sets out broad approach to assessing LCF Complaints*" (19 April 2021) (https://www.fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints).

[9] See e.g. HM Treasury consultation entitled "ISA qualifying investments: consultations on including shares traded on small and medium-sized enterprise equity markets" dated March 2013, at ¶¶2.4 and 3.7 (ISA qualifying investments: consultation on including shares traded on small and medium-sized enterprise equity markets (publishing.service.gov.uk)).

[11] Rules and regulations Trade - Resources | London Stock Exchange.

[12] Complaints_Resolution_Procedures.pdf (theice.com).

[13] See the FCA, "*Mini-bonds*" (Mini-bonds | FCA)) (17 May 2019), which was published months after LC&F's collapse into administration on 30 January 2019. The FCA did provide information with respect to mini-bonds specifically with reference to LC&F on a separate webpage entitled *London Capital and Finance Plc enters administration*, but that page was also published after LC&F's collapse on 28 December 2018 and appears to have now been replaced by a separate webpage, *London Capital and Finance plc*, first published on 15 August 2019 (London Capital and Finance plc | FCA).

14 See the OCC 2018/2019 Annual Report (OCC-Annual-report-2018-2019.pdf (frccommissioner.org.uk)) and he OCC 2019/2020 Annual Report (OCC-Annual-Report-2019-2020.pdf (frccommissioner.org.uk)).

[15] See the Complaints Commissioner's notice of 19 August 2021: LETTER 1 – (frccommissioner.org.uk).

Appendix 2

Appendix 2

FCA Investigation and Response complaints about LCF

The FCA reviewed 10 allegations which were of concern to the majority of complainants with respect to its oversight of LCF. These, are listed below, as is FCA's response to each allegation

Allegation 1: The FCA should have picked up on LCF's misleading marketing and advertising sooner. If the FCA had acted sooner it would have prevented people from investing.

Findings

The Gloster Report concluded that none of the six instances of intervention by the FCA's Financial Promotions team resulted in a detailed review of LCF's business model nor did the FCA request details of LCF's systems and controls relating to financial promotions. The Gloster Report's findings led to the view that 'The Financial Promotions Team dealt with LCF on a purely reactive basis and neither it, nor any other unit in the Supervision Division, took any steps to look at LCF's marketing activities in more detail'. The Report also concluded that 'the FCA did not have in place appropriate policies stating what steps should be taken in respect of repeat offenders under its financial promotion rules during the Relevant Period'.

In respect of LCF's financial promotions during the Relevant Period the Gloster Report outlined the following six instances when the Financial Promotions team interacted with LCF or related parties such as Sentient Capital London Limited ('Sentient Capital'). Before LCF became a full permission firm in June 2017, an authorised firm such as Sentient Capital was required to approve the financial promotions of unauthorised or limited permission firms, such as LCF.

- Between 18 January 2016 and 11 March 2016:

Following a consumer email to the FCA's Customer Contact Centre on 13 December 2015 regarding LCF's authorised status and level of permissions, the Financial Promotions team wrote to LCF on 18 January 2016 identifying a number of issues with respect to LCF's website.

LCF responded on 29 January 2016 detailing the steps it had taken to address the FCA's concerns. The FCA responded on 15 February 2016 indicating that we remained concerned that the capital at risk warning that LCF had added to its homepage was not sufficiently prominently or adequately displayed. LCF responded on 7 March 2016 setting out the steps it had taken to address this concern. The FCA confirmed to LCF on 10 March 2016 that in light of the further actions taken by LCF, the FCA had closed our file. However, this correspondence did make it clear that if we had not commented on other promotions, it should not be taken that those promotions were compliant and explained that compliance with the financial promotions rules remained with the firm.

- Between 2 September 2016 and 3 October 2016:

At least seven calls were made to the FCA's Customer Contact Centre in 2016 by a consumer (referred to in the Report as Individual A) raising a number of concerns about LCF including its

business model and financial promotions. Following one of these calls on 15 July 2016, the Customer Contact Centre reviewed LCF's website and escalated concerns to the Consumer Credit Triage Team within the Supervision Division. This team subsequently referred the case to the Financial Promotions Team as the concerns related to LCF's website. The FCA's Financial Promotions team subsequently wrote to Sentient Capital (the approver of LCF's financial promotions for its mini-bonds at that time), copying in LCF, on 2 September 2016 setting out various concerns in relation to LCF's website.

Sentient Capital responded to the FCA's letter on 6 September 2016 and indicated it would make amendments to LCF's website. Following this, the FCA raised further concerns regarding LCF's website on 8 September 2016.

Following further letters exchanged during September 2016, the FCA Financial Promotions team raised a new issue with Sentient Capital on 21 September 2016 regarding 'the risk of illiquidity of the bond lacks prominence', to which Sentient Capital responded noting "[t]he phrase 'Bond Series 3 to 7 are non-transferable' has been added". On 3 October 2016, the FCA confirmed to Sentient Capital that we had closed the case.

- Between 5 April 2017 and 6 April 2017:

Following the escalation of two issues raised by consumers, it was noted by the Financial Promotions team that the concerns raised by the FCA in September 2016 had reappeared and LCF's website was again in breach of the FCA's financial promotion rules. The FCA wrote to LCF on 5 April 2017 to raise that the previous changes made to LCF's website to address the FCA's concerns were no longer in place and questioned who was approving LCF's website as a financial promotion.

LCF replied to say it had raised this with its technical provider and the changes made in September 2016 were reinstated. On 6 April 2017, the FCA confirmed to LCF that we had closed our file on the matter.

- 1 June 2017:

The Financial Promotions team identified an advert for LCF's products in The Times from 3 May 2017 through proactive monitoring. The Financial Promotions team sent a letter to LCF on 1 June 2017 setting out that it did not consider the promotion complied with the FCA's rules as one of the statements could be misleading to consumers in the context of the financial promotion. LCF responded to say it had made the changes to the advert.

- 12 June 2017 to 13 June 2017:

On 8 June 2017 the Advertising Standards Agency (ASA) escalated a consumer complaint to the Financial Promotions Team regarding a promotion for LCF's products that appeared in the Daily Telegraph in May 2017. The Financial Promotions Team wrote to LCF on 12 June 2017 setting out that it considered the promotion was in breach of the fair, clear and not misleading requirement in the FCA's rules. LCF responded to say the promotion would be changed.

- 18 August 2017 to 4 September 2017:

A report was received from a member of the public regarding a misleading financial promotion in connection with LCF's website. The Financial Promotions Team sent a letter to LCF on 18 August

2017 identifying a number of issues in relation to LCF's website and a sponsored Google promotion. It was at this point that the Financial Promotions Team noted that they had written to LCF "on three other occasions concerning deficiencies in [LCF's] promotions". The letter explained that a further breach would result in the team seeking "a formal attestation by an approved person conducting a significant influence function from within [LCF] that there are adequate systems and controls in place for the approval of compliant financial promotions".

LCF responded on 31 August 2017 explaining the changes it had made to its website and the Google promotion.

It is also noted in the Report that a chartered financial planner contacted the FCA's Whistleblowing team in August 2017 raising the concern that LCF was conducting business without necessary permissions, after being asked for guidance by one of his retail clients about LCF's bonds. This concern was flagged to the FCA's Contact Centre which asked the chartered financial planner for further information regarding his client's contact with LCF and their knowledge and experience in investments so that the case could be referred to the appropriate team within the FCA's Supervision Division. The chartered financial planner sent a letter, received by the Contact Centre on 10 August 2017, which provided the information requested by the FCA and asked for it to be referred to management at the FCA who were responsible for unauthorised dealing. The Contact Centre emailed the chartered financial planner to explain that the matter had been referred to the FCA's Unauthorised Business Department. The Report concluded that no further action appears to have been taken in relation to the concerns raised by the chartered financial planner.

Conclusions

In light of the findings above, the FCA accepts that, whilst we acted on issues identified with LCF's financial promotions in relation to its mini-bonds on a number of occasions, we made errors in our approach to LCF's financial promotions. These errors included not considering LCF's business holistically by failing to consider whether LCF's repeated breaches of the FCA's financial promotions rules were symptomatic of a more serious problem. Furthermore, our policies in respect of intervention in cases of breaches of the financial promotion rules were too cautious. On that basis I uphold this allegation.

I note that your allegation states that if the FCA had acted sooner it would have prevented people from investing. As set out in the findings above, the FCA did intervene on a number of occasions. While we acknowledge that the FCA could have acted differently, we don't consider it is possible to determine with sufficient certainty what would have happened if the FCA had taken different action at different times. LCF happened against a backdrop of significant increases both in our responsibilities and in the number of firms we supervised; the implementation of the UK's withdrawal from the European Union; more investment freedom for consumers; and the proliferation of online marketing. These and other priorities were competing for our resources and while some of the issues may be beyond our control, we are addressing those that lie within it through ongoing work, including our continuing transformation programme to intervene faster and more effectively.

The FCA has accepted the recommendation from the Gloster Report in relation to financial promotions that 'the FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.'

Our public response to the Gloster report sets out a number of changes we have already made or are making to address the above and other relevant recommendations made by Dame Elizabeth Gloster including:

- In January 2020, we introduced a temporary ban on promotions of speculative mini-bonds to retail consumers, unless the investor is considered to be 'sophisticated' or 'high net worth', with this ban being made permanent from January 2021;

- From June 2018, our Financial Promotions and Supervision portfolio teams have worked in closer coordination where concerns have been raised about a firm's financial promotions;

- We published our Approach to Enforcement and issued new Investigation Opening Criteria in 2018. Our bolder approach to intervening means we are investigating more cases generally including cases of suspected serious misconduct concerning financial promotions. In September 2019, we established the Joint Supervision and Enforcement Taskforce (JSET). Its remit is to focus strategically on the drivers of harm we identified through our work in 2019 on mini-bonds and other high-risk investments, ensuring a co-ordinated response across the FCA;

- We alerted CEOs of firms involved in approving financial promotions for unauthorised persons in January 2019 and April 2019 that we would hold them to their obligations to ensure that these promotions were fair, clear and not misleading;

- In November 2019 we refreshed our guidance for authorised firms which approve the financial promotions of unauthorised persons, setting out our expectations for the due diligence they should perform; and

- The FCA has worked with the Treasury on a consultation to establish a regulatory 'gateway' that a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms.

We have also provided an update to the Economic Secretary to the Treasury (EST) on 16 April 2021 on the following changes we have made:

- In relation to financial promotions, we have instigated a new 'repeat breacher' policy and introduced more proactive monitoring of financial promotions.

Allegation 2: You are complaining that the FCA was in receipt of intelligence regarding the way LCF was operating and concerns about the underlying investments in 2015, and in the years since, and did not take any action.

Findings

The Gloster Report concluded that during the Relevant Period the FCA was in possession of multiple 'red flags' concerning LCF and that we failed to appreciate the potential for consumer harm as a result. This included the significance of allegations received from third parties of fraud or irregular behaviour by our Customer Contact Centre or through other means, multiple breaches of the financial promotions rules (outlined in chapters 3, 10 and 11), and regulatory returns showing that LCF was not carrying out the regulated activities it had permissions for.

In relation to the letter sent by the independent financial adviser, Mr Neil Liversidge, to the FCA in November 2015, we, unfortunately, have been unable to determine if we had received this letter or not during the Relevant Period and the Independent Investigation could also not make a definitive determination on this issue.

The Gloster Report outlines that we received a number of calls into our Customer Contact Centre alleging possible fraud or irregularities regarding LCF. This includes information contained within calls 'Individual A' made to the FCA which raised issues surrounding 'LCF's refusal to provide information to potential investors on the use of investors' capital, LCF's relationship with the trustee company, Global Security Trustees Limited, the integrity of LCF's company structure and the rate of LCF's growth' . One of these calls also raised allegations that LCF might be operating a 'pyramid scam'.

After reviewing these calls, along with certain other interactions the FCA had with members of the public during the Relevant Period, the Gloster Report confirmed that allegations of fraud and irregularities were not always forwarded on by the Customer Contact Centre to Supervision or Enforcement teams for further consideration. Further, on the occasions these calls were referred, it does not appear these were acted on or viewed in light of the range of information the FCA was in receipt of regarding LCF and how it was operating. The Gloster Report found that the FCA's Customer Contact Centre policy documents were unclear about whether call-handlers should refer allegations of fraud or serious irregularity regarding the non-regulated activities of FCA regulated firms to the Supervision Division.

The FCA also received a letter from an anonymous source in January 2017. This letter was addressed to a Detective Constable in the Metropolitan Police and was copied to a member of the FCA's Unauthorised Business Division (UBD). Part of the letter read 'They trade on the fact that they are FCA regulated well they have a consumer credit license, they are not authorised for investment purposes or dealing with the general public re investment… the product is being heavily mis sold […]' The letter was referred from the UBD to the Supervision Division as LCF was an authorised firm but no action was taken because, on investigation, it was believed that the firm referenced in the letter, 'London Capital and Finance Group', was not the same entity as LCF. The Gloster Report concluded that the FCA failed to take steps to consider the allegations raised in the anonymous letter.

During the same period of time, namely between January 2016 and September 2017, the FCA's Financial Promotions Team interacted with LCF in relation to six separate issues regarding its misleading and unclear marketing and advertising. These were acted on but in isolation and not referred onto the FCA's Supervision or Enforcement Divisions so they could be viewed holistically in

connection with other pieces of information available to us, such as information that LCF was not carrying out the regulatory activities for which it had permissions.

The regulatory returns that LCF submitted to the FCA indicated that no revenue had accrued or was expected from the firm's regulated activities. The Gloster Report concluded that we failed to address the fact that LCF was not using its permissions, despite us having specific powers to alter or revoke firms' permissions. The Gloster Report also concluded that we failed to assess the red flags mentioned above holistically to determine whether there were fundamental problems with LCF's business model or conduct which required early intervention or enforcement action.

Conclusions

In light of the findings detailed above we accept that, whilst we did take certain actions following receipt of intelligence regarding the way LCF was operating, these actions were not sufficient and were generally carried out in isolation, rather than being considered holistically in order to address wider concerns. We also accept that we did not take any action regarding some of the intelligence we received, as outlined above. On that basis we uphold this part of your complaint.

The FCA has accepted the following recommendations set out in the Gloster Report:

- 'the FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically';

- 'the FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the non regulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.';

- 'the FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (eg artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators;

- 'the FCA should consider whether it can improve its use of regulated firms as a source of market intelligence'.

Our public response to the Gloster Report detailed a number of changes we have already made or are making to address the above and other relevant recommendations made by Dame Elizabeth Gloster including:

- We are already investing £98m over 3 years to deliver our Data Strategy to harness the power of data and advanced analytics to better monitor harm, improve our analysis of data sources to detect and prevent misconduct, identify where we need to intervene and use automation to help us act more quickly;

- We will review our policies and guidance to make it clear when case officers should consider the firm and its business model holistically (including when they should consider an authorised firm's unregulated activity) to determine the appropriate course of action. We will also review our

governance and quality assurance processes to ensure that we give complex cases appropriate attention; and

- We will roll out 'a single view of the firm' within Supervision and Authorisations. Staff from these areas interacting with a firm will be able to access the same intelligence, allowing them to make better decisions based on consistent, up-to date information. This will allow us to join the dots more easily between different pieces of information and intelligence from different areas, taking full advantage of the FCA's new data lake.

We have also provided an update to the EST on 16 April 2021 on the following changes we have made:

We have made changes to our Customer Contact Centre policies regarding non-regulated activities of a regulated firm and FSCS protection. In line with these changes we have provided briefings and training to all call handlers (and supervisors) within the Hub and have reflected these changes in our Induction training programmes for new starters.

Allegation 3: The actions the FCA took under its investigation caused LCF to fail.

Findings

The Gloster Report summarised the intervention action we took in relation to LCF in December 2018, and the reasons for this action. In particular, the Gloster Report noted:

"The FCA conducted an unannounced site visit at LCF's premises on 10 December 2018 as a result of serious concerns regarding LCF's conduct, including issues with the accuracy of the firm's financial promotions. Following this intervention, the FCA imposed various requirements, including restrictions preventing LCF from issuing or approving further financial promotions. The FCA's subsequent concerns regarding the viability of LCF's business resulted in a suggestion by the FCA that the firm should obtain advice regarding its solvency. LCF's directors appointed administrators on 30 January 2019 with the consent of, among others, the FCA."

The FCA intervened at this time to stop LCF from approving or communicating any further financial promotions on the basis that its communications in relation to its mini-bonds were misleading, not fair and not clear. We, therefore, took action to address our regulatory concerns and risks to consumers.

Information regarding LCF's financial situation at the time it ceased to trade can be found in Smith & Williamson LLP's Joint Administrators' Report and Statement of Proposals dated 25 March 2019 (the Administrators' Report): https://smithandwilliamson.com/media/3772/lcf-joint-administrators-proposals.pdf.

The Administrators' Report states that LCF effectively ceased to trade in December 2018 and noted that LCF bondholders had invested over £237 million, which LCF had itself loaned to borrowers. The administrators found, on review of the loan book, that £237 million was outstanding and a large number of the borrowers did not appear to have sufficient assets to repay LCF.

The Administrators' Report stated that LCF's business model was of an unsustainable nature and also noted, "*There are a number of highly suspicious transactions involving a small group of connected people which have led to large sums of the Bondholders' money ending up in their personal possession or control.*"

Therefore, the primary reason for LCF's failure was its own actions.

As stated above, the FCA is currently investigating whether LCF's collapse was caused by serious misconduct by individuals and third parties linked to the firm. The Serious Fraud Office (SFO) is also investigating individuals associated with LCF.

Conclusions

In light of the information contained within the Gloster Report and the Administrators' Report, I do not uphold this part of your complaint.

Overall, I am satisfied that the FCA's actions in December 2018 did not cause LCF to fail because the primary cause of its collapse was its own actions and was not due to the FCA's intervention.

Allegation 4: The FCA should not have authorised LCF. The FCA should have identified issues with LCF and its business model at the point of authorisation.

Findings

Our investigation of this part of your complaint has focused on LCF's initial application for authorisation that was approved by the FCA on 7 June 2016 and the first Variation of Permissions (VOP) application that was submitted by LCF in October 2016.

By way of background, the UK Government announced in January 2012 that the regulation of consumer credit firms would transfer from the OFT to the FCA. This transfer took place on 1 April 2014, at which point the FCA assumed responsibility for the regulation of over 50,000 consumer credit firms previously regulated by the OFT. The number of firms the FCA authorised prior to this was approximately 25,000.

Firms transferring over to the FCA's remit had to apply for interim permissions to carry on consumer credit activities after 1 April 2014 and then had to apply for authorisation by a certain date, where every firm was assigned to a particular 'application window'. For LCF, it needed to apply for authorisation between 1 August 2015 and 31 October 2015.

On 21 October 2015 LCF submitted its application to us for authorisation under Part 4A of FSMA. This application was approved on 7 June 2016, following which LCF was authorised as a limited permission firm with credit broking permissions. The Gloster Report noted that the FCA reviewed LCF's initial authorisation application in circumstances where the relevant team was handling applications from a large volume of consumer credit firms following their transfer from the OFT to the FCA. The Gloster Report also noted that the FCA's authorisation process during this time was amended to focus on the consumer credit activities of incoming firms from the OFT to the FCA. One of these amendments was to dis-apply the business model threshold conditions for limited permission applications (such as LCF's application). The Gloster Report stated that, as such, the relevant member of the Credit Authorisations Division who reviewed the initial authorisation application would not necessarily have been expected to have reviewed LCF's business model and financial information or to have detected the red flags in LCF's non-consumer credit bond issuing business.

Although the Gloster Report identified certain areas where the FCA could have probed LCF's financial information further as part of reviewing the initial authorisation application, it indicated that it was not 'unreasonable for the FCA to have granted LCF's credit broking permission'.

Subsequently, LCF submitted a Variation of Permissions ('VOP') application in October 2016. The submission included an application for the following permissions: making arrangements with a view to transactions in investments; arranging safeguarding and administration of assets; arranging (bring about) deals in investments; and advising on investments (except on Pension transfers and Pension Opt Outs). These permissions were to be subject to the following standard requirements: that the firm may hold or control client money if rebated commission and be a corporate finance business only. Applying for these permissions meant that LCF would change from being a limited permission firm to a firm with full permission.

Initially, and in line with the FCA's authorisation framework at the time, LCF's VOP application was assigned to the 'Enhanced' risk channel due to the firm's request for permission to hold client money. The VOP application being initially assigned to the 'Enhanced' risk channel meant that the Authorisations team member handling the application would seek to verify what they were told by the applicant. This contrasted with the 'Standard' risk channel, which LCF's VOP application was subsequently downgraded to, whereby the Authorisations team member was required to take statements made by the applicant at face value unless there was reason to disbelieve them.3 The Report noted that, during the course of the application, the relevant Authorisations team member handling the application queried LCF's financial information and financial projections, including in relation to its bond business.

During the application process, following queries raised by the Authorisations team member, LCF decided to withdraw its application for permission to hold client money on 9 June 2017. This resulted in us viewing the application as posing lower risk, and hence resulted in us reducing the scrutiny the application received, including in relation to the unregulated activity being carried out by LCF, with it being downgraded to the 'Standard' risk channel. The Report concluded that the downgrading of the VOP application to 'Standard' was inappropriate and this occurred as a result of a combination of human errors and weaknesses in the FCA's applicable control framework.

The application was assessed against the full set of Threshold Conditions in FSMA for a fully authorised firm (as opposed to a limited permission firm which LCF was initially). Unfortunately, although our analysis of the firm's financial information (actual and projected) did result in a number of queries being raised with the firm, the serious irregularities were not identified so the application was approved on 13 June 2017.

The Gloster Report concluded that the Authorisations Division failed to appreciate the risks which LCF's unregulated business posed to consumers and this resulted in the First VOP Application being approved when it should have been rejected or only approved subject to conditions or monitoring, although we note that the firm would still have been authorised. Those failures occurred for a number of reasons including:

- the FCA's approach to risk rating LCF's VOP application was overly focused on whether the firm had financial problems which could impact LCF's regulated business as opposed to considering the unregulated business;

- the relevant member of the Authorisations Division involved in the review of the first VOP Application was inadequately trained to interpret LCF's financial information and then step back and consider LCF's business holistically; and

- there were deficiencies in the FCA's approach to the Perimeter.

Conclusions

In light of the findings detailed above the FCA accepts that, although it was not unreasonable for the FCA to have initially granted LCF's credit broking (limited) permission, we did not adequately focus on the risks which LCF's (unregulated) business posed to consumers during the first VOP application. On that basis we partly uphold this part of your complaint.

The FCA has accepted the following recommendations relevant to this part of your complaint in the Gloster Report:

- 'the FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically';

- 'the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA.';

- 'the senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the dayto-day supervision and authorisation of firms.'

Our public response to the Gloster report set out a number of changes we have already made or are making to address the above and other relevant recommendations made by Dame Elizabeth Gloster including:

- Authorisation is now a central part of our portfolio approach to supervision, with potential risks of harm for new firms or firms changing their permission being considered for each portfolio of firms. These considerations, together with the portfolio risk rating, affect how we treat firms' authorisations. Following our improvement programme in Authorisations, the percentage of applications withdrawn between January 2018 and September 2020 has doubled. This programme also improved the handover from the Authorisation case team to a firm supervisor, as Authorisations staff play an important part in portfolio assessment;

- We will review our policies and guidance to make it clear when case officers should consider the firm and its business model holistically (including when they should consider an authorised firm's unregulated activity) to determine the appropriate course of action. We will also review our governance and quality assurance processes to ensure that we give complex cases appropriate attention;

We are undertaking a 'use it or lose it' exercise7 with the aim of identifying and intervening against firms that have reported no income from regulated activities for the last 12 months, persuading these firms to exit or demonstrate that they are using all of their permissions; and

- We also worked with the Treasury on a consultation, published in July 2020, to establish a regulatory 'gateway' which a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms.

We have also provided an update to the EST on 16 April 2021 on the following changes we have made:

- We have recruited specialist expertise within Supervision and Authorisations to provide additional scrutiny and expertise to assist with making judgements on firms' financial accounts in appropriate cases. We have 56 specialists across both our Financial Resilience and Authorisations teams and recruitment continues; and

- All frontline Supervisory, Authorisations and Enforcement staff have completed mandatory training on ‘FCA Powers and Unregulated Activities’, ‘Financial Accounting’ and ‘Business Model Analysis’. We will continue to regularly update and improve the training and coaching for all relevant staff with a view to increasing their ability to spot unusual business models and indicators of financial crime.

Allegation 5: The information about LCF on the Financial Services Register was misleading. Consumer believed LCF was a reputable firm and were purchasing a regulated product which offered the associated protections or access to the Financial Ombudsman Service and Financial Services Compensation Scheme.

Findings

The Financial Services Register (the Register) is a public record of firms, individuals and other bodies that are, or have been, regulated by the PRA and/or the FCA. The FCA is under a statutory duty under section 347 of FSMA to maintain this record.

The Gloster Report highlighted feedback received from LCF bondholders who searched for LCF on the Register that they had found it difficult to use and commented that it was not clear that LCF's bonds were unregulated.

The Gloster Report also stated that it *'has not seen evidence of the FCA warning the public that LCF's FCA-authorised status as presented on the Register indicated little, or no, assurance of regulatory protection in respect of its non-FCA regulated bond business.'*

As a result, the Gloster Report found that LCF's appearance on the Register encouraged investors' belief that LCF had a badge of respectability deriving from its authorised status, including in respect of its unregulated bond business.

From June 2016 when LCF was authorised as a Limited Permission Credit Broker, the Register contained the following information about LCF:

'This is a firm that is given permission to provide regulated products and services. The Financial Ombudsman Service may be able to consider a dispute with this firm. Find out how to complain. The Financial Services Compensation Scheme (FSCS) may be able to compensate customers if this firm fails. See how to claim compensation. Read about how this firm may be able to hold or control money from its customers.'

Following LCF's first Variation of Permission (VOP) in June 2017, the Register was updated to show the following information about LCF:

'This is a firm that is given permission to provide regulated products and services. This firm has requirements or restrictions placed on the financial services activities that it can operate. Requirements or restrictions can include suspensions. See the requirements applying to the firm. The Financial Ombudsman Service may be able to consider a dispute with this firm. Find out how to complain. The Financial Services Compensation Scheme (FSCS) may be able to compensate customers if this firm fails. See how to claim compensation. Read about how this firm may be able to hold or control money from its customers.'

We have acknowledged that during the Relevant Period the Register did not present information in an easy to understand manner and could have been clearer. This was evidenced in the minutes of a FCA Executive Committee (ExCo) meeting dated 11 September 2017 and in Andrew Bailey's interview with the investigation team3. However, it is important to note that there are no findings in the Report which suggest that the Register was inaccurate in relation to LCF.

In addition, information on the FCA's ScamSmart website in August 2017 contained the following warning under the heading 'unregulated investment scams': *'If you use an authorised firm, access to the Financial Ombudsman Service and FSCS protection will depend on the investment you are making and the service the firm is providing. Even if an authorised firm is involved, our rules generally apply only to products designed for the general public, rather than 'niche' investments, which may be completely unregulated'.*

As outlined above, the Register is there as a record of firms, individuals and other bodies that are or have been regulated by the PRA and/or the FCA. It is not designed to be the sole due diligence check a consumer should carry out when making a decision to invest and the ultimate responsibility for deciding on whether to make an investment remains with the consumer.

Conclusions

As outlined above, while we do agree that the Register could have been clearer in some respects and we have been and continue to invest in its development, we do not accept it was misleading. Given this, I do not uphold this part of your complaint.

In July 2020, we relaunched our enhanced Register to include information on consumer protections and actions against individuals and firms to help users avoid scams. Additionally, since March 2021, all firm records on the Register include the following warning: '*Firms we regulate may also provide products or services that are unregulated. These may not be covered by the Financial Ombudsman Service (FOS) or the Financial Services Compensation Scheme (FSCS). If you are unsure whether a product or service is regulated by us, then you should ask the firm to clarify this in writing.*'

Allegation 6: Your complaint is about the way the FCA is handling the investigation into London Capital and Finance (LCF). You are unhappy with the lack of information being provided by the FCA regarding the financial position of LCF and the likelihood of investors receiving repayment of their investments. You have asked for further information from the FCA regarding LCF and the actions the FCA has taken, but this information has not been provided.

Findings

We understand it can be frustrating when the FCA is not able to confirm whether we are investigating (or have investigated) a firm or individual.

In this case, we note that we set up a webpage (https://www.fca.org.uk/news/newsstories/london-capital-and-finance-plc) in August 2019 to keep bondholders updated on the progress of the FCA investigation into LCF. We outlined on this page that *'due to the nature of the case and for legal reasons, we are unable to provide investors with all the information they might want. We do, however, ask that you regularly check this page and the SFO's case page for updates.'* I can see that this webpage is updated regularly.

The Serious Fraud Office (SFO) is also investigating LCF alongside the FCA. The SFO investigation was publicly announced on 18 March 2019. The SFO also set up a webpage to share updates with bondholders and I note that this webpage is being updated regularly. Please see a link here: https://www.sfo.gov.uk/cases/londoncapital-finance-plc/.

More information about what the FCA can and can't share, including the reasons why, can be found here: https://www.fca.org.uk/freedom-information/information-we-canshare.

Allegation 7: The FCA failed to supervise LCF and as a result you have suffered a loss on your investment.

Findings

Chapters 5, 6, 8 and 10 of the Gloster Report set out a number of detailed findings regarding the errors the FCA made during our supervision of LCF. I have outlined some of the key findings below,

Approach to supervision during the Relevant Period

By way of background, the FCA took over the supervision of approximately 50,000 firms from the OFT on 1 April 2014. Prior to the transfer from the OFT to the FCA, firms had not previously completed a full authorisations process with the OFT.

The Gloster Report acknowledged that this presented a significant increase in workload and responsibility for the FCA at that time.1 The increased number of firms meant that it was not possible for each of these firms to have an ongoing relationship with a supervisor, nor would it have been feasible or appropriate to respond by recruiting a substantial number of new people for the Supervision Division, and the Gloster Report accepted this.2 Only limited information was available on individual firms that transferred from the OFT to the FCA which meant that the FCA's initial supervisory strategy for these firms could not be based on pre-existing data derived from reporting.3 The FCA's initial supervisory strategy for firms previously regulated by the OFT involved adopting a risk-based approach to supervision known as the FCA's Three Pillar Model. The FCA aimed to supervise firms mainly through event supervision and some thematic work with less emphasis placed on firm specific proactive work.

Pillar One of the Three Pillar Model involved targeting some firms for proactive or preventative supervision based on information obtained from an assessment of clusters of firms. Pillar Two involved reactive supervision to cases of potential or actual detriment/harm to customers. Pillar Three involved thematic reviews of specific issues or products. 5 Following the transfer from the OFT and as an interim permission firm with credit broking permissions, an activity considered low risk, the FCA's strategy for supervision during this time meant that LCF would not have been subject to any proactive supervision by the FCA.

The FCA was aware of certain deficiencies in relation to its supervision of firms from late 2015 onwards. In 2016, the Executive Directors of the Supervision Division at the time engaged an independent consultancy firm PA Consulting Services Limited, to review the effectiveness of the FCA's approach to supervising flexible firms. This produced a report in July 2016 titled 'Effectiveness assessment of the FCA approach to flexible firm supervision' (the 'PA Report'). In response to this report, the FCA implemented and undertook a significant change programme known as 'Delivering Effective Supervision' ('DES'). The objective of this programme was to improve the way in which the FCA supervised the firms it regulated. The DES programme and its major deliverables were

concluded in November 2018, although change has continued within Supervision in 2019 and since then, such as through the implementation of a Capability Framework for supervisors in October 2019.

The FCA also undertook other change programmes between 2016 and the end of the Relevant Period. At around the same time that we commenced the DES programme, we also commenced a programme to overhaul the authorisations process, Delivering Effective Authorisations ('DEA'). In 2016, the Enforcement and Market Oversight Review (the 'EMO Review') was also commissioned and as part of its implementation, a joint project was launched in May 2017 between Supervision and Enforcement to improve ways of working together.

Red flags

Throughout the Relevant Period, we were in receipt of pieces of information which cumulatively signalled that LCF posed a significant and increasing risk to consumers. These included allegations from third parties that LCF was engaged in fraud or irregular behaviour (e.g. the anonymous letter addressed to the Metropolitan Police and copied to our Unauthorised Business Department in January 20178), repeated breaches of the financial promotions rules, regulatory returns which showed that LCF was not earning any income from the activities it had regulatory permission for and that we identified during the Relevant Period that issuing mini-bonds had the potential to be a vehicle for fraud.

The Report noted that, although there were allegations of fraud and other wrong doing in the anonymous letter received at the time LCF was going through the first VOP application, no one in the FCA conducted a review of LCF's financial information to determine whether there were circumstances suggesting that LCF was engaged in possible fraud or serious irregularities. At this stage, the FCA also had access to concerning financial information regarding LCF.

The Report identified that there were weaknesses within the Supervision Division in interpreting financial information in order to recognise circumstances suggesting fraud, financial crime or potential irregularities. 11 Further, the Report noted the Financial Promotions Team was not adequately resourced or trained to consider businesses more broadly or read financial information to recognise unusual or suspicious entries or circumstances suggesting fraud or other irregularities.

The Report concluded that the FCA's failures in supervision were partially attributable to our staff being inadequately trained to consider a firm's business as a whole. For example, there was no policy which required the Supervision Division to interrogate a firm's financial information for indicative entries following an allegation of fraud being made against a firm. There was also no policy which required the Financial Promotions Team or any other team within the Supervision Division to interrogate LCF's financial information for evidence of irregularity. Additionally, there

were weaknesses in training within the Supervision Division in how to read company financial statements to recognise circumstances suggesting financial crime or serious irregularities.

It is also relevant to note that we received a number of calls into our Customer Contact Centre raising various concerns regarding LCF during the Relevant Period, including alleging possible fraud or irregularities. These included a number of calls from Individual A. It is evident that these concerns were not always forwarded on by the Customer Contact Centre to Supervision or Enforcement teams for further consideration as a whole and if they were forwarded on, did not always contain all the relevant information for consideration. Further, on the occasions these calls were referred, it does not appear they were acted on or viewed in light of the range of information we were in receipt of regarding LCF and how it was operating.

The Gloster Report found that the FCA's Customer Contact Centre policy documents were unclear about whether call-handlers should refer allegations of fraud or serious irregularity regarding the unregulated activities of authorised firms to the Supervision Division. The Gloster Report also identified gaps and weaknesses in the FCA's policies in relation to how it should consider the business model of the firm holistically (both regulated and unregulated activities) and treat allegations of fraud or serious irregularity in the unregulated activities of authorised firms.

The Gloster Report concluded that the FCA failed to assess the cumulative red flags outlined above holistically to determine whether there were fundamental problems with LCF's business model or conduct which required early intervention or enforcement action.

The perimeter

In terms of the perimeter (namely the boundary between unregulated and regulated activities), the Gloster Report concluded that the FCA's approach meant that the Supervision Division did not take adequate steps to supervise LCF because its core activity of issuing mini-bonds was unregulated and was 'outside' of the perimeter18. Therefore, we did not consider the pieces of information we were in receipt of holistically to build an overall picture of how LCF was operating and the potential for harm.

Other than during its periods of the firm being considered for authorisation, most of the interaction with LCF during the Relevant Period was carried out by the Financial Promotions Team (which is within our Supervision Division), because its financial promotions, unlike its issuances of mini-bonds, fell within the regulatory perimeter. Although the Financial Promotions team interacted with LCF during the Relevant Period in relation to at least six separate issues with LCF's misleading advertising and marketing, each occasion was viewed in isolation and not as a whole other than on the sixth occasion when the team referred to consideration being given to next steps (such as a formal attestation by a relevant senior person in the firm) should a further breach be identified. The Gloster Report's findings were that 'The Financial Promotions Team dealt with LCF on a purely reactive basis

and neither it, nor any other unit in the Supervision Division, took any steps to look at LCF's marketing activities in more detail'.

Conclusions

In light of the findings set out above, we accept that we could have done more to ensure our staff were aware of how, and to what extent, they should have paid regard to the risks posed by the unregulated activities of LCF. The FCA also accepts that we did not react efficiently or as effectively as we should have done to the red flags received during the Relevant Period of potential harm to consumers as a result of LCF's activities. On that basis, we uphold the first part of your complaint.

However, I have not upheld the part of your complaint that you suffered a loss on your investment as a result of our failure to adequately supervise LCF. This is because I am not persuaded there is evidence that your losses were caused by the FCA. We consider that the primary cause of your loss was the actions of the firm itself (and its senior management). Our approach to financial loss is outlined further at the beginning of this letter.

We have accepted the following recommendations linked to your complaint and are in the process of implementing them through a range of actions as outlined in our Public Response to the Report and in subsequent publications:

- 'the FCA should direct staff responsible for…supervising firms, in appropriate circumstances, to consider a firm's business holistically.';

- 'the FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the nonregulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.';

- 'the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA.';

- 'the senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of

sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the day-to-day supervision and authorisation of firms.';

- 'the FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.';

- 'the FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.';

- 'the FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (eg artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.';

- 'the FCA should take urgent steps to ensure that all key aspects of the DES Programme that relate to the supervision of flexible firms are now fully embedded and operating effectively'.

Additionally, we have also committed to reporting publicly on our progress in implementing the recommendations in our Annual Report and at 6-monthly intervals to demonstrate that we are implementing the programme as promised. We provided an update to the EST by letter 16 April 2021 on the progress of our transformation programme, including the implementation of the recommendations made by Dame Elizabeth Gloster.

Following on from our findings and conclusions outlined above, we would like to reiterate that we are very sorry for the errors we made in our handling of LCF and that it has not been possible for us to provide a response to your complaint before now.

Allegation 8: You are unhappy with the length of time the FCA's Enforcement investigation is taking.

I regret to inform you that we will need to continue to defer our investigation into this part of your complaint.

This is because this part of your complaint is connected with, or arises from, ongoing regulatory action by the FCA and there is a risk that, if the complaint is investigated at the same time, it could adversely impact that action. In this case the ongoing action is the FCA investigation into the to the sale of mini-bonds and ISA bonds by LCF.

I appreciate that this will be very disappointing for you. It may help if I set out the relevant extract from the Complaints Scheme, which explains the circumstances in which complaints investigations can be deferred, and the underlying reasons for this. Paragraph 3.7 of the Scheme states:

'A complaint which is connected with, or which arises from, any form of continuing action by the regulators will not normally be investigated by either the regulators or the Complaints Commissioner until the complainant has exhausted the procedures and remedies under FSMA (or under other legislation which provides for access to the Scheme) which are relevant to that action. The complainant does not have to be the subject of continuing action by the regulators for this provision to be engaged. An investigation may start before those procedures are completed if, in the exceptional circumstances of the case, it would not be reasonable to expect the complainant to await the conclusion of the regulators' action and that action would not be significantly harmed.'

The reasoning behind paragraph 3.7 is to ensure that a complaints investigation does not have an adverse impact on any ongoing regulatory action by the FCA. There are two ways in which it might have such an adverse impact, as explained below.

First, it could divert resources away from the regulatory action, which may inhibit the FCA from achieving its statutory objectives in a timely manner. This is because the FCA staff that would be needed to assist the Complaints Team with its investigation will include the same staff who are responsible for bringing the regulatory action to a timely conclusion. Involving those staff in two processes at the same time would inevitably delay the conclusion of the action, which could be detrimental to consumers and, potentially, the individuals concerned.

Second, the complaints investigation may prejudice the regulatory action. This might happen if, for example, the complaints investigation findings cut across the likely findings of the regulatory action.

In some cases, where there are 'exceptional circumstances', the FCA will proceed with a complaints investigation notwithstanding ongoing action. I have carefully considered, in line with paragraph 3.7 of the Scheme, whether there are 'exceptional circumstances' relating to your case. Unfortunately, I have concluded that your case does not fall into this category, which means that the investigation of this part of your complaint will need to continue to be deferred.

What happens next?

You will of course be keen for the complaint investigation to commence as soon as possible, and I can assure you that we will keep you regularly updated. In six months' time, starting from the date of this letter, we will reconsider this part of your complaint to assess whether the deferral remains appropriate and contact you with an update. We will also contact you if the ongoing regulatory action concludes before this time. We will continue to update you at least every six months as necessary. As soon as we are in a position to take forward the investigation of your complaint, we will get in touch and ask you to confirm that you are happy for us to proceed with the investigation of this part of your complaint.

Allegation 9: You believe the FCA failed in its authorisation of LCF.

Findings

By way of background, the UK Government announced in January 2012 that the regulation of consumer credit firms would transfer from the OFT to the FCA. This transfer took place on 1 April 2014, at which point the FCA assumed responsibility for the regulation of over 50,000 consumer credit firms previously regulated by the OFT. The number of firms the FCA authorised prior to this was approximately 25,000.

Firms transferring over to the FCA's remit had to apply for interim permissions to carry on consumer credit activities after 1 April 2014 and then had to apply for authorisation by a certain date, where every firm was assigned to a particular 'application window'. For LCF, it needed to apply for authorisation between 1 August 2015 and 31 October 2015.

On 21 October 2015 LCF submitted its application to us for authorisation under Part 4A of FSMA. This application was approved on 7 June 2016, following which LCF was authorised as a limited permission firm with credit broking permissions. The Gloster Report noted that the FCA reviewed LCF's initial authorisation application in circumstances where the relevant team was handling applications from a large volume of consumer credit firms following their transfer from the OFT to the FCA. The Gloster Report also noted that the FCA's authorisation process during this time was amended to focus on the consumer credit activities of incoming firms from the OFT to the FCA. One of these amendments was to dis-apply the business model threshold conditions for limited permission applications (such as LCF's application). The Gloster Report stated that, as such, the relevant member of the Credit Authorisations Division who reviewed the initial authorisation application would not necessarily have been expected to have reviewed LCF's business model and financial information or to have detected the red flags in LCF's non-consumer credit bond issuing business.

Although the Gloster Report identified certain areas where the FCA could have probed LCF's financial information further as part of reviewing the initial authorisation application, it indicated that it was not *'unreasonable for the FCA to have granted LCF's credit broking permission'.*

LCF submitted a Variation of Permissions ('VOP') application in October 2016. The submission included an application for the following permissions: making arrangements with a view to transactions in investments; arranging safeguarding and administration of assets; arranging (bring about) deals in investments; and advising on investments (except on Pension transfers and Pension Opt Outs). These permissions were to be subject to the following standard requirements: that the firm may hold or control client money if rebated commission and be a corporate finance business only. Applying for these permissions meant that LCF would change from being a limited permission firm to a firm with full permission.

Initially, and in line with the FCA's authorisation framework at the time, LCF's VOP application was assigned to the *'Enhanced'* risk channel due to the firm's request for permission to hold client money. The VOP application being initially assigned to the *'Enhanced'* risk channel meant that the Authorisations team member handling the application would seek to verify what they were told by the applicant. This contrasted with the '*Standard*' risk channel, which LCF's VOP application was subsequently downgraded to, whereby the Authorisations team member was required to take

statements made by the applicant at face value unless there was reason to disbelieve them.3 The Report noted that, during the course of the application, the relevant Authorisations team member handling the application queried LCF's financial information and financial projections, including in relation to its bond business.

During the application process, following queries raised by the Authorisations team member, LCF decided to withdraw its application for permission to hold client money on 9 June 2017. This resulted in us viewing the application as posing lower risk, and hence resulted in us reducing the scrutiny the application received, including in relation to the unregulated activity being carried out by LCF, with it being downgraded to the '*Standard*' risk channel. The Report concluded that the downgrading of the VOP application to *'Standard'* was inappropriate and this occurred as a result of a combination of human errors and weaknesses in the FCA's applicable control framework.

The application was assessed against the full set of Threshold Conditions in FSMA for a fully authorised firm (as opposed to a limited permission firm which LCF was initially). Unfortunately, although our analysis of the firm's financial information (actual and projected) did result in a number of queries being raised with the firm, the serious irregularities were not identified so the application was approved on 13 June 2017.

The Gloster Report concluded that the Authorisations Division failed to appreciate the risks which LCF's unregulated business posed to consumers and this resulted in the First VOP Application being approved when it should have been rejected or only approved subject to conditions or monitoring, although we note that the firm would still have been authorised. Those failures occurred for a number of reasons including:

- the FCA's approach to risk rating LCF's VOP application was overly focused on whether the firm had financial problems which could impact LCF's regulated business as opposed to considering the unregulated business;
- the relevant member of the Authorisations Division involved in the review of the First VOP Application was inadequately trained to interpret LCF's financial information and then step back and consider LCF's business holistically; and
- there were deficiencies in the FCA's approach to the Perimeter.

Conclusions

In light of the findings detailed above the FCA accepts that, although it was not unreasonable for the FCA to have initially granted LCF's credit broking (limited) permission, we did not adequately focus on the risks which LCF's (unregulated) business posed to consumers during the first VOP application. On that basis we partly uphold this part of your complaint.

The FCA has accepted the following recommendations relevant to this part of your complaint in the Gloster Report:

- *'the FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically';*

- *'the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when*

to escalate cases to specialists teams within the FCA.';

- *'the senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the day-to-day supervision and authorisation of firms.'*

Our public response to the Gloster report set out a number of changes we have already made or are making to address the above and other relevant recommendations made by Dame Elizabeth Gloster including:

- Authorisation is now a central part of our portfolio approach to supervision, with potential risks of harm for new firms or firms changing their permission being considered for each portfolio of firms. These considerations, together with the portfolio risk rating affect how we treat firms' authorisations. Following our improvement programme in Authorisations, the percentage of applications withdrawn between January 2018 and September 2020 has doubled. This programme also improved the handover from the Authorisation case team to a firm supervisor, as Authorisations staff play an important part in portfolio assessment;

- We will review our policies and guidance to make it clear when case officers should consider the firm and its business model holistically (including when they should consider an authorised firm's unregulated activity) to determine the appropriate course of action. We will also review our governance and quality assurance processes to ensure that we give complex cases appropriate attention;

- We are undertaking a 'use it or lose it' exercise7 with the aim of identifying and intervening against firms that have reported no income from regulated activities for the last 12 months, persuading these firms to exit or demonstrate that they are using all of their permissions; and

- We also worked with the Treasury on a consultation8, published in July 2020, to establish a regulatory 'gateway' which a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms.

We have also provided an update to the EST on 16 April 2021 on the following changes we have made:

- We have recruited specialist expertise within Supervision and Authorisations to provide additional scrutiny and expertise to assist with making judgements on firms' financial accounts in appropriate cases. We have 56 specialists across both our Financial Resilience and Authorisations teams and recruitment continues; and

- All frontline Supervisory, Authorisations and Enforcement staff have completed mandatory training on 'FCA Powers and Unregulated Activities', 'Financial Accounting' and 'Business Model Analysis'. We will continue to regularly update and improve the training and coaching for all relevant staff with a view to increasing their ability to spot unusual business models and indicators of financial crime.

Allegation 10: You are extremely unhappy that the FCA had caused a delay in the Independent Review of the FCA's report.

Findings:

Information covering the extension to the deadline for completion of the Review can be found in Dame Gloster's report in section 8 of Chapter 1, from page 14 to 21.

On 28 March 2019, the FCA Board agreed that there should be an investigation by an independent person into the issues raised by the failure of LCF. The Chair of the FCA, Charles Randell, wrote to the Economic Secretary to the Treasury, John Glen MP, to inform him of this request, and the Economic Secretary agreed that such a Direction should be given.

The Direction was laid before Parliament on 22 May 2019. This outlined that the investigation *'must be completed within a period of 12 months beginning on the date upon which the Investigator is appointed by the FCA'.1* The Direction also stated that *'If the Investigator considers that it will not be possible to complete the Investigation within the period of 12 months mentioned in sub-paragraph (1), the FCA must inform the Treasury of – (a) the reasons for the delay in the conclusion of the Investigation, and (b) a revised target for the conclusion of the Investigation.'2* The FCA appointed Dame Elizabeth Gloster on 10 July 2019, so the Report was expected to be delivered on or before 10 July 2020.

The Gloster report finds that *'a combination of factors, arising from the FCA's delay in producing documents and information to the Investigation, resulted in Dame Elizabeth writing to the Chair of the FCA on 15 May 2020 to notify him formally that the duration of the Investigation would need to be extended as her revised target date for the production of this Report had changed to 30 September 2020.'3* The Report explains that *'the Investigation had planned to conduct interviews with junior FCA employees in December 2019 and January 2020, but that depended on receiving relevant documents and information from the FCA sufficiently in advance of that window. As a result of the delays described above, the Investigation was only in a position to begin the interviews of junior FCA employees in March 2020.'*

The report states that these interviews were then impacted by the Covid-19 pandemic and by the FCA's implementation of a policy (in line with UK Government guidance) which asked employees to work from home. Therefore, the in-person interviews had to be cancelled and re-arranged to be conducted remotely.

Charles Randell sent a letter to Dame Gloster on 26 May 2020. In this letter he said *'I would again like to assure you that, despite the unforeseen technology challenges in the retrieving and providing documents and information, and the consequent impact on the timings of interviews, the FCA has been committed to doing everything we can to support the independent investigation and the delivery of your report by 10 July 2020.'*

The letter further explained that *'we have taken your concerns about the delays and the impact on the conduct and completion of the investigation very seriously; for example, upgrading our technology to increase the pace of delivery. Given this, I welcome your comments that the FCA has not intentionally delayed or deliberately not co-operated with the investigation.'*

Mr Randell also discussed how the Covid-19 pandemic had affected the FCA both in terms of *'employee working arrangements and regulatory tasks more generally, with the need to respond urgently to develop and implement major policy measures to support the market, regulated firms and consumers. This has particularly affected the availability of the FCA's Senior Management, who have had to – and continue to – respond urgently to a wide range of significant issues across most financial services sectors.'*

In early August 2020, Dame Gloster had a conversation with Charles Randell and explained that a further extension would be necessary. This was subsequently followed up in a letter dated 21 August 2020, where Dame Gloster formally confirmed a revised deadline for completion of the Investigation of 23 November 2020. Dame Gloster sets out that reasons for this further extension were the result of:

- An FCA audit of the data provided to the Independent Investigation revealed 3,500 documents which were not provided initially and were not received by the Independent Investigation until July 2020.

- The first interviews with the relevant members of the FCA's senior leadership team in office during the Relevant Period raised a new line of enquiry for the Independent Investigation team to consider. This included the Delivering Effective Supervision (DES) and Delivering Effective Authorisation (DEA) programmes.

Charles Randell responded to Dame Gloster's letter on 22 August 2020. He apologised for *'the delays in the provision of information in response to your requests and the matters highlighted in recent correspondence which have contributed to this delay in the completion of your Investigation. We have previously highlighted the matters which have contributed to this delay, including the impact of urgent Coronavirus response work on senior leaders' availability'10*. He further shared that *'we too are frustrated by the limitations of our legacy technology systems in retrieving information. This is being addressed through a multi-year and multi-million-pound investment programme.'*

Following the notification of a revised target date of 23 November 2020, The Gloster Report finds that *'the FCA's delays and errors in providing documentation to the Investigation Team continued into August and September 2020.'*

Dame Gloster delivered the Report to the FCA on 23 November 2020. The Gloster Report was published on 17 December 2020 by HM Treasury.

Conclusions

I uphold this part of your complaint. We are sorry for the delays experienced as a result of the FCA not being able to retrieve documentation in a timely manner. Delays caused by systems limitations were then further exacerbated by the urgent demands placed on the FCA's time and resource by the Covid-19 pandemic. We understand the disappointment caused to LCF investors by the delays in the publication of the Gloster Report.

It is important to note, however, that the Gloster Report *'does not consider that these delays were intentional or the result of deliberate non-cooperation by the FCA'*

In our public response to the Report, we outlined that we are investing £98m over 3

years to build the technology and skills needed across the FCA for our strategy focused on data analytics. We have also recruited a Chief Data, Information and Intelligence Officer to the Executive Committee to drive fundamental change in the way we manage and use our information and intelligence, in line with our Data Strategy launched in January 2020. As Charles Randell explained in his letter to Dame Gloster on 22 August 2020, this investment will help to address the limitations of our legacy technology systems.

Appendix 3a

Appendix 3a

27 April 2021 **By email only**

Open Letter to Charles Randell – Chairman of Financial Conduct Authority

CC:
Mel Stride – Chair of the Treasury Select Committee
Richard Lloyd - Senior Independent Director of Financial Conduct Authority
Amerdeep Somal - Complaints Commissioner

Dear Mr Randell

We are in receipt of a letter from the Economic Secretary to the Treasury, John Glen, dated 19 April 2021 in response to a letter from ourselves in which we set out serious concerns about the reforms to the FCA Complaints Scheme. In our view many of the proposed reforms appear to be noncompliant with the obligations placed on the Regulator by Part 6 of the Financial Services Act 2012 ('the Act'), yet many of these proposals have been implemented prior to the FCA's consultation process being completed, let alone approved. This does not seem to be consistent with the normal principles of due process.

In the Minister's response, he states: '*The details of the complaints scheme, including how the regulators consider complaints and the proposals for changes to the scheme in Consultation Paper 20/11, are a matter for the regulators. The specific questions on the scheme raised in your letter are therefore best raised directly with the FCA Chair.'* Accordingly, we are reverting to you to solicit substantive responses to our concerns.

In your letter of 23 March 2021[1] to Mr Stride, Chair of the Treasury Select Committee, you wrote:
'*For the FCA to consider it appropriate to offer an ex-gratia compensatory payment in respect of financial loss, complainants would normally need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA. Any such payment made would not, typically, cover the full loss*.'

However, the current version of the Complaints Scheme, as referred to by the Complaints Commissioner, last updated on March 2016[2], and displayed on the FCA's own website, states [our emphasis added]:

[1] https://committees.parliament.uk/publications/5318/documents/52976/default/
2 https://frccommissioner.org.uk/wp-content/uploads/LCF-wording-update.pdf

6.6 Where it is concluded that a complaint is well founded, the relevant regulator(s) will tell the complainant what they propose to do to remedy the matters complained of. This may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an ex-gratia basis.

9.2 To be eligible to make a complaint under the transitional complaints 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.

We are not aware of any provision within either the March 2016 Complaints Scheme or the 2012 Financial Services Act that stipulates that any compensatory payment should normally be made only in circumstances in which an individual has '*suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA'* or that *'any such payment made would not, typically, cover the full loss*', as you maintain.

It is almost inconceivable that the FCA could ever be considered the sole cause of loss since the financial loss will necessarily involve a third-party firm/individual. Consumers that have lost money in financial scandals will have entered contracts with third party firms/individuals, never the FCA directly and thus the FCA can always argue it is not the sole cause of the loss as another party will always exist. Furthermore, in almost every case it will be almost impossible to argue the FCA is the primary cause of loss since the FCA's regulatory inaction will simply be an enabling factor to the third-party firm/individual's misconduct. The conduct of a third-party individual firm/individual will always be the primary cause and the FCA's conduct, where relevant, the secondary cause.

We therefore believe the '*sole or primary cause of loss'* qualification makes it inevitable that almost no claimant could ever again be monetarily compensated for the contributing factor of the FCA's own regulatory failures. It makes the whole scheme 100% worthless in practise.

The only places in which we are aware of the '*sole or primary cause of loss'* qualification and that "*any such payment would not, typically cover the full loss*" is in the FCA's July 2020 Consultation and the reference in your letter to the FCA's approach to remedies. Neither significant qualification appears in the latest March 2016 updated Complaints Scheme nor the 2012 Financial Services Act. The March 2016 Complaints Scheme places no limits on compensation and states that it covers where "*some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the regulators' actions or inaction."*

We have subsequently learned that, although the Consultation was not launched until July 2020, the FCA chose to publish its new approach within a webpage entitled '*Complaints Scheme: our approach to remedies'* on 16 June 2020, with a further update three days later, a month before the consultation commenced. Could you please explain this timeline?

We are also deeply concerned that the FCA's new June 2020 'Approach to Remedies' also states that '*Where an impact is more severe or prolonged, a payment in the region of £100-£300 may be appropriate'* and that *'In most cases where a complaint is upheld, we consider that an apology and taking action to address the complaint is the most appropriate remedy*.' Again, we have been unable to find any corresponding text in the Complaints Scheme (updated in March 2016) or the 2012 Financial Services Act, and are puzzled as to how the FCA would be able adequately to assess in advance, what the most appropriate remedy would be to future individual cases?

In the 12 August 2020 submission from the Financial Regulators Complaints Commissioner[3] to yourself, it states (emphasis added): *'The myth (not backed by the statutory provisions) grew up – and was related to me - that the Scheme was 'not primarily a compensation scheme', and that compensation payments should be considered 'exceptional'. In fact, compensation payments are a core feature of the Scheme, as provided by statute.'*.

Furthermore, the Complaints Commissioner does not argue that either payments should be limited in any way or even restricted to those when the regulator is the sole or principal cause, saying that regarding the latter eventuality *"in my view the presumption should be that the regulator will compensate the complainant in full".* He also stated that *"The draft indicates that payments for direct financial loss will be limited to £10,000 save in exceptional circumstances. While I agree that it is likely that the vast majority of such payments would be below that figure, as a matter of principle it seems to me undesirable to impose a ceiling of this kind. It does not seem to me that the statutory immunity granted by Parliament was intended to protect the regulators from major blunders of their own making. In my view, the approach to compensation for financial loss set out in paragraphs 8- 15 is broadly sound, but I think that the caveats in paragraph 16-17 are not, and represent an explicit fettering of compensation for direct financial loss, which makes it especially important that there is proper consultation before it is adopted*.'

What we find even more surprising is that the FCA Board minutes of 12 November 2020 stated: "*2.4 The Board was cognisant of the concerns raised by some respondents regarding the timing of the amendments*

[3] https://frccommissioner.org.uk/wp-content/uploads/OCC-FSRFR-response-final-15-February-2021.pdf

to the Complaints Scheme described in Consultation Paper CP20/11. In light of this, it was proposed that the policy statement on the consultation should not be published until towards the end of Q2 2021. The Board would shortly be asked to give effect to this by written resolution." We note that this Board meeting was chaired by you.

We are therefore at a loss to understand what was intended by your letter to the Treasury Select Committee (TSC), on 23 March 2021, particularly in respect of your points relating to key changes to the compensation process being implemented by the FCA in June 2020, prior to the FCA publishing its finalised policy statement on the matter which is expected towards the end of Q2 2021. We would very much welcome clarification from you on these points.

Our strongly held view is that your statements run contrary to the spirit of Part 6 of the original Financial Services Act 2012 in which legislators clearly envisaged compensation being paid in addition to, or instead of, other remedies, which stated that:

"(5) The complaints scheme must confer on the investigator the power to recommend, if the investigator thinks it appropriate, that the regulator to which a complaint relates takes either or both of the following steps –
(a) makes a compensatory payment to the complainant, or
(b) remedies the matter complained of.

This approach is clearly reflected in the 2016 Scheme but not within your June 2020 approach to remedies[4], implemented prior to the July 2020 FCA Consultation which is described by the FCA as (emphasis added) '*proposing a revised version of our Complaints Scheme*'.[5] Furthermore, within your proposal, it was argued that the scheme was not designed to decide on complex causation issues, and this justified taking a "modest" approach to compensation. Again, we are at a loss to understand how or where such a limitation is provided for in either the Financial Services Act 2012 or the 2016 Scheme.

We consider that this argument flies in the face of the fact that this is exactly what FOS does in relation to complaints against firms – i.e., it considers cases based on principles of fairness and its final determinations are binding on firms that it considers have not acted fairly in all the circumstances, even where there is a complex factual matrix and multiple factors and parties involved. Why, therefore, should the FCA to subject to a different approach, different standards and less stringent levels of scrutiny?

[4] https://www.fca.org.uk/news/statements/complaints-scheme-our-approach-remedies
[5] https://www.fca.org.uk/publications/consultation-papers/cp20-11-complaints-against-regulators-fca-pra-boe

In summary, we believe your urgent clarification is now required to bring clarity, certainty and equity to a range of key issues including the following:

- Is the 2016 updated Scheme the current legally valid scheme?
- How does the FCA approach to remedies as detailed by you in your letter to the TSC accord with the 2016 updated Scheme?
- Why would the FCA publish an approach to remedies on their website, a month prior to its own Consultation began, let alone finished?
- Does the FCA's 19 June 2020 approach to remedies contradict previous approaches by the FCA (none are disclosed on the FCA website) and has this approach ever been ratified by the FCA Board and/or the Complaints Commissioner?

We note that you wrote to the TSC on 27 November 2020 stating that the FCA did not think that the new proposals would result in *"materially different outcomes for most complainants"* and that the primary focus is on making the scheme more user-friendly. We consider this to be woefully misleading and unfair. The introduction of caps, evidential burdens and the move towards an apology being the likely outcome of any complaint, clearly significantly erodes the rights of the consumer.

These are serious and substantive issues which give rise to legitimate and urgent concerns about the processes, quality of decision-making, and accountability of the FCA, and of you as its Chair. Moreover, the evidence we have highlighted in this letter is bound to give rise to the suspicion that you, as Chair of the FCA, are seeking to introduce the FCA's proposed new scheme through the back door, without proper scrutiny or debate.

As longstanding campaigners who are committed to securing improved financial consumer protection, treating customers fairly, and a better regulated industry we are truly astonished by your actions in relation to the FCA Complaints Scheme. These do not seem to us to be the hallmarks of a considered and effective regulator, or the action of a fit and proper person.

More than anything else, the public and victims of failings such as LC&F, Blackmore and Woodford that may occur in the future, are entitled to know that you and the FCA are treating these issues with the utmost importance and timeliness and with appropriate levels of transparency and clarity.

As an example of how the FCA appears to be currently misinterpreting both the Financial Services Act 2012 and the 2016 Complaints Scheme, the independent report[6] into the Connaught scandal found, "*the Regulator's regulation of the relevant entities and individuals connected to the Fund was not appropriate or effective*" and that "*overall it remains my view that it could have acted in a more effective way to protect investors in the Fund*". However, the FCA recently stated[7] that "*We have now reconsidered these complaints taking account of our approach to remedies, the relevant factors in the complaints scheme and the statutory framework within which we operate. We consider that an apology is the most appropriate remedy in the circumstances*." How can such a stance possibly be justified based on either the basis of the 2012 Financial Services Act or the 2016 updated Complaints Scheme?

In view of the immense gravity of the issues that we have identified, which we believe are anti-consumer and represent an incorrect and potentially unlawful interpretation of the Financial Services Act 2012, we require a reply that answers each of the points raised, clearly and comprehensively, within fourteen days of the date of this letter. Should it be confirmed that there has been a lack of proper regard for consumers and that your own poor leadership and judgment as Chair of the FCA may have contributed to this, then we hope you will not hesitate to do the right thing and, in such circumstances, will consider your own position.

Given this, as well as copying in the Chair of the Treasury Select Committee and the Complaints Commissioner, we are copying in the FCA's Senior Independent Director who under the FCA's corporate governance[8], is mandated to '*provide a sounding board for the Chair and to serve as an intermediary for the other directors when necessary*'.

We very much look forward to hearing from you.

Yours sincerely,

Gina Miller *Alan Miller*

Gina Miller Alan Miller

[6] https://www.fca.org.uk/publication/corporate/connaught-independent-review.pdf
[7] https://www.ftadviser.com/regulation/2021/04/19/fca-to-pay-lcf-complainants-but-not-connaught/
[8] https://www.fca.org.uk/publication/corporate/fca-corporate-governance.pdf

Appendix 3b

Appendix 3b

Financial Regulators Complaints Commissioner
23 Austin Friars
London
EC2N 2QP BY EMAIL

9 August 2021

Dear Amerdeep Somal

Second Letter of Support: London Capital & Finance Plc ("LC&F") in administration (FRN: 722603)

Complaint regarding:

(i) lack of compensation to LC&F investors for regulatory failures and
(ii) the Financial Conduct Authority's incorrect reliance upon a purported "solely or primarily responsible" causation test for ex gratia compensation payments, which has no basis.

Introduction

We write further to our correspondence relating to the Letter of Complaint from certain investors in London Capital & Finance Plc (in administration) dated 25 June 2021; and the letter from Charles Randell (copied to you) dated 29 June 2021.

As you will recall, we wrote to you to communicate our support of the central tenant of the LC&F Investors Complaint, namely, the unlawful introduction by the FCA of a "*solely or primarily responsible*" test of causation.

We now write to you to update you on our position.

Mr Randell's Letter of 29 June 2021

Our concerns with the FCA's attempts to adopt its revised version of the Scheme Rules (set out in CP20/11: "Complaints against the Regulators") through the back door have never been adequately and comprehensively addressed to date by the FCA.

On 29 June 2021, we received a response to our correspondence with the FCA from Mr Randell.

You were copied in this correspondence. We have no doubt that you will agree that it is unfortunate – although perhaps not surprising – that this correspondence raised more questions as regards the FCA's approach than it answered and creates further uncertainty in the already complex and difficult issue of compensation.

Our grounds for concern are as follows:

1. **The "solely or primarily responsible" test of causation**

Once again, the FCA's asserts that the "*solely or primarily responsible*" test is the correct starting point.

We have already established that this purported test first emerged in 2020 in CP20/11: "Complaints against the Regulators" and has absolutely no basis in law.

The FCA's inability to coherently explain the genesis of this test confirms our belief that the true rationale for the introduction of this test is that the FCA is concerned to avoid the proper payment of compensation to consumers because of its own failings, which have started to become increasingly apparent in the string of recent catastrophic cases including LC&F.

We note that the previous Complaints Commissioner shared similar concerns as regards the application of this test and this will no doubt be an issue that you will be live to and will be considering carefully as part of the development of your own policy position.

2. **Justification for the "solely or primarily responsible" test**

In an attempt to justify introducing the test, the FCA previously implied that it had to do as a result of a request from the Complaints Commissioner. The FCA now appears to justify the introduction of the test as necessary in order for it to process complaints more efficiently.

The time taken for the FCA to process the complaints made on behalf of the LC&F investors, where the solely or primarily responsible test was adopted, proves that this test will not make the FCA more efficient.

In any event, a potential benefit of efficiency does not justify the introduction of a mechanism which is contrary to law.

We urge you to clarify your position and whether it is correct that the FCA was obliged to adopt this test as a result of a request from the Complaints Commissioner for the FCA to either clarify the grounds for and/or to speed up the processing of complaints.

3. Repositioning

Interestingly, we note that the FCA now appears to be repositioning when the solely or primarily responsible test will be deployed.

From previously stating "*complainants would need to evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*" as a prerequisite for the FCA to consider making an ex gratia payment. The FCA has softened this firm principle and now states "*where the FCA is the sole or primary cause of a consumer's loss, it is likely to be appropriate to make an offer of ex gratia compensation*". To clarify, "*The FCA accepts that there may be circumstances in which it is appropriate to make an offer of ex gratia compensation even where the loss is caused solely or primarily by a third party*."

If Mr. Randell's letter is correct, then we are concerned that customers now face greater uncertainty and confusion as to when they can expect to receive compensation for the failings of the regulator.

As you have articulated previously, there is a longstanding lack of clarity about the circumstances in which the FCA will accept it has been at fault and will offer an ex gratia payment of compensation. This apparently contradictory approach of the FCA further muddies the waters and we urge you to communicate your position on this issue so as to provide some certainty for consumers.

Action

It is clear to us that the FCA appears to be:

1. happy to pursue its attempt to introduce legislation with a blatant disregard for the law and due process,
2. unconcerned with the legitimate expectations and interests of consumers; and

3. content to capriciously fetter your role and responsibilities as Complaints Commissioner, which are set out in statute.

In these circumstances, we urge you to take this newest development into account when considering and responding to the Letter of Complaint and when considering your policy position.

Yours faithfully,

Gina Miller *Alan Miller*

Gina Miller Alan Miller

Appendix 4

Appendix 4

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Amerdeep Somal
Financial Regulators Complaints Commissioner
Tower 42
25 Old Broad Street
London
EC2N 1HN

By email only: complaints@frccommissioner.org.uk

cc. Thomas.Donegan@Shearman.com

09 August 2021

Dear Amerdeep,

London Capital & Finance Plc (in administration) – Complaint from Shearman and Sterling LLP on behalf of bondholders

1. I am writing further to a letter dated 25 June 2021 (copied to me) from Shearman & Sterling LLP ("**S&S**") on behalf of certain London Capital and Finance Plc ("**LC&F**") bondholders[1] (the "**Group Complaint**"). The 25 June letter refers to a number of complaints relating to the alleged failures in the FCA's authorisation and supervision of LC&F. The letter seeks to make a formal referral to the Commissioner of these complaints for the purposes of paragraph 6.8 of the Complaints Scheme (the "**Scheme**").

2. In this letter, to which S&S is copied, I address two topics which we hope will assist your consideration of the Group Complaint.

   (1) The first is what we consider to be a fundamental and wide-reaching issue raised by the Group Complaint - the proper approach to compensation under the Scheme.

   (2) The second is the FCA's position on the means by which S&S suggest that the FCA could fund the award of further compensation to bondholders.

1 [redacted] and [redacted]

3. These are taken in turn below, but in summary:

(1) The FCA has set out what it considers to be the proper approach to the award of compensation to affected LC&F bondholders in a statement published on the FCA's website (the "**LC&F Compensation Statement**"). As I explain in paragraphs 15-25, this approach has been applied by both the FCA and successive Complaints Commissioners since the Scheme's inception and is also consistent with the Parliamentary debates on financial services legislation and the formation of the Scheme. Put simply, the Scheme was set up to ensure that complaints could be investigated in a transparent way, and justified complaints appropriately acknowledged by the FCA; it was not set up to function as a scheme to provide substantial compensation for the loss of high risk unregulated investments through suspected fraud, as S&S seem to suggest.

(2) The FCA is unable to fund further compensatory payments to bondholders in the manner suggested by S&S. As we explain in paragraph 34, it would be unlawful for the FCA to use fines received from enforcement action to fund compensatory payments to complainants since the FCA is required under statute to pay its financial penalty receipts to the Treasury. As for the suggestion that the FCA could simply deplete its 'surplus funds', this assertion is based on a fundamental misunderstanding of the FCA's balance sheet. Therefore, contrary to what is suggested by S&S, the FCA does not have any means to fund compensation payments to bondholders without raising significant further revenue from regulated firms (see paragraphs 35-37).

(1) The approach to requests for compensation

4. The LC&F Compensation Statement reflects what the FCA considers is the appropriate general approach, having regard to the terms of the Scheme.

5. In summary, the LC&F Compensation Statement explains that, while each complaint will be considered individually, the FCA expects to offer *ex gratia* compensation to a small number of bondholders who were given incorrect information in direct communications with the FCA which may have led those bondholders to conclude their investment was safer than it was. The Statement goes on to explain that (again, subject to an individual review of each complaint)

the FCA does not expect to make *ex gratia* compensatory payments to the other complainants, but expects instead to respond by acknowledging the errors which the FCA made in relation to LC&F and reiterating its apology.

6. We set out below why this is the most appropriate approach, and at the same time address the contention in the Group Complaint that these amount to a departure either from the Scheme or past practice.

(a) The Regulatory Context

7. It is important at the outset to explain why we consider that the approach which the FCA has taken is the appropriate one in light of the statutory scheme of regulation established by (in particular) the Financial Services and Markets Act 2000 ("**FSMA"**) and the Financial Services Act 2012 ("**FSA 2012**"). By establishing this scheme, Parliament has entrusted the FCA with the task of regulating the conduct of approximately 51,000 businesses[2], while at the same time ensuring that this regulation is conducted proportionately and without imposing an undue burden on those it regulates.

8. The FCA is funded by levies imposed on those it regulates, which are ultimately passed on to consumers in the form of higher prices for products and services. The consequence is that the FCA is required to exercise judgement as to how its finite resources are best deployed, which necessarily means that it prioritises some areas over others. In some cases, hindsight will indicate that better outcomes could have been achieved if different prioritisation decisions had been made. However, Parliament has made clear that so long as those decisions were made in good faith, the FCA ought not to be liable in respect of them.

9. Furthermore, the regulatory scheme established by Parliament is one which permits investors to take risks and sets out the principle that consumers should take responsibility for their decisions. Where the regulatory scheme intends consumers to have legal recourse in respect of financial losses, it does so expressly, as it has done for example by legislating for the Financial Ombudsman Scheme ("**Ombudsman Service"**, Part XVI of FSMA) and the Financial Services Compensation Scheme ("**FSCS"**, Part XV of FSMA). Under the Ombudsman Scheme, persons who suffer loss can obtain redress on a fair and reasonable

2 However, during the relevant period of the Gloster Report's investigation the FCA regulated up to approximately 60,000 firms.

basis, in respect of a loss suffered due to failures by a firm. The FSCS (which is established under FSMA but operates under rules made by the FCA and the Prudential Regulatory Authority) provides protection for consumers under certain circumstances , including that there is a protected type of claim and a relevant firm is unable or unlikely to be able to satisfy civil claims against it.

10. When it comes to the FCA's liability for damages for financial losses caused by its actions or inactions, Parliament has decided that the FCA should be exempt from liability in damages under paragraph 25 of Schedule 1ZA to FSMA. The exemption applies to anything done or omitted in the discharge, or purported discharge, of the FCA's functions. The exemption covers both the acts and omissions of the FCA as well as of any person who is, or is acting as, a member, officer or member of staff. This is subject only to two narrow exceptions, that is where the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998 or where the act or omission has been done in bad faith. Neither of these exceptions apply in this case.

11. This may be contrasted with Part XVI of FSMA, establishing the Ombudsman Service. Here, Parliament has expressly provided that the Ombudsman Service may, in the exercise of its compulsory jurisdiction, make awards of compensation for "loss or damage" which are payable by the firm subject to the complaint. This power is found in section 229 of FSMA, which explicitly authorises the Ombudsman Service to make a money award to compensate for (amongst other things) "financial loss". No such provision is made in respect of complaints regarding the FCA's exercise of its regulatory functions.

12. Furthermore, unlike the Ombudsman Service, the Scheme is not intended to be, in effect, an informal alternative to the Courts. Notably:

    (1) Complaints considered by the Ombudsman Service will be against the firm in question. Furthermore, the determination of the award made by the Ombudsman Service is on a 'fair and reasonable' basis. In reaching its decision, the Ombudsman Service must take account of, amongst other things, the relevant law, and if the Ombudsman Service wishes to depart from it, it must provide cogent reasons for doing so. Any failure to do so, or any arbitrary or inconsistent departure from the law is a reason for setting aside a determination: *R (Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service* [2008] Bus LR 1486 (CA). Furthermore,

where a consumer accepts a final determination by the Ombudsman Service, they are not then able to pursue a claim against the firm on the same facts for the same losses in civil proceedings, as the Ombudsman Service is a "tribunal" and its final determinations "judgments" for the purposes of the merger doctrine (whereby a claimant's rights are extinguished by a judgment of a tribunal): *Clark v In Focus Asset Management & Tax Solutions Ltd* [2014] 1 WLR 2502 (CA).

(2) In respect of complaints concerning the FCA's regulatory conduct, the position is entirely different. There can be no question (absent bad faith or violation of the Human Rights Act) of any action for damages in the Courts against the FCA. Furthermore, were a consumer to be compensated on an *ex gratia* basis by the FCA in respect of financial loss which was caused not by the FCA but by a third party, there would be no such barrier on the consumer seeking to recover from that third party.

13. As explained by your predecessors in their published decisions[3], the Complaints Scheme is not set up to consider complex questions of causation – which include considerations of remoteness, foreseeability, mitigation of losses – and such matters are more appropriately left to a Court to consider. Accordingly, while the FCA agrees that it is not necessary strictly to apply legal tests of causation, liability and quantum when considering whether to offer a compensatory payment, we consider that it is in general appropriate to limit compensation for financial loss to cases where the FCA is solely or primarily responsible for the loss.

14. It is, of course, open to the Government (from which the FCA is independent) to determine that the circumstances of a particular case are such that individuals ought to be compensated on a broader basis, outside of the Scheme. Indeed, this is what has occurred in respect of LC&F, as HM Treasury determined that it would be appropriate for bondholders to receive significant sums in compensation and is in the process of establishing a specific scheme for this purpose. Three points stand out here:

(1) First, this represents what the Government considers to be the appropriate approach to compensation having regard to the Gloster Report's criticisms

3 See paragraph 25.

of the FCA. As the Economic Secretary to the Treasury (John Glen MP) explained during the second reading debate:

(a) "*one of the central findings in Dame Elizabeth Gloster's excellent report is that because LC&F was authorised, the FCA should have considered its business holistically, including the unregulated activity of issuing mini-bonds"*; and

(b) "*Although the Government have not seen evidence to suggest that the regulatory failings at the FCA caused the losses for bondholders, they were a major factor that the Government considered when deciding to establish the scheme.*"

(2) Secondly, this could not be accomplished within the Scheme, as separate primary legislation was required, and the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill is currently before Parliament. As the explanatory notes to that Bill set out, the upfront cost of that compensation scheme is expected to be in the region of £120million. HM Treasury will take an assignment of bondholders' rights in the insolvency proceedings, allowing the department to recover a portion of the compensation paid out as assets are sold by the administrators.

(3) Thirdly, as the Minister (Guy Opperman MP) made clear when moving the second reading of the Bill, the decision had been taken on an exceptional basis and "*the Government cannot and should not be expected to stand behind every failed investment firm. That would, with respect, create the wrong incentives for individuals and an unacceptable burden on the taxpayer*". This point was re-iterated later in the debate by the Economic Secretary to the Treasury who stated:

(a) "*I must be clear that the Government cannot step in to pay compensation in respect of every failed financial services firm. That falls outside the financial services compensation scheme, would create a moral hazard for investors and would potentially lead individuals to choose unsuitable investments, thinking that the Government would provide compensation in all cases if things went wrong*."; and that

(b) "*The Government's approach follows the historical precedent. I note that only three compensation schemes have been established in the past 35 years—for Barlow Clowes, a Ponzi scheme that failed in the late 1980s, Equitable Life and LC&F—despite many investment firms failing over that period.*"

(b) The historical approach

15. The approach summarised above has been applied both by the FCA and successive Complaints Commissioners since the Scheme's inception. This reflects the fact that the Scheme is part of a series of accountability measures designed to provide a counterbalance to, but not to undermine, the FCA's statutory immunity from damages for its acts and omissions, save in cases of bad faith or breaches of human rights. Parliament's recognition of the need for statutory immunity for financial regulators dates back to the Financial Services Act 1986 and the formation of the Securities and Investments Board ("**SIB**") and the self-regulatory organisations that were the predecessor bodies of the Financial Services Authority ("**FSA**"). The primary arguments for statutory immunity at that time were twofold: firstly, so that the regulators would be independent and fearless in the execution of their duties; and secondly, so that the regulators could attract practitioners of the highest quality to work for them without fear of facing legal action in relation to their regulatory decisions.

16. Subsequent Parliamentary debates on financial services legislation – to form the FSA in 1999-2000 and then to form the FCA and PRA in 2011-12 – have all reaffirmed the requirement for statutory immunity from damages to allow the regulator to carry out its duties with a focus on doing the right thing, rather than focussing on avoiding the risk of liability of the regulator. The Joint Committee on the Financial Services and Markets Bill in 1999 concluded:

> "*An essential aspect of regulation is that supervision should not take place to the extent necessary to prevent all possible business failures. If the FSA are vulnerable to suit in the event of business failure, they will go as far as possible to avoid all failures; this will be a recipe for over-regulation*."

17. The Government's response to the Reports of the Joint Committee were published on 17 June 1999 and explained that:

"*The Government sees the role of the Complaints Investigator as being… to ensure that any alleged shortcomings* [of the FSA] *can be investigated in a transparent way, not as a route to additional recompense for firms and consumers*". (Part 1, para 4)

18. Thus, Parliament determined the need for regulatory accountability through a complaints scheme which would act as an appropriate counterweight to this immunity, but not in a way that would undermine it. This was to prevent comparable risk aversion at the FSA to that which would arise from a lack of statutory immunity; to acknowledge the impact on those who funded the FSA - the financial services industry and ultimately, therefore, consumers; and in the knowledge that avenues for consumer redress were being established through the Ombudsman and FSCS. For these reasons, the statute made clear that the Complaints Commissioner would have powers only to recommend compensatory payments rather than require them[4].

19. Speaking in the House of Commons at the Report stage of the Bill which ultimately became FSMA, the Minister said:

"It is important that the complaints scheme is not seen as a means of circumventing the FSA's statutory immunity. We do not want to encourage people to take pot shots at the FSA and distract it from its proper business of regulating…The complaints scheme is an informal mechanism for investigating complaints and, where appropriate, bringing shortcomings into the open; it is not a court, nor is there a right of appeal for the FSA if the investigator makes an adverse finding against it.

[…]

I do not think that people should view the complaints investigator as a potential first port of call, as the Opposition seem to suggest. In any event, the post is not being established for the purpose of financial redress; the point is for the focus to be on the process, and on the importance of transparency."

20. When FSMA came into force on 1 December 2001 it introduced significant changes for the remit, powers and responsibilities of the FSA, including the mechanisms for improving investor protection and the powers introduced to hold

4 Under section 87(7) of the FS Act 2012, the Commissioner may also require the regulator to which a complaint relates to publish the whole or a specified part of their response to a complaint.

the FSA to account for its performance. These included an expansion in the remit and powers of the statutory Complaints Scheme (for complaints against the FSA). Relevant documents for defining the expected operation of the revised Complaints Scheme include the original CP73[5] from November 2000, and the subsequent Policy Statement – CP93[6] from May 2001. The Complaints Scheme in operation today remains substantially the same as when it was established in 2001, save for minor amendments introduced by the subsequent consultations, and to reflect the legal basis of the Scheme moving to the FSA 2012.

21. The FSA's approach to *ex gratia* compensation was explained in Policy Statement CP93 as follows (at para 13.3):

> "[w]*e will give serious consideration to any recommendation by the Commissioner to make a compensatory payment. However, mindful of our statutory obligation* [section 3B(1)(a) FSMA] *to use our resources economically and efficiently, the FSA Board remains of the view that it should retain a wide discretion as to when it will make a compensatory payment... It would in our view not be right for the FSA to make an open-ended commitment to make a payment where recommended to do so without having regard to a number of factors, including the impact on those who fund the FSA's operations*."

22. It also said that:

> "*compensatory payments would be unlikely to be appropriate for consumers who may complain that the Authority could and should have acted to prevent the failure of a regulated firm*."

23. Parliament revisited this matter in the course of debates around the formation of the FCA and PRA in 2011-12, but did not consider that it was appropriate to make any statutory changes. This is unsurprising because, in written evidence to the Joint Committee considering the matter, the then Complaints Commissioner, Anthony Holland, described the competing positions before indicating that, viewed objectively, it could be concluded that the existing approach represented "*a reasonable compromise"*[7]*.*

5 https://webarchive.nationalarchives.gov.uk/20081113045726/http:/www.fsa.gov.uk/pubs/cp/cp73.pdf
6 https://webarchive.nationalarchives.gov.uk/20081113052746/http:/www.fsa.gov.uk/pubs/cp/cp93.pdf
7 https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/430vw02.htm

24. That being so, the intention is that the complaints mechanisms, including investigation by the Commissioner, are not to provide for a full testing of legal argument and evidence. The FCA is not intended to be an insurer of last resort, nor is it a backstop to the unavailability of FSCS compensation or to remedies against the relevant firm or individual which is the primary cause of the consumer's loss.

25. This has been reflected in the approach adopted by both the FCA and successive Complaints Commissioners. To give two recent examples:

    (1) In FCA00684/2057789931, your immediate predecessor decided that it was not appropriate to recommend an award of compensation in response to an alleged failure by the FCA to act on allegations of mortgage fraud, which led to financial loss by the complainant. When pressed as to why this approach was taken, the Commissioner provided a detailed response on 27 May 2020, which read as follows:

    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[8].

    e. I understand that the Financial Services Compensation Scheme (FSCS), which is the statutory scheme to reimburse customers who have lost

[8] As noted in paragraph 25 (paragraph 44 of decision FCA00684/2057789931), similar points have been made by successive Commissioners.

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.

(2) In FCA00641/205205644, the Complaints Commissioner explained that:

Parliament has given the FCA protection from being sued for damages, save for cases involving bad faith or a breach of human rights. The Complaints Scheme cannot be used to undermine that protection, but it can offer generally modest ex gratia payments for administrative shortcomings … I do not accept your view that the Regulator can be seen as a 'backstop' upon which investors are entitled to 'rely' – investors in bonds are not offered financial guarantees of the kind given for depositors in bank accounts. That being the case, while I do not consider that the FCA should have dismissed the notion of any form of ex gratia payment, I agree with the FCA that you would not be entitled under this Scheme to an ex gratia payment which amounted to compensation for the financial losses arising from the financial statements.

(c) The FCA's current position

26. It is for these reasons that the FCA considers that the approach to the award of *ex gratia* payments set out in the LC&F Compensation Statement is appropriate and consistent with both the regulatory scheme and past practice.

27. To summarise the current position, section 87(5) of the FSA 2012 requires that the FCA, the Prudential Regulation Authority and the Bank of England (together, "**the Regulators"**) operate a complaints scheme which confers a discretion on you, as the Complaints Commissioner, to recommend that the FCA makes an *ex gratia* compensatory payment.

28. The Regulators have done so in the Scheme which was adopted following a full public consultation and which has been in effect from 1 April 2013 and was most recently updated in March 2016. Importantly, the Scheme sets out, at paragraph

7.14, the matters which the Regulators should normally take into account when considering a recommendation in relation to compensation:

"*7.14. In deciding how to respond to a report from the Complaints Commissioner, the relevant regulator(s) will normally take into account:*

a) the gravity of the misconduct which the Complaints Commissioner has identified and its consequences for the complainant;

b) the nature of the relevant regulator(s)' relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s);

c) whether what has gone wrong is at the operational or administrative level;

d) the impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers."

29. Those factors must be considered both individually and cumulatively. Contrary to what is suggested by S&S none of the factors set out in the Scheme is more important than the others. What is required is an assessment of the particular circumstances of each individual case by reference to these factors.

30. Additionally, the Scheme provides (at paragraph 6.6) that the FCA will, where it considers that a complaint is well-founded, itself consider (at the first stage of the investigation) whether it would be appropriate to make an offer of *ex gratia* compensation. The FCA will, accordingly, consider any individual complaints to consider whether it is appropriate to make an *ex gratia* payment of compensation. Its consideration will be guided by the FCA's statement "*Complaints Scheme: our approach to remedies"* (the "**Remedies Statement"**) which concerns the circumstances in which the FCA considers it is likely to be appropriate to make such an offer. While the FCA will consider representations as to why *ex gratia* compensation ought to be paid in circumstances not provided for by the Remedies Statement, the purpose of having such a published statement is to assist with ensuring a consistent and fair approach to proposals for compensation based on the individual features of the complaint and the FCA's culpability.

31. The Remedies Statement explains that in order for the FCA to consider it appropriate to offer an *ex gratia* payment, a complaint would be expected to provide "*evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*". As explained below, while the way this has been expressed has varied, the concept of "sole or primary" cause encapsulates the FCA's longstanding approach[9] to when it will be appropriate to offer *ex gratia* payments in recognition of financial loss.

32. The reasons for this approach are set out in the Remedies Statement itself, which explains that:

> *The FCA has legal immunity from liability to pay damages (compensation) unless it is found that we have acted in bad faith or have breached a complainant's human rights. Therefore, whilst the Scheme does include a provision for ex gratia payments, we do not award compensation or damages in the same way as a court would do.*
>
> *In some cases, a complainant may have suffered a specific inconvenience or an emotional impact, for example due to delays or poor service by the FCA. In such cases, we consider whether a payment might be appropriate to recognise their distress and inconvenience. We do not have set amounts that we award in such cases as individual complainants are affected differently depending on their specific circumstances. Typically, such payments are in the region of £25-£100. Where an impact is more severe or prolonged, a payment in the region of £100-£300 may be appropriate.*
>
> *We sometimes receive complaints from individuals seeking reimbursement of financial losses they have suffered. In many of these cases, the loss is caused by a third party, such as a regulated firm, and so we do not make any payment. The complaint made about the FCA is typically that our regulation lacked sufficient care, or failed to prevent their loss.*

9 See, for example, the decision in FCA00503 (description provided in the Commissioner's annual report for the year 19/20) where the FCA decided not to award compensation for financial loss as it was not the principal cause of the complainant's loss. The Commissioner has also declined to recommend that the FSA/FCA make compensatory payments for financial loss as the regulator was not the principal cause – see, for example, FCA00684 and FCA00398.

(2) The Group Complaint

33. We do not here set out to address every aspect of the Group Complaint, which is now before you for determination. However, we wish to address the suggestion from S&S that there are two means by which the FCA could fund the grant of *ex gratia* compensation to LC&F bondholders. The first is to use fines received from enforcement action and the second is to deplete the FCA's surplus funds. For the following reasons neither of these is appropriate.

34. The first proposal would be unlawful.

    (1) The FCA is required to pay its financial penalty receipts to the Treasury after deducting certain of its enforcement costs[10] (paragraph 20 of Schedule 1ZA FSMA).

    (2) Under paragraph 21 of Schedule 1ZA, the FCA must prepare and operate a scheme to ensure that the amounts relating to the deducted enforcement costs are applied to the benefit of regulated persons[11]. 'Regulated persons' are defined in sub paragraph 2 as authorised persons, recognised investment exchanges and certain types of issuers.

    (3) LC&F bondholders do not fall into any of these categories and the FCA therefore has no vires to pay this money to LC&F bondholders.

35. The second proposal proceeds on the mistaken premise that the FCA has at its disposal some £121 million of "surplus assets". This is incorrect. The sum referred to is the accounting surplus for the year. While the FCA's total assets exceed total liabilities, the cash balances are more than matched by current liabilities and the remaining total asset value in the FCA's balance sheet is in fixed assets, which are not convertible to cash.

36. For completeness, the FCA 2020/21 annual report and accounts published on 15 July 2021 reported a deficit of £55.6m for the year and a reduction in net assets to £7.7m at 31 March 2021. Consistent with 2019/20, the FCA's current liabilities more than match available cash balances at 31 March 2021 and the existing fixed assets are not convertible to cash.

10 Paragraph 20(3) of Schedule 1ZA FSMA sets out the narrow scope of what constitutes the FCA's 'enforcement costs'

11 As explained in the Financial Penalty Scheme, the FCA will apply retained penalties, received in any financial year, as a rebate to the periodic fees paid in the following financial year by certain authorised firms. See Annex 2 to PS21/7: https://www.fca.org.uk/publication/policy/ps21-7.pdf.

37. The consequence is that the FCA would not be able to make any significant compensation payments without raising significant further funds.

Yours sincerely

Charles Randell

Chair

Appendix 5

Appendix 5

Thomas.Donegan@shearman.com
[redacted]

22 October 2021

By email: complaints@frccommissioner.org.uk

Office of the Complaints Commissioner
Tower 42
25 Old Broad Street
London
EC2N 1HN

Dear Sirs

FCA/001022 - complaint against the Financial Conduct Authority ("FCA"). Comments on Preliminary Report of the Complaints Commissioner dated 5 October 2021

We refer to the above-mentioned preliminary report ("**Preliminary Report**"). We continue to act on a *pro bono* basis for our clients as referred to in our letters dated 25 June 2021 and 3 September 2021.

In the cover email with which the Preliminary Report was sent, you asked us to "provide any comments you wish to make" prior to 16 November 2021. Our clients are grateful that the Complaints Commissioner has provided them with this opportunity to review and comment on the Preliminary Report prior to a final report ("**Final Report**") being issued. This letter comprises our clients' comments on this matter, but our clients may wish to raise any particular issues with you directly and separately.

Overall, our clients are pleased and grateful that the Complaints Commissioner has accepted the main points set forth in our letters dated 25 June 2021 and 3 September 2021. Our clients do, however, have some comments on the Preliminary Report, which are made below in two Parts. In Part 1, we make five key points in relation to the Preliminary Report which we ask the Complaints Commissioner to consider carefully before issuing its Final Report. In Part 2, we include a number of more minor comments and typographical corrections and also draw

attention to where amendments would be required within the text if the Complaints Commissioner accepts any of the key points addressed in Part 1.

Part 1: Key points

1. **The Complaints Commissioner should make an explicit recommendation that the FCA removes the "*solely or primarily responsible*" test of causation in the Remedies Statement. If the Complaints Commissioner accepts that this test of causation could be retained in some form, she should make an explicit recommendation that the test should at most become a non-exhaustive example of a situation in which the FCA *will* make *ex gratia* compensation payments, but not a precondition as presently stated**

The Complaints Commissioner's preliminary report states that:

(a) the "*solely or primarily responsible*" test of causation has no basis and is "*contrary to the statutory purpose underpinning the Complaints Scheme*" (paragraph 106);

(b) the reference to the "*solely or primarily responsible*" test in the FCA's Remedies Statement dated 16 June 2020 ("Remedies Statement") was the "*first time*" this test was introduced by the FCA (paragraph 78), meaning that it does not reflect the "*historical approach*" of the FCA;

(c) that this test is "*contrary to the statutory purpose underpinning the Complaints Scheme*" (paragraph 106);

(d) the "*FCA's approach to compensation in the LCF cases is unjustified and does not stand up to scrutiny*" (paragraphs 111, 130); and

(e) the FCA's decision on compensation for LCF investors should be reconsidered (paragraph 132).

It is also noted that: "*The introduction of the ["solely or primarily responsible"] test via a Remedies Statement without the benefit of public consultation, at the time and in the circumstances in which it was introduced, tends to suggest that this may have been an attempt to introduce what amounts to a substantive change to the Scheme via the backdoor, without the proper level of fair scrutiny to which it ought to have been subject.*" (paragraph 108).

Our clients believe that it would be important for the Final Report to follow through properly on the logical consequences of the Complaints Commissioner's conclusions in this regard, in the form of a specific recommendation that the FCA amends the Remedies Statement.

Our clients would in the first instance ask that the Complaints Commissioner considers recommending that the FCA amends the Remedies Statement so as to remove any reference to the "*solely or primarily responsible*" test. Our clients believe that this would be the most

correct outcome and that which would most promote compliance with the regime established under the Financial Services Act 2012. Any retention of the test, even as an example, could be misleading or create the wrong impression for consumers.

Our clients are however concerned that the Complaints Commissioner may not be willing to go this far (based upon paragraph 106 of the Preliminary Report, which needs careful reconsideration in any event). If the Commissioner is not prepared to recommend that the "*solely or primarily responsible*" test be removed from the Remedies Statement altogether, then, in the alternative, it is critical that she at least issues a firm recommendation that the Remedies Statement be amended such that the status of the test - as presented by the FCA in the Remedies Statement as a precondition to any eligibility of any consumer for *ex gratia* compensation – should be changed. The Commissioner could consider a recommendation in the format set out in our letter dated 25 June 2021 (p. 32), i.e. that the "*solely or primarily responsible*" test be retained only as a *non-exhaustive example* of a situation in which there is a presumption that the FCA *will* pay compensation. The FCA could also be recommended to remove reference in the Remedies Statement to the "*solely or primarily responsible*" test as a *precondition* to any claim at all, as it is presently asserted in the Remedies Statement. It would then be important for the FCA also to include in the Remedies Statement other examples of situations in which it may or will pay *ex gratia* compensation, since if this becomes the only example, then that could also be misleading to consumers.

In either case, the last sentence of paragraph 106 of the Preliminary Report sits uneasily with the other conclusions of the Preliminary Report as regards the contents of the Remedies Statement. This states that: "*If the FCA does intend to maintain this test, then I would expect it to be able to clearly identify examples of cases in which the payment of substantive ex gratia payments for financial loss could qualify under the Remedies Statement*". Our clients ask that the Complaints Commissioner reconsiders and amends this sentence, so as to follow through properly on her other conclusions. Specific suggestions in this regard are set out in Part 2 of this letter.

2. **The government's 80% scheme should be referred to as a *minimum* amount of fair compensation for LC&F investors, *not a cap*; further guidance should be given in relation to how the FCA should re-take its decision on compensation**

Paragraph 131 of the Preliminary Report states that the "*cost to the FCA of making substantive ex gratia payments is likely to be substantial and would fall on business and indirectly on customers*" and that "*HMT has decided to set up a compensation scheme, which reflects the government's view of where the balance should be struck".* Our clients are concerned that whilst this paragraph seems almost to discourage any meaningful pay-outs being awarded to LC&F investors by the FCA, when the FCA reassesses its decision on compensation for LC&F investors.

We would disagree that the HMT compensation scheme reflects the government's view of the appropriate "balance to be struck", if that wording is meant to imply that it is the intention of government or Parliament that LC&F investors should not be entitled to additional amounts. Instead, our clients would contend, and ask the Complaints Commissioner to

clarify in its Final Report, that the government scheme is clearly intended to establish only a *floor* for fair compensation for LC&F investors, not a *cap*, for the following reasons:

- *The Compensation (London Capital & Finance plc and Fraud Compensation Fund) Act 2021 does not disapply the ex gratia compensation scheme under the Financial Services Act 2012.* This Act received Royal Assent on 20 October 2021.[1] If the government had intended for the FCA to make any *ex gratia* awards, the Act could have disapplied the *ex gratia* compensation scheme under the Financial Services Act 2012 to recipients of compensation under the *ad hoc* LC&F scheme. However, it does not do so. It is unclear that any such provision would have received Parliamentary support, since the overwhelming preponderance of interventions and amendments in the House of Commons and House of Lords during the Bill's progress through Parliament involved MPs and Lords arguing that the 80% level of compensation did not go far enough[2] or involved strong criticism of the FCA's conduct in its supervision and regulation of LC&F.[3]

- *The intention behind the government scheme is clearly for FCA ex gratia compensation to apply in parallel.* When the government's scheme was announced by John Glen MP in a written ministerial statement dated 17 December 2020, he noted that "*there are several ongoing, interlinked processes … seeking to recover bondholders' investments*", including that "*the FCA will consider claims for compensation from LCF bondholders through their complaints scheme, which is*

[1] See https://www.legislation.gov.uk/ukpga/2021/29/enacted.

[2] See, for example, remarks made by Peter Grant MP, that the Bill, "*does not go nearly far enough*", by Pat McFadden MP, who queried, "*why has compensation been set at 80% of the Financial Services Compensation Scheme maximum of £86,000, not the full level?*" and by James Grundy MP, who argued "*there is a case to be made that the Government scheme ought to provide the same level of compensation as the Financial Services Compensation Scheme, namely 100% of loss capped at £85,000 instead of the current £68,000.*" (Hansard HC Deb. vol 701, cols 313-335, 22 September 2021: https://hansard.parliament.uk/commons/2021-09-22/debates/480AFB46-A34A-4BD7-A9DB-405971E2DE37/Compensation(LondonCapitalAndFinancePlcAndFraudCompensationFund)Bill). In the House of Lords, Baroness Kramer queried why, in view of Dame Gloster's unqualified condemnation of the FCA, compensation is subject to the 80% cap. She also pointed out the confusing discrepancy between pensioners in defined benefit schemes, who will receive more or less 100% of their investment back through their pension protection fund, and pensioners in defined contribution schemes who will receive just 80% of their investment, up to the £68,000 maximum. Baroness Bennett of Manor Castle argued that given the LC&F scandal was the result of a government failure and investors incurred losses through no fault of their own, investors should be entitled to be full compensation. Lord Sikka illustrated the litany of failures committed by the FCA in recent years and highlighted the lack of any penalty levied on the FCA for its negligence. (Hansard HL Deb. vol 815, cols 51-71, 19 October 2021: https://hansard.parliament.uk/lords/2021-10-19/debates/5CB014B3-4AF7-4B6B-A7A1-6A4EE06F68D1/Compensation(LondonCapitalAndFinancePlcAndFraudCompensationFund)Bill).

[3] Peter Grant MP referred to the "*catalogue of regulatory failures*" surrounding LC&F and Gareth Thomas MP proposed "*a need for another body to keep oversight of the quality of financial regulation, and perhaps in particular over whether the FCA continues to do its job properly in the future*" (Hansard HC Deb. vol 701, cols 313-335, 22 September 2021: https://hansard.parliament.uk/commons/2021-09-22/debates/480AFB46-A34A-4BD7-A9DB-405971E2DE37/Compensation(LondonCapitalAndFinancePlcAndFraudCompensationFund)Bill).

available to bondholders who believe they have suffered financial loss as a result of actions or inactions of the FCA". There was clearly therefore no intention for the government scheme to displace or disapply the FCA complaints scheme. In its most recent report, the House of Commons Treasury Committee discussed the government's compensation scheme and made clear that it expected compensation under the FCA's complaints scheme to be available alongside the government scheme, observing, "*there are other ongoing discussions and channels by which LCF bondholders can seek compensation, such as through the FCA complaints scheme* […] *The Treasury and the FCA should ensure that these discussions and channels are coordinated to the best extent possible, in order to prevent any detriment to consumers*."[4] The Act provides for payments to be made by the Treasury to compensate LC&F investors, but makes no mention of this being in full and final settlement of claims or in place of compensation from any other bodies.

- *Many LC&F investors have actually been paid out in full under FSCS rules*. As referred to in paragraph 37 of the Preliminary Report, the FSCS has paid out £57m in compensation to LC&F investors, at 100% of principal, capped at £85,000, a higher rate of return than the 80% return available under the government's *ad hoc* scheme. The government's *ad hoc* scheme does not seek to recover those funds, but rather to level up (in part) the discrepancies between the binary and stark LC&F investor outcomes resulting from the FSCS's process. Many LC&F investors (whether or not they have now been compensated by FSCS) will have been taken in by LC&F's misleading advertising and promotional materials, duped by LC&F's call staff and fooled by the "halo effect", which the Complaints Commissioner rightly highlighted in the Preliminary Report, but not all have been compensated by the FSCS.

- *The FCA is paying out ex gratia compensation to LC&F investors*. That the FCA has already paid out small amounts to many investors in respect of delays on the handling of their complaints, and also for "direct communication" investors, is a clear indication that neither the FCA nor the government intend the 80% scheme to be a maximum entitlement.

- *If there is any upper limit on LC&F investor compensation, then the Complaints Commissioner should consider whether the amounts available under the FSCS scheme would not be a more appropriate point of reference.* In paragraph 2.5 of the FCA board minutes dated 16 April 2021, the FCA introduced a principle "*that [LC&F] investors should not be overcompensated, and they should not receive in total more than Financial Services Compensation Scheme (FSCS) limit of £85K from all sources*". The Complaints Commissioner does not comment upon this aspect of the FCA's *ex gratia* award decision. If the Complaints Commissioner is to give any guidance as to quantum, then it should consider and comment upon whether this is an

[4] House of Commons Treasury Committee, The Financial Conduct Authority's Regulation of London Capital & Finance plc: Fourth Report of Session 2021-22, Para 159 (https://committees.parliament.uk/publications/6397/documents/70132/default/).

appropriate measure for the maximum amount that an investor might expect to receive across all compensation schemes taken together, based on the public sector equality duty, which is discussed in paragraph 110(vii) of the Preliminary Report. In our clients' view, in some cases, there may be cause for higher pay-outs to be made in some circumstances to some LC&F investors. However, the FSCS limit would be a more reasonable benchmark or point of reference than the 80% of £85,000 benchmark. Moreover, the FSCS limit is one that was already adopted by the FCA in its original decision. In making these remarks, our clients would like to highlight that the wording of "over-compensation" as used by the FCA caused much anger among LC&F investors and is insensitive in light of the devastating effect that the LC&F scandal has had on their savings, not least given the FCA's culpability in this situation.

3. **The scope of the Preliminary Report is surprisingly narrow, considering the broader nature of complaints that have been submitted to the FCA, several of which were deferred by the FCA and do not feature in the Preliminary Report**

A broader range of complaints have been submitted to the FCA than those covered in the Preliminary Report. Our clients were surprised to see such a narrow range of issues being considered (i.e. Allegations One to Ten, as detailed in paragraphs 45-46 *et seq*). In a letter dated 29 August 2019 (Annex 3) (together with a letter dated 24 June 2019 (Annex 1), a letter dated 17 July 2020 (Annex 5), and responses by the FCA on 3 July 2019 (Annex 2) and 22 June 2020, (Annex 4)), we made various complaints to the FCA on behalf of one of our clients, concerning the FCA's response to the LC&F scandal. Only one of these complaints has been decided upon by the FCA and none of them are addressed in the Preliminary Report. As you will be aware, the FCA started processing complaints of FCA investors on 19 April 2021 and stated that it anticipated being able to provide a response to complainants by the end of June 2021.[5] However, no response was received to our client's wide-ranging complaints until an email was received from the FCA dated 24 September 2021 (Annex 6), in which the FCA invited our client to drop the complaints. Our client has written to the FCA today to press these complaints and a copy of that letter is being provided to the Complaints Commissioner (Annex 7).

The six complaints in question are as follows:

1. Part One - You disagree with the FCA's decision to label LCF's products as "mini-bonds".

2. Part Two - You disagree with the FCA's statement that "LCF's Bond Instruments made clear that its bonds were not transferable".

3. Part Three - You consider that the conclusions and directions in the FCA's Supervisory Notice "are back-to-front, in giving precedence to the LCF

[5] https://www.fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints.

documentation concerning non-transferability instead of giving precedence to the status of LCF bonds at the point of sale or issuance as an ISA product issued by an approved ISA provider. Those provisions of the documentation which afford transferability must prevail as a matter of contract law and not those provisions that prejudice consumers. Provisions asserting non-transferability must be regarded as invalid under the Consumer Rights Act 2015".

4. [Part Four - No longer being pressed.]

5. Part Five – You consider that the FCA's guidance on "mini-bonds" as issued on 17 May 2019 was inaccurate in stating unequivocally that issuance of such products is always unregulated.

6. Part Six - You are concerned that the FCA has repeatedly taken positions which are opposed to the interests of LC&F bondholders.

We would note that in the judicial review case *R (Donegan and others) v Financial Services Compensation Scheme* [2021] EWHC 760 (Admin), the position taken by the FCA on Parts Two and Three of this complaint were resoundingly rejected by the Court, implying failures by the FCA in its capacity as an unfair terms regulator under the Consumer Rights Act 2015, both during its authorisation and supervision of LC&F and in the FCA's response to the scandal. These matters were not considered in detail by the Gloster Report. If the Complaints Commissioner is able to encourage or procure the FCA's prompt response to these open complaints and consider any appeal on any of them which are not upheld, then this would result in its Final Report being more complete and the FCA's position on *ex gratia* payments not needing to be reconsidered again.

For completeness, we note that our client is also pressing for further compensation in respect of the unacceptable delays in the processing of these complaints.

If the Complaints Commissioner is unable to include these complaints, then we would ask that it should refer to them as being outstanding matters which will need to be considered further and which could result in further findings against the FCA which have an effect on the total amount of *ex gratia* compensation for LC&F investors.

4. Certain references to LC&F products as "mini-bonds" in the Preliminary Report should be reconsidered

The Complaints Commissioner makes various references to "mini-bonds" in the Preliminary Report, which may be regarded as inaccurate or insensitive by LC&F investors. It is important that the Complaints Commissioner be aware of the contents of LC&F marketing documentation, the relative timings of LC&F's falling into administration and the timing of the FCA's guidance on "mini-bonds". Our clients would also like to emphasise the universal strength of feeling among LC&F investors as regards the inappropriate "development" by the

FCA of the "mini-bond" category after LC&F had fallen into administration and the misapplication of this term by the FCA to LC&F investments.

LC&F's bonds were not sold as "mini-bonds". Advertising materials described LC&F bonds variously as "corporate bonds", "fixed interest corporate bonds", "fixed rate corporate bonds", "fixed interest bonds" and "fixed rate ISAs". The information memoranda described LC&F's products as, "bonds", "growth bonds", "fixed interest corporate bonds", "income bonds" and "ISA bonds". The term "mini-bond" does not appear in any of the 12 LC&F information memoranda made available to us (which run to a total of 436 pages) or any of the bond instruments or public advertising of LC&F. The words "*mini-bonds*" did appear *once* only in *some* of the brochures provided to investors for *some* of the bond series. These were in each case single appearances in the small print, within reams of promotional and contractual material. In each case, the wording was used within text paragraphs without any emphasis and the term "*mini-bond*" is described only as a "*type of loan to a company*", with no reference to non-transfer provisions or the consequences in terms of the regulatory regime.

LC&F went into administration on 30 January 2019. The FCA first issued public guidance using the term " mini-bond" and drawing attention to the risks of such products on 17 May 2019, over three months later. In the Gloster Report, Dame Elizabeth stated that, "*a common theme in the correspondence received by the Investigation from Bondholders is that they did not consider that they were investing in mini-bonds. Accordingly, this Report avoids the use of the term mini-bond unless absolutely necessary.*" (Ch 1, FN7, p. 2 of the Gloster Report). We would invite the Complaints Commissioner to adopt the same language and approach. Specific suggestions in this regard are set out in Part 2 of this letter.

5. The need for an executive summary

Despite the Preliminary Report arguably reaching an overall favourable outcome for LC&F investors, the Complaints Commissioner should be aware that some LC&F investors have posted negative comments on Facebook groups concerning their impression from the Preliminary Report. We suspect, from what has been written, that some LC&F investors will only have read the start of the Preliminary Report, in particular noting the Complaints Commissioner's overall broad agreement with the FCA as to whether the various grounds of complaint should be upheld or may have focused on the excusal of Mr Andrew Bailey.

Given the vulnerable nature of the LC&F investor base (as, we think, with respect, was appropriately recognised by the Complaints Commissioner at paragraph 11) and the false impression that some have already taken from the Preliminary Report, it would in our clients' view be very helpful to include a digestible executive summary in the Final Report in simple terms. This would allow LC&F investors who are less familiar with the Financial Services Act 2012 regime to understand the Final Report's conclusions and implications.

In addition to dealing with the specific complaints before the Complaints Commissioner and its recommendations, we would suggest that any such summary would also helpfully explain briefly what the FCA *ex gratia* compensation regime involves, what the FCA's decision was,

and some context as to how the FCA *ex gratia* regime and Complaints Commissioner's recommendations sit alongside the FSCS and the government's 80% *ad hoc* scheme.

Appendix 6

Appendix 6

THE FINANCIAL CONDUCT AUTHORITY

RE: London Capital & Finance Plc

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16 November 2021 – FCA Response to the Complaints Commissioner's Preliminary Report on LCF Complaints

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1. Thank you for the opportunity to provide comments on your Preliminary Report ("**PR**") dated 5 October 2021 in respect of complaints concerning the FCA's Regulation of London Capital & Finance Plc ("**LCF"**), the FCA's approach to the award of *ex gratia* compensation to LCF bondholders, and the FCA's complaints handling process.

2. We recognise the strength of feeling around the collapse of LCF and the devastating impact on the lives of many people. We repeat our apology for the mistakes we made in our regulation of the firm.

3. We have carefully considered your comments and have set out our response below in three sections corresponding to your report (The FCA's Regulation of LCF, Ex Gratia Compensation, and Complaint Handling). In summary, we intend to accept the following recommendations if they are included in the Final Report ("**FR**"):

   (1) To keep you informed of the progress of the programme to implement Dame Elizabeth Gloster's recommendations for the FCA, all of which we have accepted;

   (2) That it would have been best practice to directly inform complainants when the Gloster Report was delayed both in May and August 2020; and

   (3) That we explain our calculation of *ex gratia* payments for the delays in handling LCF complaints, including the levels of payments applied. We note that our response to your PR will be published alongside your FR, so the approach we have taken in this case, along with the levels of *ex gratia* payments we have made, will be publicly available.

4. There are two recommendations which we do not agree with, and we would ask that you take our comments into account in considering your FR:

(1) While we have considered carefully your comments on the 'test' we have adopted regarding *ex gratia* compensation for our handling of LCF, we consider our approach remains appropriate and have provided our justification below.

(2) For the reasons set out below, we consider that the FCA's decision not to uphold allegation 5 about the FCA Register is appropriate.

5. Attached to this letter are 5 annexes, which include our previous correspondence relevant to this case and which are referred to below in our detailed response.

(1) Annex 1: Our letter to you dated 9 August 2021 from Charles Randell.

(2) Annex 2: Our letter to Shearman & Sterling dated 27 April 2021.

(3) Annex 3: Examples of where we have made statements about investment risks and scams.

(4) Annex 4: Case examples of how we have calculated *ex gratia* payments for the delay in handling LCF complaints.

(5) Annex 5: Factual accuracy points.

The FCA's Regulation of LCF

6. We welcome your conclusions in relation to the allegations 1-4 and 6-10, and do not have any comments to make in respect of these.

7. We have considered your analysis of allegation 5, which contends that information about LCF on the Financial Services Register (the "**Register**") was misleading, alongside your recommendation that the FCA uphold this allegation. We understand that your concern is that investors may have concluded that they were investing in a safe product because LCF held an FCA authorisation, and the Register itself did not at that time contain a warning regarding the risks associated with unregulated products such as mini-bonds. This is because you consider that LCF's inclusion on the Register would be seen as a badge of respectability by investors (referred to by Dame Elizabeth Gloster as the 'halo effect' in her Report), and that the information contained in the Register was not presented in a sufficiently intelligible way.

8. We have carefully reflected on your conclusion and reasoning but do not agree with your recommendation in respect of allegation 5, and would request that you take into account the points below in preparing your FR.

(1) The starting point is that the FCA is under a statutory obligation to produce the Register. This is because section 347 of the Financial Services and Markets Act 2000 ("**FSMA"**) requires that the FCA maintain a record of, among other things, every person who appears to the FCA to be an authorised person and to make the record available for inspection by members of the public in a legible form at such times and in such place or places as the FCA may determine.

(2) The FCA complied with this obligation in respect of LCF. We reached the conclusion that the Register was not inaccurate or misleading after reviewing what the Register would have looked like at the relevant time as well as our records in relation to LCF.

(3) The fact that LCF (in common with a large number of authorised firms) <u>also</u> undertook unregulated activities does not mean that the information provided on the Register was misleading. In this regard, it is important to bear in mind what the Register is and is not intended to do. In particular, while the Register is an important source of information, it is <u>not</u> designed to be the sole source of information for investors before making investment decisions, nor does it give any warranty about the security or performance of an investment.

(4) It is not the case, however, that no warnings and additional safeguards were provided. The rules that the FCA put in place in 2014 covering the promotion[1] of 'non-readily realisable securities' (NRRS), which covers most minibonds, meant that firms were only permitted to promote NRRS to retail clients who were certified as sophisticated investors, high net worth investors or 'restricted investors' (i.e. those who had confirmed they will limit their investment in NRRS to 10% of their net investible assets). Investors in any of these categories were (and are) also required by our rules to acknowledge a warning that '*the investments to which the*

[1] These rules apply to 'direct offer' financial promotions (e.g. where the consumer is offered an investment opportunity along with a method enabling them to proceed with the investment).

promotion will relate may expose [the consumer] to a significant risk of losing all of the money or other property invested'.

(5) In your PR at paragraph 55 you mention that *'…there were no warnings displayed regarding the risks associated with unregulated products such as mini-bonds…'* In our decision letters to complainants, we explained that in March 2021 a warning was added to each firm on the Register to increase clarity[2]. We are aware, however, that despite this warning, the 'halo effect' will continue to pose an unavoidable challenge so long as the legislative framework permits firms to carry on both regulated and unregulated activities. Firms or individuals are not required to inform the FCA if they are carrying out unregulated activities, nor would it be practicable to provide specific warnings about what is or is not covered on each individual entry on the Register in respect of all the unregulated activities a firm carries on. We also note there are cases where investors contacted the FCA prior to investing in LCF, received the right information regarding the level of protection they could expect to receive, and still went onto invest.

(6) Relatedly, there is an important distinction between the fact of the firm being authorised giving a false sense of security (the 'halo effect') and the suggestion that the Register was misleading. We do not believe that in correctly presenting information the Register is legally required to contain, namely the information as to the services which an authorised person is able to provide and any address where a notice or other document may be served, the Register could be described as misleading.

For these reasons, we do not consider the information about LCF on the Register was inaccurate or misleading.

9. We also note your comments about the Chair of the FCA, Charles Randell, giving a speech in 2019 about the risks of placing all of your investments in one basket. We would

[2] The warning currently reads "*Firms we regulate may also carry out activities that are not regulated by either the FCA or the Prudential Regulation Authority (PRA). Complaints or claims about these unregulated activities may not be covered by the Financial Ombudsman Service (FOS) or the Financial Services Compensation Scheme (FSCS). If you are unsure whether an activity undertaken by a firm is regulated by us or the PRA, then you should ask the firm to confirm in writing what protections will be available to you if you need to make a complaint or claim compensation*"

like to highlight that the FCA has on a number of previous occasions warned of investment risks before this statement in 2019. We have provided examples of where we have issued warnings about investment risks and scams in Annex 3.

10. In this section of your PR, you make a recommendation that we keep you informed of our progress in implementing the recommendations of the Gloster Report. We restate our commitment to provide regular public updates and to share these updates with you as well as meeting with you to discuss our progress after each such publication. Our most recent update was provided in July 2021: https://www.fca.org.uk/publication/corporate/implementing-recommendations-independent-reviews-update.pdf. Our next update is scheduled for December 2021 and we will share this with you.

Ex-Gratia Compensation

11. We turn next to your recommendations that the FCA reconsider its approach to the award of *ex gratia* compensation, provide adequate justification for the approach adopted, and that the FCA then reconsider complaints in line with this new approach.

12. Here, we understand that your concerns relate both to the application of the FCA's statement '*Complaints Scheme: our approach to remedies*', published on 16 June 2020 (the "**Remedies Statement**") and to the approach which the FCA has adopted in the specific circumstances of LCF, which you consider to be flawed for the reasons set out at paragraphs 109 to 111 of your PR. We take each in turn.

The Remedies Statement

13. We do not agree that the Remedies Statement introduces a new 'test'. We have explained the origin of, and reasons for, the Remedies Statement in our previous correspondence[3]. In our response to a Final Report from the Commissioner published on 16 June 2020 (ref: FCA00684)[4], we explained that we were publishing the statement to set out *'further*

[3] See our letter of 27 April 2021 at paragraphs 6 to 8 (sent to Shearman & Sterling LLP, and copied to you), and our letter to you of 9 August 2021 at paragraphs 30 to 32

4 https://frccommissioner.org.uk/wp-content/uploads/FCA00684-Issued-27-May-2020.-Published-16-June-2020.pdf (This footnote was updated on 3 February 2022 following a request from the Office for the Complaints Commissioner to ensure the anonymity of the complainant in this case.)

clarification on the remedies offered under the Scheme including how we assess whether an ex gratia payment should be awarded'[5].

14. As we explained in our letter of 9 August 2021, while the way this approach has been described by the FCA and Commissioners in previous decisions has varied (e.g. using language such as 'directly caused' or 'principal cause'), the intention and effect is the same. The concept of "sole or primary" cause therefore encapsulates the FCA's longstanding approach to when we have generally considered it to be appropriate to offer *ex gratia* payments in recognition of financial loss, in light of the terms of the Complaints Scheme and the statutory framework in which the FCA operates.

15. You suggest in your report we have not provided support "for the alleged practice of making *ex gratia* payments only when the FCA is the sole or principal cause of the loss". This is not correct. The application of this general approach by the FCA can be seen in the three examples we set out in our letter of 9 August 2021 at paragraph 31 (see footnote 9 of that letter)[6]. For the avoidance of doubt, we have set out below further details of where FCA has decided not to make *ex gratia* compensatory payments for this reason:

    (1) On 7 September 2016 the Commissioner recommended that the FCA pay £5,839 compensation for loss of business as the Commissioner considered that a firm's suspension as an Appointed Representative was displayed in a misleading way on the Register which could have had a broader impact. The FCA did not accept this recommendation.

    (2) On 30 January 2018 in upholding a complaint that the FCA had not followed its processes in considering whether to issue a warning about a clone firm, the FCA declined to offer compensation on the basis that the process failing did not render the FCA liable for losses ultimately caused by fraudsters (ref: 205665280 (stage 1 decision)). The Commissioner recommended that we pay compensation in two other complaints about the same clone firm because the Register had not been updated promptly (ref: FCA00503 (referred to in footnote 9 of our letter of 9

[5] https://www.fca.org.uk/publication/corporate/response-complaint-commissioner-report-fca00684.pdf

[6] We note that our letter of 9 August also highlighted that the original consultation for the complaints scheme (CP93) stated that "*compensatory payments would be unlikely to be appropriate for consumers who may complain that the Authority could and should have acted to prevent the failure of a regulated firm"*

August 2021) and FCA00631). In both cases the FCA declined to follow the recommendation as this was not the cause of their losses.

(3) On 4 December 2019, the FCA upheld a complaint because an entry on the Register had not been updated following a notification. The Complainant requested compensation for investing in a clone of the passporting firm. The FCA declined to pay compensation at stage 1 on the basis that it was the dishonest actions of the clone firm which were the direct cause of the loss and the complainant did not carry out adequate due diligence before investing. The Commissioner agreed that the principal responsibility lay not with the FCA but recommended a contribution of 5% of the lost investment on the basis that the clerical error on the Register could have increased the risk of this series of events happening. The FCA did not accept the recommendation to make a contribution towards the financial loss because it was not the direct cause of the loss. (Ref FCA00650).

(4) On 28 June 2019 the FCA upheld a complaint about the failure of the FSA to investigate misleading statements in the accounts of the Cooperative Bank in 2013. The FCA did not make an ex-gratia monetary award because the failure to review the accounts and Capital Adequacy Statement in good time was not the 'direct cause' of the complainant's losses, and because the responsibility for the misleading statements lay with the Bank's directors and the auditors (ref: FCA00641).

16. The long-standing practice under the Scheme of not (in general) paying compensation for financial loss when the regulator is not the direct or principal cause has also been noted by previous Commissioners. For example:

(1) In November 2017, in case FCA00398 (referred to in Footnote 9 of our letter of 9 August 2021), the Commissioner providing a specific response to a question raised by a solicitor representing the complainant, commented: "I should say that even if I had found evidence that the FCA had failed in its duties (which I have not), the FCA is protected from claims for damages (with a few exceptions), and in any event it seems clear to me that the principal cause of your clients' losses was the actions of the firm (which may in turn have been cause [sic] by external events). In those circumstances, the question of a payment by the FCA does not arise."

(2) The Commissioner's Annual Report for 2019/20 noted as follows "out of the 37 remedies identified, the FCA did not accept 3 and accepted one partially. Two were related to losses the complainant had incurred in part due to the FCA register being inaccurate. In these cases, the Commissioner recommended the FCA offer a substantial ex-gratia payment to the complainants which the FCA did not accept on the grounds that the principal cause of the loss was a scam." (emphasis added).

17. It is also important to bear in mind that as the Remedies Statement is a statement of the FCA's general approach, the FCA remains willing to depart (and has in the past departed) from this approach where it considers this to be justified, and it is not therefore a 'bright line' test. Indeed, the FCA has departed from this approach in this case by (exceptionally) making an offer of compensation to those bondholders who were directly and individually provided with incorrect or misleading information by the FCA.

18. The PR further suggests that the approach the FCA has adopted is so narrow as to exclude all or almost all *ex gratia* payments for financial loss, which is contrary to the purpose of the Scheme. Again, we do not consider this is correct, as it is not the case that the FCA's approach has the consequence of no payments for financial loss being made to any complainant. By way of example the FCA has made payments in the following cases where it accepted it was the sole or primary cause of the loss:

(1) In 2015 the FCA paid complainants compensation for losses they incurred due to the FCA's pre-briefing of its business plan, causing a reduction in the share price of a number of insurers. The amount paid to complainants was the loss we calculated between the previous day's closing figure and the price sold at on that day.

(2) In 2016 the FCA paid a complainant compensation after the FCA's Authorisations Division incorrectly advised a firm with interim permission that they could not trade. This error was not corrected for six weeks, during which time the complainant stopped trading. The payment was to represent the lost profits within that period that the complainant was able to evidence.

(3) In 2015 the FCA paid compensation to a complainant company who alleged a loss of business because the FCA had erroneously listed the company on the FCA's

'warnings' webpage, indicating the firm was unregulated (when it was a genuine firm).

19. The FCA is therefore of the view that, for the reasons previously explained, the approach set out in the Remedies Statement remains the appropriate general approach to the award of *ex gratia* compensation under the Scheme.

What is appropriate in the case of LCF bondholders?

20. We turn next to your concerns regarding the approach which the FCA has adopted in the specific circumstances of LCF, and in particular the matters set out at paragraphs 109 to 111 of your PR. We address the particular concerns you have identified below, but we have also stepped back and reconsidered the matter in the round.

21. Having done so, we remain of the view that the appropriate approach to the award of compensation to affected bondholders remains that set out in the FCA's published statement of 19 April 2021 (the "**LCF Compensation Statement**"). In reaching this conclusion, we have considered your reasons for urging a different approach, and respond as follows (we have summarised our understanding of your comments below, followed by our response):

The Gloster Report noted a wide number of failings on the part of the FCA and none of these are given "specific consideration" (Paragraph reference 109 (i)).

(1) We have had regard to the findings of the Gloster Report and we have responded to each of the 10 'standard' allegations which align to the failings in the Gloster Report. As you rightly acknowledge at paragraph 10, our "*investigation was extensive and thorough and resulted in a further comprehensive analysis of the facts relating to its oversight of LCF*." We have explained our conclusions in relation to the accuracy of the Register above.

The Gloster Report placed emphasis on the 'halo effect' of FCA authorisation and the distinction between reliance by consumers upon direct communications with the FCA and reliance by consumers upon the 'halo effect' is not clear (Paragraph reference 109 (ii) & (iv)).

(2) In our view there is an important difference between cases where an investor consulted the Register and received accurate information about LCF's

authorisation and cases where an investor contacted the FCA and was given incorrect information and was therefore misled[7].

(3) This difference is a significant one given the factors set out in paragraph 7.14 of the Complaints Scheme. In particular, paragraph 7.14(b) of the Complaints Scheme states that the regulator ought normally to take into account "*the nature of the relevant regulator (s) relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s).*" The cohort of investors who contacted the FCA prior to investing in LCF and were given incorrect information about the level of protection for an investment in LCF is in a different category from those investors who merely consulted the Register or were otherwise subject to the 'Halo effect'. For those investors to whom we gave 'false reassurance', for example, by informing them that their investment was protected by the Financial Services Compensation Scheme (FSCS), the 'false reassurance' may have added some weight in their decision making.

(4) As noted above, the risk that consumers may be influenced by the 'Halo effect' is present for many firms regulated by the FCA who (as they are legally entitled to do) undertake both regulated and unregulated activities. This is a feature of the legislative framework which is not within the FCA's control.

The analysis of each of the factors at paragraph 7.14 of the Complaints Scheme is brief and inadequate (Paragraph reference 109 (iii) and (iv)).

(5) We acknowledge that our decision letters to complainants contained a reasonably brief explanation of our reasoning as to why we are not making compensatory payments by reference to paragraph 7.14 of the Scheme. However, we considered that the gist of our reasoning was adequately provided in circumstances where the decision letters were already lengthy and must go through each allegation in detail. The reasoning in the decision letters therefore aimed to strike a balance between providing sufficient information to explain our approach, and not overloading the

[7] We note that the FSA has also previously paid an *ex gratia* compensatory payment to a complainant where the consumer contact centre provided incorrect information regarding the FSCS which was relied on by an investor (ref FSA 01616)

complainant with information. Our letter to Shearman & Sterling LLP of 27 April 2021 (copied to you) explained in more detail our approach to applying paragraph 7.14 of the Scheme to LCF complaints (see paragraphs 24 to 27).

(6) We also note your more general comments on the factors set out at paragraph 7.14 of the Scheme, including that they are "general and high level". As you are aware from our 9 August 2021 letter, these factors were the subject of detailed consultation and have formed part of the Scheme since 2001. In these circumstances we consider that it would be wrong to criticise the FCA for having regard to them.

It is not clear where FCA draws the distinction between operational and administrative failures, what happens when failures are both operational and administrative, and which of operational or administrative failures is regarded as stronger justification for a compensatory payment (Paragraph reference 109 (iii)).

The FCA relies upon the need to allocate its resources, despite the Gloster Report clearly rejecting this as a reason for the FCA's failings (Paragraph 109 (v)).

(7) The original consultation in November 2000 (CP73)[8] on revising the Complaints Scheme expanded on the meaning of paragraph 7.14(c) (operational and administrative failures) as follows "*whether what has gone wrong is at the operational or administrative level (rather than in relation to matters of policy or where the FSA's actions have necessarily had to reflect a balancing of conflicting interests and complex issues)"*. In our view the purpose of this factor is to distinguish between cases where there were operational or administrative failures (where it may be more appropriate to offer compensatory payments) and cases where we have exercised our regulatory discretion to balance conflicting interests and complex issues (where it may be less appropriate to offer compensatory payments).

(8) While there were clearly a number of operational errors in respect of our regulation of LCF (for which the FCA has apologised), the FCA's overall approach must be viewed in light of the fact that it had to make complex judgments around where to

[8] https://webarchive.nationalarchives.gov.uk/ukgwa/20081113045726/http:/www.fsa.gov.uk/pubs/cp/cp73.pdf

prioritise its resources. While Dame Elizabeth Gloster did not consider this excused the FCA's failings, we remain of the view that this is a relevant factor to take into account when determining who ought to be offered compensation.

The FCA does not give fair consideration to the Gloster Report's view about its causative role. Rather, it wrongly relies upon the Government's view that it has not seen evidence that would indicate that regulatory failings at the FCA were the primary cause of the losses incurred by LCF bondholders (Paragraph reference 109 (vi)).

(9) We have had regard to the Gloster Report's comments on causation (and the limitations of those comments). In particular, the Gloster Report made clear that the investigation had neither considered nor determined whether there was a "*causal link between the deficiencies in the FCA's regulation of LCF during the Relevant Period and the losses incurred during that period by Bondholders, either as a class, a series of classes or individually*." This was because "*specific evidence, which the Investigation has not considered, would be necessary to determine those types of causation issues."*

(10) However, we accept that Dame Elizabeth Gloster did not exclude the possibility that a different course of action by the FCA might have prevented LCF from receiving the volume of investments in its bond programmes that it did. It is an inevitable feature of a system of risk-based regulation that consumers will be exposed to a greater or lesser amount of risk in respect of any particular area depending on the choices made by regulators. What regulators must do is to exercise their judgement as to where to focus resources and to what extent. In this case, the FCA has accepted that, with hindsight, better judgements could have been made. However, these are the types of judgements which Parliament has tasked the FCA with making in good faith, and for which it has specifically excluded liability. There has not been (and cannot be) any suggestion that the FCA acted in bad faith.

(11) We also acknowledge that, had different decisions been made during the Relevant Period, the errors the FCA made in its handling of LCF may not have happened. However, this does not translate into a general entitlement to compensation via the Scheme. We have carefully considered the extent to which the FCA might be said to have caused loss to the LCF investors and have concluded that the FCA was not

the sole or primary cause of such loss. We also note there are ongoing FCA Enforcement and Serious Fraud Office investigations into the sale of mini-bonds and ISA bonds by LCF. We have nevertheless considered it appropriate to make *ex gratia* payments to those investors who received false reassurance in direct dealings with the FCA.

(12) Ultimately, while the regulatory failings identified in the Gloster Report raise questions as to whether the FCA could have intervened at an earlier stage, this does not alter the fact that the primary cause of investor losses was not the FCA. This is a conclusion which the FCA has reached itself.

The FCA's statutory objective to encourage consumer responsibility is an aspect of the FCA's consumer protection objective and a legitimate factor for the FCA to take into account in deciding its approach. However, it is perverse to single out one part of the objective and turn that against consumers to exclude the possibility of compensation in nearly every case (Paragraph reference 110 (viii)).

(13) The FCA is required by statute to have regard to the role of consumer responsibility in the context of fulfilling its consumer protection objective – see FSMA, s. 1C(2)(d). In these circumstances, we consider that it is appropriate to have regard to this factor in determining what is an appropriate degree of consumer protection. Our approach needs to be balanced across our statutory objectives, including consumer and firm responsibility. It is not the case that we have sought to "turn that against" consumers – it is an aspect which we are required to take into account alongside other consumer protection factors when determining what level of protection for consumers may be appropriate. We have reflected again on this matter and do not consider that the other elements the FCA must have regard to in considering what degree of protection for consumers may be appropriate[9], or our integrity and competition objectives, indicate that we should take a different approach to determining when *ex gratia* compensatory payments are appropriate.

The way in which the FCA has invoked the public sector equality duty (PSED) as part of its reasoning seem misconceived. The PSED should apply not only to individual cases but also

[9] See https://www.legislation.gov.uk/ukpga/2000/8/section/1C

to the overall approach that the FCA has chosen to adopt. It does not appear that the FCA gave consideration to the PSED at the stage of deciding to adopt a generic test (Paragraph reference 109 (vii)).

(14) We have considered your concerns about the manner in which the FCA complied with its obligations under section 149 of the Equality Act 2010, which imposes the Public Sector Equality Duty ("**PSED"**). An Equality Impact Assessment (EIA) was carried out before individual decisions were made, and we remain of the view that it was appropriate to consider equality considerations at the stage of individual decisions, as consideration of the individual circumstances of each complaint is the point at which it is most likely that the impact of any protected characteristics could be determined. In this case, our case handlers took into account any specific factors that were raised or identified relating to the complainant which might have had equality implications. These factors were also noted in our assurance processes. However, we take our obligations under the PSED seriously and in light of your concerns, the FCA Board considered a further EIA at the time it confirmed the continued appropriateness of the approach set out in the LCF Compensation Statement.

Wider implications

22. In preparing your FR we also ask that you take into account the wider implications of an approach to *ex gratia* compensation which would generally lead to the FCA paying compensation where it is not the primary cause of the loss. As we have noted previously, the FCA regulates around 51,000 firms. Unfortunately, there will be times where different judgments could have been made, and mistakes will happen. To expect the regulators to act as an insurer of last resort in such circumstances is not, in our view, the purpose of the scheme[10]. We note, however, that it is open to the Government to determine that individuals should be compensated on a broader basis, outside of the Scheme, as has occurred in respect of LCF.

23. In the case of LCF the implications are all the more concerning as the losses arose from unregulated activities. Recommending that the FCA pay compensation in such

[10] Charles Randell's letters of 2 December 2020 and 9 August 2021 set out further background on the origins of the Complaints Scheme.

circumstances would expand the FCA's potential costs (which would be passed on to regulated firms, and ultimately to consumers), and further undermine the statutory framework that has been put in place by Parliament.

Complaint handling

24. You have recommended that the FCA explain the approach to calculating *ex gratia* payments for complaint handling delays. We agree that we could explain this to you in more detail.

25. We have previously provided to you the internal guide used for calculations of *ex gratia* payments for delays in our complaints handling. In the context of LCF complaints, each case was assessed on its own merits, taking into account any delays and service issues. Complaints were made at different times and the level of FCA service varied depending on when they were received. For example, complaints received between July and September 2020, took longer to acknowledge and defer than complaints received in March and April 2019. Therefore, although the complaints we received in March and April 2019 were older, investors who complained in July to September 2020 are likely to have received higher *ex-gratia* payments. We have provided some examples in Annex 4 to illustrate this.

26. We used a calculator for every case which calculated (a) the number of days between the receipt of the complaint and the date of deferral, and then (b) the number of days between the publication of the Gloster report[11] and the date of the stage 1 decision letter. The total of (a) and (b) is the time used to calculate the minimum *ex-gratia* payment. The appropriate minimum *ex-gratia* amount was then determined by reference to an internal guide (subject to adjustment depending on the particular factors in any individual case. For example, for one complainant we increased our offer from £75 to £150 because we failed to respond adequately and promptly to their communications with us which caused additional inconvenience to this complainant). We have provided the checklist used on each case in our individual case submissions to your office.

[11] This date was selected as the point at which the complaints were no longer deferred. This was in the complainants' favour as it is worth noting that we were required to assess at that time (post publication of the Gloster Report) whether we could review LCF complaints without prejudicing the ongoing Enforcement and SFO investigations.

27. You have also recommended that the FCA publish on the website the internal guide for *ex-gratia* payments for complaint handling delays. We have detailed the approach we have taken for LCF complainants above and are aware that you plan to publish our response to your PR alongside your FR, so believe this sufficiently covers this recommendation. We do not propose that we add these levels of information to our external website.

28. Although complaints were deferred because of both the Gloster Review and the FCA Enforcement and SFO investigations into LCF, we accept that it would have been best practice to have directly informed complainants about the progress of the Gloster Report and accept your recommendation in this regard. Therefore, where there are similar circumstances in the future we will consider a proactive communications approach.

Conclusion

29. We consider our explanation above adequately sets out why we have taken the approach we have in this case.

30. As outlined in your PR, we have accepted and are in the process of implementing the recommendations from the Gloster Report and we will continue to provide you with updates on our progress.

Appendix 7

Appendix 7

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09 August 2021

cc. Thomas.Donegan@Shearman.com

Dear Amerdeep,

London Capital & Finance Plc (in administration) – Complaint from Shearman and Sterling LLP on behalf of bondholders

1. I am writing further to a letter dated 25 June 2021 (copied to me) from Shearman & Sterling LLP ("**S&S**") on behalf of certain London Capital and Finance Plc ("**LC&F**") bondholders[1] (the "**Group Complaint**"). The 25 June letter refers to a number of complaints relating to the alleged failures in the FCA's authorisation and supervision of LC&F. The letter seeks to make a formal referral to the Commissioner of these complaints for the purposes of paragraph 6.8 of the Complaints Scheme (the "**Scheme**").

2. In this letter, to which S&S is copied, I address two topics which we hope will assist your consideration of the Group Complaint.

   (1) The first is what we consider to be a fundamental and wide-reaching issue raised by the Group Complaint - the proper approach to compensation under the Scheme.

   (2) The second is the FCA's position on the means by which S&S suggest that the FCA could fund the award of further compensation to bondholders.

[1] [REDACTED]

3. These are taken in turn below, but in summary:

(1) The FCA has set out what it considers to be the proper approach to the award of compensation to affected LC&F bondholders in a statement published on the FCA's website (the "**LC&F Compensation Statement**"). As I explain in paragraphs 15-25, this approach has been applied by both the FCA and successive Complaints Commissioners since the Scheme's inception and is also consistent with the Parliamentary debates on financial services legislation and the formation of the Scheme. Put simply, the Scheme was set up to ensure that complaints could be investigated in a transparent way, and justified complaints appropriately acknowledged by the FCA; it was not set up to function as a scheme to provide substantial compensation for the loss of high risk unregulated investments through suspected fraud, as S&S seem to suggest.

(2) The FCA is unable to fund further compensatory payments to bondholders in the manner suggested by S&S. As we explain in paragraph 34, it would be unlawful for the FCA to use fines received from enforcement action to fund compensatory payments to complainants since the FCA is required under statute to pay its financial penalty receipts to the Treasury. As for the suggestion that the FCA could simply deplete its 'surplus funds', this assertion is based on a fundamental misunderstanding of the FCA's balance sheet. Therefore, contrary to what is suggested by S&S, the FCA does not have any means to fund compensation payments to bondholders without raising significant further revenue from regulated firms (see paragraphs 35-37).

(1) The approach to requests for compensation

4. The LC&F Compensation Statement reflects what the FCA considers is the appropriate general approach, having regard to the terms of the Scheme.

5. In summary, the LC&F Compensation Statement explains that, while each complaint will be considered individually, the FCA expects to offer *ex gratia* compensation to a small number of bondholders who were given incorrect information in direct communications with the FCA which may have led those bondholders to conclude their investment was safer than it was. The Statement goes on to explain that (again, subject to an individual review of each complaint)

the FCA does not expect to make *ex gratia* compensatory payments to the other complainants, but expects instead to respond by acknowledging the errors which the FCA made in relation to LC&F and reiterating its apology.

6. We set out below why this is the most appropriate approach, and at the same time address the contention in the Group Complaint that these amount to a departure either from the Scheme or past practice.

(a) The Regulatory Context

7. It is important at the outset to explain why we consider that the approach which the FCA has taken is the appropriate one in light of the statutory scheme of regulation established by (in particular) the Financial Services and Markets Act 2000 ("**FSMA"**) and the Financial Services Act 2012 ("**FSA 2012**"). By establishing this scheme, Parliament has entrusted the FCA with the task of regulating the conduct of approximately 51,000 businesses[2], while at the same time ensuring that this regulation is conducted proportionately and without imposing an undue burden on those it regulates.

8. The FCA is funded by levies imposed on those it regulates, which are ultimately passed on to consumers in the form of higher prices for products and services. The consequence is that the FCA is required to exercise judgement as to how its finite resources are best deployed, which necessarily means that it prioritises some areas over others. In some cases, hindsight will indicate that better outcomes could have been achieved if different prioritisation decisions had been made. However, Parliament has made clear that so long as those decisions were made in good faith, the FCA ought not to be liable in respect of them.

9. Furthermore, the regulatory scheme established by Parliament is one which permits investors to take risks and sets out the principle that consumers should take responsibility for their decisions. Where the regulatory scheme intends consumers to have legal recourse in respect of financial losses, it does so expressly, as it has done for example by legislating for the Financial Ombudsman Scheme ("**Ombudsman Service"**, Part XVI of FSMA) and the Financial Services Compensation Scheme ("**FSCS"**, Part XV of FSMA). Under the Ombudsman Scheme, persons who suffer loss can obtain redress on a fair and reasonable

[2] However, during the relevant period of the Gloster Report's investigation the FCA regulated up to approximately 60,000 firms.

basis, in respect of a loss suffered due to failures by a firm. The FSCS (which is established under FSMA but operates under rules made by the FCA and the Prudential Regulatory Authority) provides protection for consumers under certain circumstances , including that there is a protected type of claim and a relevant firm is unable or unlikely to be able to satisfy civil claims against it.

10. When it comes to the FCA's liability for damages for financial losses caused by its actions or inactions, Parliament has decided that the FCA should be exempt from liability in damages under paragraph 25 of Schedule 1ZA to FSMA. The exemption applies to anything done or omitted in the discharge, or purported discharge, of the FCA's functions. The exemption covers both the acts and omissions of the FCA as well as of any person who is, or is acting as, a member, officer or member of staff. This is subject only to two narrow exceptions, that is where the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998 or where the act or omission has been done in bad faith. Neither of these exceptions apply in this case.

11. This may be contrasted with Part XVI of FSMA, establishing the Ombudsman Service. Here, Parliament has expressly provided that the Ombudsman Service may, in the exercise of its compulsory jurisdiction, make awards of compensation for "loss or damage" which are payable by the firm subject to the complaint. This power is found in section 229 of FSMA, which explicitly authorises the Ombudsman Service to make a money award to compensate for (amongst other things) "financial loss". No such provision is made in respect of complaints regarding the FCA's exercise of its regulatory functions.

12. Furthermore, unlike the Ombudsman Service, the Scheme is not intended to be, in effect, an informal alternative to the Courts. Notably:

    (1) Complaints considered by the Ombudsman Service will be against the firm in question. Furthermore, the determination of the award made by the Ombudsman Service is on a 'fair and reasonable' basis. In reaching its decision, the Ombudsman Service must take account of, amongst other things, the relevant law, and if the Ombudsman Service wishes to depart from it, it must provide cogent reasons for doing so. Any failure to do so, or any arbitrary or inconsistent departure from the law is a reason for setting aside a determination: *R (Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service* [2008] Bus LR 1486 (CA). Furthermore,

where a consumer accepts a final determination by the Ombudsman Service, they are not then able to pursue a claim against the firm on the same facts for the same losses in civil proceedings, as the Ombudsman Service is a "tribunal" and its final determinations "judgments" for the purposes of the merger doctrine (whereby a claimant's rights are extinguished by a judgment of a tribunal): *Clark v In Focus Asset Management & Tax Solutions Ltd* [2014] 1 WLR 2502 (CA).

(2) In respect of complaints concerning the FCA's regulatory conduct, the position is entirely different. There can be no question (absent bad faith or violation of the Human Rights Act) of any action for damages in the Courts against the FCA. Furthermore, were a consumer to be compensated on an *ex gratia* basis by the FCA in respect of financial loss which was caused not by the FCA but by a third party, there would be no such barrier on the consumer seeking to recover from that third party.

13. As explained by your predecessors in their published decisions[3], the Complaints Scheme is not set up to consider complex questions of causation – which include considerations of remoteness, foreseeability, mitigation of losses – and such matters are more appropriately left to a Court to consider. Accordingly, while the FCA agrees that it is not necessary strictly to apply legal tests of causation, liability and quantum when considering whether to offer a compensatory payment, we consider that it is in general appropriate to limit compensation for financial loss to cases where the FCA is solely or primarily responsible for the loss.

14. It is, of course, open to the Government (from which the FCA is independent) to determine that the circumstances of a particular case are such that individuals ought to be compensated on a broader basis, outside of the Scheme. Indeed, this is what has occurred in respect of LC&F, as HM Treasury determined that it would be appropriate for bondholders to receive significant sums in compensation and is in the process of establishing a specific scheme for this purpose. Three points stand out here:

(1) First, this represents what the Government considers to be the appropriate approach to compensation having regard to the Gloster Report's criticisms

[3] See paragraph 25

of the FCA. As the Economic Secretary to the Treasury (John Glen MP) explained during the second reading debate:

(a) "*one of the central findings in Dame Elizabeth Gloster's excellent report is that because LC&F was authorised, the FCA should have considered its business holistically, including the unregulated activity of issuing mini-bonds"*; and

(b) "*Although the Government have not seen evidence to suggest that the regulatory failings at the FCA caused the losses for bondholders, they were a major factor that the Government considered when deciding to establish the scheme.*"

(2) Secondly, this could not be accomplished within the Scheme, as separate primary legislation was required, and the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill is currently before Parliament. As the explanatory notes to that Bill set out, the upfront cost of that compensation scheme is expected to be in the region of £120million. HM Treasury will take an assignment of bondholders' rights in the insolvency proceedings, allowing the department to recover a portion of the compensation paid out as assets are sold by the administrators.

(3) Thirdly, as the Minister (Guy Opperman MP) made clear when moving the second reading of the Bill, the decision had been taken on an exceptional basis and "*the Government cannot and should not be expected to stand behind every failed investment firm. That would, with respect, create the wrong incentives for individuals and an unacceptable burden on the taxpayer*". This point was re-iterated later in the debate by the Economic Secretary to the Treasury who stated:

(a) "*I must be clear that the Government cannot step in to pay compensation in respect of every failed financial services firm. That falls outside the financial services compensation scheme, would create a moral hazard for investors and would potentially lead individuals to choose unsuitable investments, thinking that the Government would provide compensation in all cases if things went wrong*."; and that

(b) "*The Government's approach follows the historical precedent. I note that only three compensation schemes have been established in the past 35 years—for Barlow Clowes, a Ponzi scheme that failed in the late 1980s, Equitable Life and LC&F—despite many investment firms failing over that period.*"

(b) The historical approach

15. The approach summarised above has been applied both by the FCA and successive Complaints Commissioners since the Scheme's inception. This reflects the fact that the Scheme is part of a series of accountability measures designed to provide a counterbalance to, but not to undermine, the FCA's statutory immunity from damages for its acts and omissions, save in cases of bad faith or breaches of human rights. Parliament's recognition of the need for statutory immunity for financial regulators dates back to the Financial Services Act 1986 and the formation of the Securities and Investments Board ("**SIB**") and the self-regulatory organisations that were the predecessor bodies of the Financial Services Authority ("**FSA**"). The primary arguments for statutory immunity at that time were twofold: firstly, so that the regulators would be independent and fearless in the execution of their duties; and secondly, so that the regulators could attract practitioners of the highest quality to work for them without fear of facing legal action in relation to their regulatory decisions.

16. Subsequent Parliamentary debates on financial services legislation – to form the FSA in 1999-2000 and then to form the FCA and PRA in 2011-12 – have all reaffirmed the requirement for statutory immunity from damages to allow the regulator to carry out its duties with a focus on doing the right thing, rather than focussing on avoiding the risk of liability of the regulator. The Joint Committee on the Financial Services and Markets Bill in 1999 concluded:

"*An essential aspect of regulation is that supervision should not take place to the extent necessary to prevent all possible business failures. If the FSA are vulnerable to suit in the event of business failure, they will go as far as possible to avoid all failures; this will be a recipe for over-regulation*."

17. The Government's response to the Reports of the Joint Committee were published on 17 June 1999 and explained that:

"*The Government sees the role of the Complaints Investigator as being… to ensure that any alleged shortcomings* [of the FSA] *can be investigated in a transparent way, not as a route to additional recompense for firms and consumers*". (Part 1, para 4)

18. Thus, Parliament determined the need for regulatory accountability through a complaints scheme which would act as an appropriate counterweight to this immunity, but not in a way that would undermine it. This was to prevent comparable risk aversion at the FSA to that which would arise from a lack of statutory immunity; to acknowledge the impact on those who funded the FSA - the financial services industry and ultimately, therefore, consumers; and in the knowledge that avenues for consumer redress were being established through the Ombudsman and FSCS. For these reasons, the statute made clear that the Complaints Commissioner would have powers only to recommend compensatory payments rather than require them[4].

19. Speaking in the House of Commons at the Report stage of the Bill which ultimately became FSMA, the Minister said:

"It is important that the complaints scheme is not seen as a means of circumventing the FSA's statutory immunity. We do not want to encourage people to take pot shots at the FSA and distract it from its proper business of regulating…The complaints scheme is an informal mechanism for investigating complaints and, where appropriate, bringing shortcomings into the open; it is not a court, nor is there a right of appeal for the FSA if the investigator makes an adverse finding against it.

[…]

I do not think that people should view the complaints investigator as a potential first port of call, as the Opposition seem to suggest. In any event, the post is not being established for the purpose of financial redress; the point is for the focus to be on the process, and on the importance of transparency."

20. When FSMA came into force on 1 December 2001 it introduced significant changes for the remit, powers and responsibilities of the FSA, including the mechanisms for improving investor protection and the powers introduced to hold

[4] Under section 87(7) of the FS Act 2012, the Commissioner may also require the regulator to which a complaint relates to publish the whole or a specified part of their response to a complaint.

the FSA to account for its performance. These included an expansion in the remit and powers of the statutory Complaints Scheme (for complaints against the FSA). Relevant documents for defining the expected operation of the revised Complaints Scheme include the original CP73[5] from November 2000, and the subsequent Policy Statement – CP93[6] from May 2001. The Complaints Scheme in operation today remains substantially the same as when it was established in 2001, save for minor amendments introduced by the subsequent consultations, and to reflect the legal basis of the Scheme moving to the FSA 2012.

21. The FSA's approach to *ex gratia* compensation was explained in Policy Statement CP93 as follows (at para 13.3):

> "[w]*e will give serious consideration to any recommendation by the Commissioner to make a compensatory payment. However, mindful of our statutory obligation* [section 3B(1)(a) FSMA] *to use our resources economically and efficiently, the FSA Board remains of the view that it should retain a wide discretion as to when it will make a compensatory payment... It would in our view not be right for the FSA to make an open-ended commitment to make a payment where recommended to do so without having regard to a number of factors, including the impact on those who fund the FSA's operations*."

22. It also said that:

> "*compensatory payments would be unlikely to be appropriate for consumers who may complain that the Authority could and should have acted to prevent the failure of a regulated firm*."

23. Parliament revisited this matter in the course of debates around the formation of the FCA and PRA in 2011-12, but did not consider that it was appropriate to make any statutory changes. This is unsurprising because, in written evidence to the Joint Committee considering the matter, the then Complaints Commissioner, Anthony Holland, described the competing positions before indicating that, viewed objectively, it could be concluded that the existing approach represented "*a reasonable compromise*"[7].

[5] https://webarchive.nationalarchives.gov.uk/20081113045726/http:/www.fsa.gov.uk/pubs/cp/cp73.pdf
[6] https://webarchive.nationalarchives.gov.uk/20081113052746/http:/www.fsa.gov.uk/pubs/cp/cp93.pdf
[7] https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/430vw02.htm

24. That being so, the intention is that the complaints mechanisms, including investigation by the Commissioner, are not to provide for a full testing of legal argument and evidence. The FCA is not intended to be an insurer of last resort, nor is it a backstop to the unavailability of FSCS compensation or to remedies against the relevant firm or individual which is the primary cause of the consumer's loss.

25. This has been reflected in the approach adopted by both the FCA and successive Complaints Commissioners. To give two recent examples:

    (1) In FCA00684/2057789931, your immediate predecessor decided that it was not appropriate to recommend an award of compensation in response to an alleged failure by the FCA to act on allegations of mortgage fraud, which led to financial loss by the complainant. When pressed as to why this approach was taken, the Commissioner provided a detailed response on 27 May 2020, which read as follows:

    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[8].

    e. I understand that the Financial Services Compensation Scheme (FSCS), which is the statutory scheme to reimburse customers who have lost

[8] As noted in paragraph 25 (paragraph 44 of decision FCA00684/2057789931), similar points have been made by successive Commissioners.

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.

(2) In FCA00641/205205644, the Complaints Commissioner explained that:

Parliament has given the FCA protection from being sued for damages, save for cases involving bad faith or a breach of human rights. The Complaints Scheme cannot be used to undermine that protection, but it can offer generally modest ex gratia payments for administrative shortcomings … I do not accept your view that the Regulator can be seen as a 'backstop' upon which investors are entitled to 'rely' – investors in bonds are not offered financial guarantees of the kind given for depositors in bank accounts. That being the case, while I do not consider that the FCA should have dismissed the notion of any form of ex gratia payment, I agree with the FCA that you would not be entitled under this Scheme to an ex gratia payment which amounted to compensation for the financial losses arising from the financial statements.

(c) The FCA's current position

26. It is for these reasons that the FCA considers that the approach to the award of *ex gratia* payments set out in the LC&F Compensation Statement is appropriate and consistent with both the regulatory scheme and past practice.

27. To summarise the current position, section 87(5) of the FSA 2012 requires that the FCA, the Prudential Regulation Authority and the Bank of England (together, "**the Regulators"**) operate a complaints scheme which confers a discretion on you, as the Complaints Commissioner, to recommend that the FCA makes an *ex gratia* compensatory payment.

28. The Regulators have done so in the Scheme which was adopted following a full public consultation and which has been in effect from 1 April 2013 and was most recently updated in March 2016. Importantly, the Scheme sets out, at paragraph

7.14, the matters which the Regulators should normally take into account when considering a recommendation in relation to compensation:

"*7.14. In deciding how to respond to a report from the Complaints Commissioner, the relevant regulator(s) will normally take into account:*

a) the gravity of the misconduct which the Complaints Commissioner has identified and its consequences for the complainant;

b) the nature of the relevant regulator(s)' relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s);

c) whether what has gone wrong is at the operational or administrative level;

d) the impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers."

29. Those factors must be considered both individually and cumulatively. Contrary to what is suggested by S&S none of the factors set out in the Scheme is more important than the others. What is required is an assessment of the particular circumstances of each individual case by reference to these factors.

30. Additionally, the Scheme provides (at paragraph 6.6) that the FCA will, where it considers that a complaint is well-founded, itself consider (at the first stage of the investigation) whether it would be appropriate to make an offer of *ex gratia* compensation. The FCA will, accordingly, consider any individual complaints to consider whether it is appropriate to make an *ex gratia* payment of compensation. Its consideration will be guided by the FCA's statement "*Complaints Scheme: our approach to remedies"* (the "**Remedies Statement"**) which concerns the circumstances in which the FCA considers it is likely to be appropriate to make such an offer. While the FCA will consider representations as to why *ex gratia* compensation ought to be paid in circumstances not provided for by the Remedies Statement, the purpose of having such a published statement is to assist with ensuring a consistent and fair approach to proposals for compensation based on the individual features of the complaint and the FCA's culpability.

31. The Remedies Statement explains that in order for the FCA to consider it appropriate to offer an *ex gratia* payment, a complaint would be expected to provide "*evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*". As explained below, while the way this has been expressed has varied, the concept of "sole or primary" cause encapsulates the FCA's longstanding approach[9] to when it will be appropriate to offer *ex gratia* payments in recognition of financial loss.

32. The reasons for this approach are set out in the Remedies Statement itself, which explains that:

> *The FCA has legal immunity from liability to pay damages (compensation) unless it is found that we have acted in bad faith or have breached a complainant's human rights. Therefore, whilst the Scheme does include a provision for ex gratia payments, we do not award compensation or damages in the same way as a court would do.*
>
> *In some cases, a complainant may have suffered a specific inconvenience or an emotional impact, for example due to delays or poor service by the FCA. In such cases, we consider whether a payment might be appropriate to recognise their distress and inconvenience. We do not have set amounts that we award in such cases as individual complainants are affected differently depending on their specific circumstances. Typically, such payments are in the region of £25-£100. Where an impact is more severe or prolonged, a payment in the region of £100-£300 may be appropriate.*
>
> *We sometimes receive complaints from individuals seeking reimbursement of financial losses they have suffered. In many of these cases, the loss is caused by a third party, such as a regulated firm, and so we do not make any payment. The complaint made about the FCA is typically that our regulation lacked sufficient care, or failed to prevent their loss.*

[9] See, for example, the decision in FCA00503 (description provided in the Commissioner's annual report for the year 19/20) where the FCA decided not to award compensation for financial loss as it was not the principal cause of the complainant's loss. The Commissioner has also declined to recommend that the FSA/FCA make compensatory payments for financial loss as the regulator was not the principal cause – see, for example, FCA00684 and FCA00398.

(2) The Group Complaint

33. We do not here set out to address every aspect of the Group Complaint, which is now before you for determination. However, we wish to address the suggestion from S&S that there are two means by which the FCA could fund the grant of *ex gratia* compensation to LC&F bondholders. The first is to use fines received from enforcement action and the second is to deplete the FCA's surplus funds. For the following reasons neither of these is appropriate.

34. The first proposal would be unlawful.

    (1) The FCA is required to pay its financial penalty receipts to the Treasury after deducting certain of its enforcement costs[10] (paragraph 20 of Schedule 1ZA FSMA).

    (2) Under paragraph 21 of Schedule 1ZA, the FCA must prepare and operate a scheme to ensure that the amounts relating to the deducted enforcement costs are applied to the benefit of regulated persons[11]. 'Regulated persons' are defined in sub paragraph 2 as authorised persons, recognised investment exchanges and certain types of issuers.

    (3) LC&F bondholders do not fall into any of these categories and the FCA therefore has no vires to pay this money to LC&F bondholders.

35. The second proposal proceeds on the mistaken premise that the FCA has at its disposal some £121 million of "surplus assets". This is incorrect. The sum referred to is the accounting surplus for the year. While the FCA's total assets exceed total liabilities, the cash balances are more than matched by current liabilities and the remaining total asset value in the FCA's balance sheet is in fixed assets, which are not convertible to cash.

36. For completeness, the FCA 2020/21 annual report and accounts published on 15 July 2021 reported a deficit of £55.6m for the year and a reduction in net assets to £7.7m at 31 March 2021. Consistent with 2019/20, the FCA's current liabilities more than match available cash balances at 31 March 2021 and the existing fixed assets are not convertible to cash.

[10] Paragraph 20(3) of Schedule 1ZA FSMA sets out the narrow scope of what constitutes the FCA's 'enforcement costs'

[11] As explained in the Financial Penalty Scheme, the FCA will apply retained penalties, received in any financial year, as a rebate to the periodic fees paid in the following financial year by certain authorised firms. See Annex 2 to PS21/7: https://www.fca.org.uk/publication/policy/ps21-7.pdf.

37. The consequence is that the FCA would not be able to make any significant compensation payments without raising significant further funds.

Yours sincerely

Charles Randell

Chair

Appendix 8

Appendix 8

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27 April 2021

Dear Sirs,

London Capital & Finance Plc (in administration) (FRN: 722603) - *ex gratia* payments and complaints process

1. We write further to your letter dated 9 April 2021 in which you seek a series of confirmations in relation to the FCA's approach to handling complaints regarding its regulation of London Capital & Finance Plc ("**LC&F"**). The requested confirmations concern, in particular, the Financial Conduct Authority's ("**FCA**") proposed approach to the award of *ex gratia* compensation in response to complaints. We understand that your clients' position is that it would be appropriate for the FCA to compensate all those LC&F investors who have not otherwise been compensated. Your clients also consider that any other approach would be inconsistent with the FCA's response to Dame Elizabeth Gloster's report into the FCA's regulation of LC&F (the **"Gloster Report**").

2. Subsequent to your letter, the FCA has set out its general approach to the award of compensation to affected bondholders in a statement published on the FCA's website: https://www.fca.org.uk/news/statements/fca-sets-out-broad-approach-assessing-lcf-complaints (the "**LC&F Compensation Statement**"). The LC&F Compensation Statement reflects what the FCA considers is the appropriate general approach, having regard to the terms of the "*Complaints against the regulators: the Scheme"*, published by the FCA and Prudential Regulation Authority ("**PRA**") (the "**Scheme**"), and the FCA's statement "*Complaints Scheme: our approach to remedies"* (the "**Remedies Statement"**).

3. In summary, the LC&F Compensation Statement explains that, while each complaint will be considered individually, the FCA expects to offer *ex gratia*

compensation to a small number of investors who were given incorrect information in direct communications with the FCA which may have led those investors to conclude their investment would be safer than it was. The Statement goes on to explain that (again, subject to an individual review of each complaint), the FCA does not expect to make *ex gratia* compensatory payments to the other complainants, but expects instead to respond by acknowledging the errors which the FCA made in relation to LC&F and reiterating its apology.

4. As we understand that your clients will be disappointed by this, we explain below why the FCA has concluded that it ought not to offer compensation to all of LC&F's investors.

The Scheme

5. Section 87(5) of the Financial Services Act 2012 ("**FSA 2012"**) requires that the FCA, PRA and the Bank of England (together, the **"Regulators"**) operate a complaints scheme which confers a discretion on the investigator (known as the "**Complaints Commissioner**"), to recommend that the Regulator to which a complaint relates makes a compensatory payment. The Regulators have complied with this obligation through the Scheme, which has been in effect from 1 April 2013 and was most recently updated in March 2016.

6. The Scheme provides (at §6.6) that the FCA will, where it considers that a complaint is well-founded, itself consider (at the first stage of the investigation) whether it would be appropriate to make an offer of an *ex gratia* compensatory payment. The FCA will, accordingly, consider any individual complaints to decide whether it is appropriate to make an *ex gratia* payment of compensation. Its consideration will be guided by its published Remedies Statement, which refers to the factors set out in §7.14 of the Scheme (to which we return below), and concerns the circumstances in which the FCA considers it is likely to be appropriate to make such an offer. While the FCA will consider representations as to why *ex gratia* compensation ought to be paid in circumstances not provided for by the Remedies Statement, the purpose of having such a published statement is to assist with ensuring a consistent, transparent and fair approach to proposals for compensation based on the individual features of the complaint and the gravity of the FCA's misconduct. Further, the Remedies Statement was published to address specific requests from the Complaints Commissioner that we be more transparent about our approach to providing remedies to complainants.

7. The Remedies Statement explains that in order for the FCA to consider it appropriate to offer an *ex gratia* payment, a complaint would be expected to provide "*evidence that they have suffered a quantifiable financial loss caused solely or primarily by the actions or inaction of the FCA*". Contrary to what you suggest in your letter, this reflects the FCA's longstanding approach to the offer of *ex gratia* payments in recognition of financial loss. Additionally, the FCA will consider making an offer of payment in respect of distress and inconvenience directly caused by its actions.

8. The reasons for this approach are set out in the Remedies Statement itself, which explains that:

> "*The FCA has legal immunity from liability to pay damages (compensation) unless it is found that we have acted in bad faith or have breached a complainant's human rights. Therefore, whilst the Scheme does include a provision for ex gratia payments, we do not award compensation or damages in the same way as a court would do.*
>
> *In some cases, a complainant may have suffered a specific inconvenience or an emotional impact, for example due to delays or poor service by the FCA. In such cases, we consider whether a payment might be appropriate to recognise their distress and inconvenience. We do not have set amounts that we award in such cases as individual complainants are affected differently depending on their specific circumstances. Typically, such payments are in the region of £25-£100. Where an impact is more severe or prolonged, a payment in the region of £100-£300 may be appropriate.*
>
> *We sometimes receive complaints from individuals seeking reimbursement of financial losses they have suffered. In many of these cases, the loss is caused by a third party, such as a regulated firm, and so we do not make any payment. The complaint made about the FCA is typically that our regulation lacked sufficient care, or failed to prevent their loss*."

9. The FCA is of the view that this general approach is appropriate in light of the statutory framework of regulation established by (in particular) the Financial Services and Markets Act ("**FSMA**") and the FSA 2012. By establishing this framework, Parliament has entrusted the FCA with the task of regulating the conduct of approximately 60,000 businesses, while at the same time ensuring that this regulation is conducted proportionately and without imposing an undue burden on those whom it regulates.

10. The FCA is funded by levies imposed on those whom it regulates, which are ultimately passed on to consumers in the form of higher prices for regulated products and services. The consequence is that the FCA is required to exercise judgement as to how its finite resources are best deployed, which necessarily means that it prioritises some areas over others. In some cases, hindsight will indicate that better outcomes could have been achieved if different decisions had been made. However, Parliament has made clear (in paragraph 25 of Schedule 1ZA to FSMA) that so long as those decisions were not made in bad faith, or in breach of human rights, the FCA ought not to be liable to individual investors in respect of them.

11. Furthermore, the regulatory framework established by Parliament is one which permits investors to take risks. Where it intends for consumers to have legal recourse in respect of financial losses, it provides for this expressly and in detail, as it has done e.g. in respect of the Financial Services Compensation Scheme ("**FSCS**") (Part XV of FSMA) and the Financial Ombudsman Service ("**FOS**") (Part XVI of FSMA). The former addresses the level of protection which Parliament intended consumers to have where a firm is unable to meet its liabilities for loss which it has caused to investors, the latter provides a means of obtaining redress in respect of loss suffered due to failures by a firm (and sits alongside s 138D(2) FSMA, which renders civilly actionable, in certain circumstances, contravention by authorised persons of the rules in the FCA Handbook).

12. Parliament has not expressed any intention that the FCA ought to make payments to investors in respect of losses primarily caused by others/firms. Indeed, the contrary intention is clear from the FCA's exemption from liability in damages referred to in paragraph 10 above. The exemption applies to anything done or omitted in the discharge, or purported discharge, of the FCA's functions. The exemption covers both the acts and omissions of the FCA as well as any person who is, or is acting as, a member, officer or member of staff. This is subject only to two narrow exceptions, that is, where the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998 or where the act or omission has been done in bad faith. Neither of these exceptions applies in this case.

13. This may be contrasted with Part XVI of FSMA, establishing the FOS. Here, Parliament has expressly provided that the FOS may, in the exercise of its compulsory jurisdiction, make awards of compensation for "loss or damage". This power is found in s. 229 of FSMA, which explicitly authorises the FOS to make a

money award to compensate for (amongst other things) "financial loss". No such provision is made in respect of complaints regarding the FCA's exercise of its regulatory functions.

14. Furthermore, unlike the FOS, the Scheme is not intended to be, in effect, an informal alternative to the Courts. Notably:

    (1) The respondent to matters before the FOS will be the authorised firm or individual themselves. Furthermore, the determination of what is "fair and reasonable" by way of compensation must be determined having regard to the relevant law, and if the FOS wishes to depart from it, it must provide cogent reasons for doing so. Any failure to do so, or any arbitrary or inconsistent departure from the law is a reason for setting aside a determination: *R (Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service* [2008] Bus LR 1486 (CA). Furthermore, where a consumer accepts a FOS final determination, they are not then able to pursue a claim on the same facts for the same losses in civil proceedings, as the FOS is a "tribunal" and its final determinations "judgments" for the purposes of the merger doctrine (whereby a claimant's rights are extinguished by a judgment of a tribunal): *Clark v In Focus Asset Management & Tax Solutions Ltd* [2014] 1 WLR 2502 (CA).

    (2) In respect of complaints in respect of the FCA's regulatory conduct, the position is entirely different. There can be no question (absent bad faith or violation of the Human Rights Act) of any action in the Courts against the FCA. Furthermore, were a consumer to be compensated on an *ex gratia* basis by the FCA in respect of financial loss, there would be no such barrier on the consumer seeking to recover from the relevant firm or individual.

15. Accordingly, while the FCA agrees that it would be neither necessary nor appropriate strictly to apply legal tests of causation, liability and quantum when determining eligibility for compensation, we consider that it is in general appropriate to limit compensation offers to cases where the FCA is solely or primarily responsible for the loss suffered.

16. If any individual (including your clients) is dissatisfied with the approach adopted by the FCA, then it will be open to them to refer the matter to the Complaints Commissioner. Should the Complaints Commissioner ultimately recommend that the FCA make an offer of *ex gratia* compensation, then that recommendation will be individually considered by the FCA. That consideration will be guided by the

factors set out in §7.14 of the Scheme, approved following a statutory consultation carried out pursuant to s. 86 of the FSA 2012 which, consistently with the principles set out in the Remedies Statement, provides that:

"*In deciding how to respond to a report from the Complaints Commissioner, the relevant regulator(s) will normally take into account:*

a) the gravity of the misconduct which the Complaints Commissioner has identified and its consequences for the complainant;

b) the nature of the relevant regulator(s)' relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the relevant regulator(s);

c) whether what has gone wrong is at the operational or administrative level;

d) the impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers."

17. Your letter makes a number of comments regarding the FCA's consultation on Complaints against the Regulators (CP20/11). Where responses have been provided to the FCA these will be considered as part of that consultation. Given the consultation does not apply to the FCA's approach to complaints relating to LC&F we do not propose to address those comments in this correspondence, save to note that the consultation was clear from the outset (at §5.3) that "*For complaints made before the revised Scheme comes into force, we propose that complaints should continue to be handled under the current Scheme."* Your suggestion that open LC&F complaints were affected by the consultation is therefore not correct.

The Gloster Report

18. The FCA accepted and has committed to implementing each of the nine recommendations directed at it in the Gloster Report. Having done so, the FCA did not seek in its public response to go line by line through the report making "reservations" as to individual findings or comments that it might take issue with (as you imply it ought to have done at page 9 of your letter).

19. Nor would it have been appropriate to do so. The Gloster Report represents Dame Elizabeth's conclusions in respect of the matters she was tasked with investigating. The FCA has accepted her substantive recommendations and does not resile from

this, its commitment to implement them, or anything which was said in the FCA's December 2020 response to which you refer.

20. We would also draw your attention to a section of §3.3 of Chapter 1 of the Gloster Report which you omit from the quotation at page 8 of your letter. There, Dame Elizabeth makes clear that her investigation had neither considered nor determined whether there was a "*causal link between the deficiencies in the FCA's regulation of LCF during the Relevant Period and the losses incurred during that period by Bondholders, either as a class, a series of classes or individually*". This was because "*specific evidence, which the Investigation has not considered, would be necessary to determine those types of causation issues*."

21. As you rightly note, however, Dame Elizabeth did observe that it was possible that earlier intervention by the FCA might have prevented LC&F from receiving investments in its bond programme and reduced exposure of investors to LC&F's collapse. The FCA has accepted that, with hindsight, better judgements could have been made. It does not resile from that conclusion. However, these are the types of judgements which Parliament has tasked the FCA with making in good faith, and which it has specifically excluded liability for.

22. We also acknowledge that, had different decisions been made at the time, the FCA might have done better in supervising LC&F. Indeed, the FCA has previously acknowledged this. However, the FCA does not consider that this should translate into a general entitlement to compensation through the Scheme.

23. This is because, for the reasons set out above, the FCA's general approach is to compensate individuals for financial loss only where it is the sole or primary cause of that loss. While any representations from individual complainants to the contrary will be considered on their merits, the FCA does not accept that (as a general proposition) it was the sole or primary cause of the loss to investors in LC&F. Rather, the FCA considers that the primary cause of the bondholders' losses was the actions of LC&F itself, and its senior management.

The LC&F Compensation Statement

24. Notwithstanding that the FCA does not consider that it is the primary cause of bondholders' losses, the LC&F Compensation Statement reflects the FCA's conclusion that it is likely to be appropriate (exceptionally) to offer a payment of *ex gratia* compensation to a small number of investors who were given incorrect information in direct communications with the FCA which may have led those investors to conclude their investment would be safer than it was (the

"**Incorrect Information Investors**"). This conclusion was reached having regard to the terms of the Scheme and the Remedies Statement and reflects the fact that, while not the primary cause of these investors' losses, those direct and individual communications, involving the provision of specific information which was inaccurate, may have been a factor in their decision to invest, or to remain invested.

25. As explained in the LC&F Compensation Statement, while complaints by other investors will be considered individually in accordance with the terms of the Scheme, we do not expect to make *ex gratia* payments to these investors. The FCA is not the primary cause of these investors' losses and, having regard to the factors in §7.14 of the Scheme, we do not consider that an *ex gratia* payment is the appropriate remedy in these cases. To help explain our approach, we set out below the factors in §7.14 which guide our approach, together with our view as to how these factors might apply to both the Incorrect Information Investors and other investors (subject to individual consideration of each complaint). While some of these matters referred to below may individually be present in some complaints, it is the cumulative effect of these factors which leads us to conclude that Incorrect Information Investors should receive an ex-gratia compensatory payment.

(1) *The gravity of the misconduct and its consequences for the complainant.*

As noted above, the FCA accepts that, with hindsight, there were errors in its handling of LC&F and better judgements could have been made. For Incorrect Information Investors we have also had regard to the fact that the errors do not arise from the exercise of a general discretion conferred upon the FCA in respect of its regulatory functions; they instead relate to the provision of specific information to individual investors following an individual inquiry which was incorrect.

We note that for the Incorrect Information Investors the incorrect information may have been a factor in their decision to invest (or remain invested). It is also likely to have caused them additional distress and inconvenience.

(2) *The nature of our relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with the FCA.*

Each of the Incorrect Information Investors had direct dealings with the FCA, whether by telephone or in writing. The direct interaction with the FCA

adversely affected the individual since they were led to believe that their investment was less risky than it was, and they subsequently invested, or decided to remain invested.

In other cases, such as an allegation that the FCA failed in its supervision of LC&F, the complaints do not relate to any direct dealings between investors and the FCA. Rather, an investor may allege that they suffered a loss indirectly attributable to the FCA's failures.

(3) *Whether what has gone wrong is at the operational or administrative level.*

While there were operational errors in respect of LC&F, we consider that some of the FCA's actions also need to be viewed in light of the fact that it had to make complex judgements around where to prioritise its resources.

The FCA's errors in respect of the Incorrect Information Investors were operational, as opposed to being one where the FCA's judgement and actions had to reflect a balance of conflicting and complex issues.

(4) *The impact of the cost of compensatory payments on firms, issuers of listed securities and, indirectly, consumers.*

At the point of LC&F's failure, 11,625 people had invested a total of £237,207,497 in LC&F minibonds. Making a payment to every investor that complains is likely to impose a disproportionate financial burden on the firms and issuers we regulate and their consumers (who would ultimately bear that financial burden).

One of the key purposes of the Scheme is to ensure a consistent and fair approach to proposals for remedies based on the individual features of a complaint. This factor in §7.14 of the Scheme therefore requires the FCA to consider the wider impact of any decision that it takes in a particular case. In this instance, if we were to award compensation to all LC&F complainants, we would also need to consider making payments in similar circumstances where we have indirectly contributed to a loss, i.e. where, in hindsight, we could have exercised our discretionary judgement more effectively to achieve better outcomes for investors. For the reasons above, we consider that making payments in these circumstances would not give effect to the policy underlying the regulatory framework established by Parliament.

For the avoidance of doubt, we have considered the financial consequences of making payments to the Incorrect Information Investors and have concluded that such payments would not have a disproportionate impact on firms, issuers or listed securities and, indirectly, consumers.

26. The above is not intended to represent a comprehensive account of our approach to every LC&F complaint. However, we hope that by setting out the factors in §7.14 and our consideration of how they might apply to LC&F complaints will assist you in understanding why we intend to (exceptionally) make *ex gratia* payments to the Incorrect Information Investors despite not being the primary cause of these investors' losses. We also hope that this assists you in understanding why, generally, the FCA does not expect to make *ex gratia* payments to other LC&F investors. Again, we must emphasise that we keep an open mind as to whether there might be other exceptional cases where an *ex gratia* payment is appropriate, having regard to the individual circumstances of each complaint.

27. Finally, for the avoidance of doubt, we do not consider that it would be appropriate to make *ex gratia* payments to investors who consulted the Register. The Register did not contain any incorrect information regarding LC&F and there was a lack of direct interaction with investors. There were also warnings on the Register which outlined that the customer should not invest based on the Register alone.

The Commitments you seek

28. In relation to the confirmations which you seek, the FCA responds as follows (taking each in turn):

    (1) The FCA cannot provide the first requested confirmation as it rests on a flawed premise. The Gloster Report, while making some observations regarding causation, explicitly refrained from reaching a conclusion as to whether there was a causal link between the deficiencies in the FCA's regulation of LC&F during the Relevant Period and the losses incurred during that period by Bondholders, either as a class, a series of classes or individually.

    (2) The FCA will consider all complaints made under the Scheme individually, on their merits. In doing so, it will be guided by the terms of the Scheme, the Remedies Statement, and the LC&F Compensation Statement.

(3) While the FCA will consider any representations to the contrary in an individual complaint, the FCA does not consider that it was the sole or primary cause of financial losses to any of LC&F's bondholders. Those losses were primarily caused by LC&F and its management.

(4) The FCA has decided that, in general, it will be appropriate to make a payment of *ex gratia* compensation in the circumstances set out in the LC&F Compensation Statement. The FCA does not consider that it would, in general, be appropriate to make a payment of compensation in any other circumstances, however, it will consider any complaint requesting a payment in any other circumstances on the basis of the representations received.

(5) Individual complainants' right to refer the FCA's response to their complaints to the Complaints Commissioner is unaffected by the above. The Complaints Commissioner is independent of the FCA, and any recommendations she makes will be considered individually by the FCA if and when they arise. While we have kept the OCC informed as to our proposed approach, the FCA does not consider that it is appropriate (or contemplated by the Scheme) for this matter to be "referred" as a "preliminary issue" as you suggest. Further, you will have seen from the Complaints Commissioner's statement published on her website on 19 April 2021 that LC&F complainants are asked to await the FCA's response to their complaint before approaching the Commissioner. The statement goes on to advise that "*only then will complainants be able to approach The Commissioner to review their complaint if they remain unhappy with the FCA's decision"*. The statement can be found here: https://frccommissioner.org.uk/wp-content/uploads/LCF-update-doc.pdf.

29. We hope that this assists you to understand the FCA's general approach to the award of *ex gratia* payments of compensation to LC&F bondholders.

Yours faithfully

[REDACTED]

[REDACTED]
[REDACTED] General Counsel's Division

Cc:

Rt Hon Mel Stride

MP John Glen MP

Amerdeep Somal, Complaints

Commissioner HM Treasury

John Bedford, Dechert LLP

Appendix 9

Annex 3: Examples where the FCA has warned of investment risks and scams

March 2015 – FCA Speech: The defining challenge of our time by Martin Wheatley, Former CEO of the FCA, delivered at the NAPF Investment Conference

March 2015 – FCA News Article: Consumers struggling to understand structured products as Financial Conduct Authority calls for improvements from firms

- For consumers, the message is simple – think very carefully before buying a product if you don't understand how it works and if you're unsure, ask for more information or consider seeking financial advice.

April 2016 – FCA Webpage: Crowdfunding

- Given the typical risks involved, under our regulations, firms are only allowed to promote crowdfunding offers to certain investors. These include experienced or sophisticated investors, or ordinary investors who confirm that they will not invest more than 10% of their net investable assets.
- You should only invest money you can afford to lose.

April 2016 – FCA Webpage: Unregulated collective investment schemes

- This is considered a high-risk investment, and you should be prepared to lose all your money.
- If you are considering investing in a UCIS:
    1. make sure you read all the available information;
    2. make sure you understand the risk that you may lose some or all of the money invested;
    3. ask your adviser what the charges are;
    4. ask your adviser what the rate of return is and whether this is an actual rate or only a target; and
    5. ask whether you would have access to the Financial Ombudsman Service and Financial Services Compensation Scheme if things go wrong.
- If your adviser is not able to clearly explain the nature of the investment and the risk to you, then consider whether you fully understand what you are investing in.
- Seek independent professional advice if you are in any doubt about the potential risk and returns involved.

December 2016 – FCA News Article: FCA proposes stricter rules for contract for difference products

August 2017 – FCA Webpage: Types of pension scams

- If you get a cold call about your pension, the safest thing to do is hang up - it's illegal and probably a scam.
- Most of the companies offering free pension reviews are not FCA authorised but may falsely claim they are. They may also claim that they don't have to be FCA authorised as they aren't providing the advice themselves.

August 2017 – FCA Webpage: Graphene investment scams

- Most firms promoting and selling graphene investments are not authorised by the FCA. This means you won't have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong.

- Even if an FCA-authorised firm is involved in the sale of graphene, because it's an unregulated product you have no right to compensation if something goes wrong.

September 2017 – FCA News Article: Initial Coin Offerings

- ICOs are very high-risk, speculative investments. You should only invest in an ICO project if you are an experienced investor, confident in the quality of the ICO project itself (e.g. business plan, technology, people involved) and prepared to lose your entire stake.
- Most ICOs are not regulated by the FCA. You are extremely unlikely to have access to UK regulatory protections like the Financial Services Compensation Scheme or the Financial Ombudsman Service.
- BBC coverage - https://www.bbc.co.uk/news/business-41240803.

December 2017 – FCA News Article: Protect your pension pot from risky investments and scams

- Most of the companies making these offers are not authorised or regulated by the FCA. This means you may have no right to complain to the Financial Ombudsman Service or to claim compensation from the Financial Services Compensation Scheme if things go wrong.
- If you are considering investing some of your pension pot in unregulated investments, you should first seek impartial advice from a financial adviser unconnected to the firm that has contacted you.
- All investment alternatives should be considered and leaving your pension pot where it is may be the best decision.

April 2019 – FCA News Article: Investing in Innovative Finance ISAs

- These types of investments may not be protected by the Financial Service Compensation Scheme so customers may lose the money invested or find it hard to get back.
- Anyone considering investing in an IFISA should carefully consider where their money is being invested before purchasing an IFISA.

September 2019 – FCA Speech: The fight against skimmers and scammers, by Charles Randell, Chair of the FCA, delivered at the Cambridge Economic Crime Symposium

Appendix 10

Appendix 10

Annex 4: Case examples of how we have calculated ex gratia payments for the delay in handling LCF complaints

Case 1:

We received the complaint on 30 March 2019. An email was sent to the complainant on 16 April 2019 deferring the complaint. The deferral was lifted on 17 December 2020 and the complainant received a decision on 14 June 2021. Therefore, the calculation is:

(a) 30 March 2019 to 16 April 2019	17 days
(b) 17 December 2020 to 14 June 2021	179 days
(a) + (b) = (c)	196 days (a £75 ex gratia payment).

Case 2:

We received the complaint on 29 August 2020. An email was sent to the complainant on 9 November 2020 deferring the complaint. The deferral was lifted on 17 December 2020 and the complainant received a decision on 8 September 2021. Therefore, the calculation is:

(a) 29 August 2020 to 9 November 2020	72 days
(b) 17 December 2020 to 8 September 2021	265 days
(a) + (b) = (c)	337 days (a £125 ex gratia payment).

Levels of ex-gratia payments:

The ex gratia payment levels applied to each case in the circumstances of LCF in relation to delays were as follows:

Up to 120 days from receipt	Apology offered
Between 121 and 180 days from receipt	A £50 ex gratia payment would have been offered.
Between 181 and 240 days from receipt	A £75 ex gratia payment would have been offered.
Between 241 and 300 days from receipt	A £100 ex gratia payment would have been offered.
Between 301 to 365 days from receipt	A £125 ex gratia payment would have been offered.
Over 366+ days from receipt	£150-£250 depending on the factors in the individual case.

Appendix 11

Appendix 11

Annex 5: Factual accuracy points

In your PR, at paragraph 54, you sought clarity on our use of the acronym ‘TSC’. We can confirm that ‘TSC’ stands for the Treasury Select Committee.

In paragraph 108 in your PR, you mention ‘… but instead decided to introduce it by way of internal guidance without the benefit of public consultation.’ Our full response on the Remedies Statement is contained within our reply to your PR. We would like to clarify that as the Remedies Statement was published on our external website, we would consider this a public document rather than ‘internal guidance’.