



House of Commons  
Treasury Committee

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# The Financial Conduct Authority's Regulation of London Capital & Finance plc

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**Fourth Report of Session 2021–22**

*Report, together with formal minutes relating  
to the report*

*Ordered by the House of Commons  
to be printed 21 June 2021*

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### Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is [treascom@parliament.uk](mailto:treascom@parliament.uk).

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## Summary

The collapse of London Capital & Finance is due to one of the largest conduct regulatory failures of the last three decades and is one of only three that has led to a Government compensation scheme. Dame Elizabeth Gloster's investigation has highlighted a range of changes needed at the Financial Conduct Authority under its new leadership. This report highlights some further recommendations for both the regulator and the Treasury.

### *Culture at the FCA*

We welcome the FCA's ongoing transformation programme which has cultural change as one of its priorities. We however note that the FCA has undergone numerous structural and operational changes since its inception, with more changes expected as part of the ongoing transformation. We recognise that culture change takes time but recommend that the FCA Board sets itself an end date for the transformation programme and that it creates milestones at which improvements and evidence of changes in culture can be reviewed. These milestones and reviews should be put into the public domain. At the completion of the transformation programme, the FCA should ensure it has in place measures that will ensure that its improved culture is maintained and embedded.

The FCA should ensure that it keeps its contact centre policies and training up to date to ensure clarity and consistency, not just in relation to firms such as LCF but to the wider organisation.

### *Responsibility*

We believe that the FCA was wrong not to have engaged in a fuller recruitment programme for the Executive Director for Transformation role, including the consideration of potential recruits from outside the FCA. It appears that there was a missed opportunity to consider fresh leadership for the Transformation programme.

Given that Dame Elizabeth's report cited Megan Butler as bearing responsibility for important areas of failure and that her recruitment was conducted internally with just one alternative candidate, we understand why many will feel that "a buck that does not stop with an individual stops nowhere" when it comes to the personal consequences for those involved with the failings at the FCA in relation to LCF. We recommend that the default position should be that the FCA take a holistic approach when recruiting for critical roles, rather than engaging in a restricted recruitment process.

It is not readily justifiable for the FCA to require the firms that it regulates to adhere to the principles of the Senior Managers Regime but seemingly not to apply similar principles internally when there are failings of practice and culture in the organisation. The FCA Board should reflect on whether it has, in this case, met the standards which it seeks to impose upon others. We believe that there are doubts as to whether it has.

*Perimeter of regulation*

The “halo effect” appears to be inevitable as long as authorised firms also carry out unregulated activities. We reiterate the recommendation made by our predecessors that the FCA should ensure that it requires authorised firms to make clear explicitly the risks to customers associated with their unregulated activities.

In future, the FCA should set out in its annual perimeter report how its supervisory strategies and policies reflect the activities of authorised firms both within and outside the perimeter.

Any changes to the perimeter must be matched with appropriate changes in the FCA's resources, and the FCA should republish its priorities. The Treasury should publish a policy statement on how it will analyse changes to the FCA's perimeter and what factors it will take into account.

*Regulation of mini-bonds*

In light of the recent failings of several mini-bond issuers and the nature of the existing regulatory arrangements, the Treasury should proceed with its analysis as soon as the consultation on the regulation of non-transferable debt securities closes, and it should aim to publish the outcome by the end of September 2021. In publishing its response, it should also publish a way forward that can be implemented rapidly.

*Financial promotions*

We welcome the steps taken by the FCA to change its approach to financial promotions, as well as introducing the “use it or lose it” programme. In future, the FCA should be more interventionist and should make more frequent use of its powers rather than maintaining a culture of risk aversion.

The Treasury should—as a matter of priority—re-evaluate the Financial Promotion Order exemptions to determine their appropriateness and consider what changes need to be made to protect consumers.

*Online Safety Bill*

We recommend that the Government should include measures to address fraud via online advertising in the Online Safety Bill, in the interests of preventing further harm to customers being offered fraudulent financial products.

Pending any legislative changes, the FCA should continue to work with online platforms such as Google to remove misleading and fraudulent adverts as quickly as possible, to protect customers from scams.

# Introduction

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## London Capital & Finance plc

1. London Capital & Finance plc (LCF) was a firm authorised<sup>1</sup> by the Financial Conduct Authority (FCA). It issued “mini-bonds”—described by the Treasury and FCA as an unregulated investment product—to investors.<sup>2</sup> The FCA describes a mini-bond as a type of investment that typically offers high returns, reflecting the much higher risks involved in comparison to other types of investments.<sup>3</sup>
2. On 30 January 2019, LCF entered administration following regulatory intervention by the FCA. In December 2018, the FCA had directed LCF to withdraw its promotional material immediately on the basis that the way the firm was marketing its bonds was misleading, not fair and unclear.<sup>4</sup> The marketing of mini-bonds is regulated under the Financial Services and Markets Act 2000.
3. The FCA had serious concerns about the way LCF was conducting its business<sup>5</sup> and was also concerned that LCF bonds were being marketed as ISA-eligible when they were not.<sup>6</sup>
4. At the time of its collapse, LCF had issued about 16,706 mini-bond/ISA products to 11,625 investors, to a total value of £237,207,497.<sup>7</sup> On 25 March 2019, Smith & Williamson, LCF’s administrators, estimated a return to the bondholders from the assets of the company of as low as 20% of their investment.<sup>8</sup>

## Independent investigation

### *FCA & HM Treasury consultation*

5. Following the collapse of LCF, the then Chair of the Treasury Committee, the Rt Hon Nicky Morgan MP,<sup>9</sup> wrote to the FCA, asking the Board to consider whether the failure of LCF warranted an investigation under section 73 of the Financial Services Act 2012.<sup>10</sup> At the same time, she wrote to John Glen MP, Economic Secretary to the Treasury, asking

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1 The FCA notes that in line with the Financial Services and Markets Act 2000, financial activities have to be regulated by the FCA. Any firm (whether a business, a not-for-profit or a sole trader) carrying out a regulated activity must be authorised or registered by the FCA, unless they are exempt. (See Financial Conduct Authority, [‘Authorisation: what’s involved’](#), accessed 3 June 2021)

2 [Financial Services Update, Statement made on 17 December 2020](#), Statement UN HCWS678, Statement made by John Glen, Economic Secretary to the Treasury, accessed 3 June 2021; Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital and Finance plc—The FCA Response](#), (December 2020), page 10

3 Financial Conduct Authority, [‘Minibonds’](#), accessed 3 June 2021

4 Financial Conduct Authority, [‘London Capital and Finance plc’](#), accessed 3 June 2021

5 *Ibid.*

6 Financial Conduct Authority, [Second Supervisory Notice to London Capital & Finance plc](#), 17 January 2019, accessed 3 June 2021

7 Smith & Williamson, [London Capital & Finance Plc \(in administration\): Joint administrators’ Report and Statement of Proposals pursuant to Paragraph 49 of Schedule B1 Insolvency Act 1986](#) (25 March 2019), p 6

8 *Ibid.*, page 4

9 Now the Rt Hon Baroness Morgan of Cotes

10 Treasury Committee, Letter from the Chair of the Treasury Committee to the Chair of the Financial Conduct Authority, [Chair-to-Chair-of-FCA-re-LCF-190319.pdf \(parliament.uk\)](#), 19 March 2019 (accessed 3 June 2021);

the Treasury to consider the use of its power under section 77 of the Financial Services Act 2012, in the event that the FCA Board decided not to conduct an investigation into the failure of LCF.<sup>11</sup>

6. The FCA Board invited HM Treasury to direct a review to be commissioned to consider whether the existing regulatory system adequately protects retail purchasers of mini-bonds from unacceptable levels of harm; and the FCA's supervision of LCF, under section 77 of the Financial Services Act 2012, on the grounds of the public interest.<sup>12</sup>

7. The Economic Secretary to the Treasury, John Glen MP, agreed to the FCA Board's request,<sup>13</sup> and on 22 May 2019 he issued a Direction for an independent investigation into the circumstances surrounding the collapse of LCF.<sup>14</sup>

8. The FCA formally appointed the Rt Hon Dame Elizabeth Gloster DBE to lead the independent investigation. Dame Elizabeth has worked as a barrister, QC and as a judge of the High Court and a Lady Justice of the Court of Appeal. Her current work includes a role as an international arbitrator.<sup>15</sup> The appointment was approved by the Economic Secretary.<sup>16</sup>

### ***Dame Elizabeth Gloster's investigation***

9. Dame Elizabeth and her Investigation Team conducted the investigation in line with the scope set out in HM Treasury's Direction and the Protocol agreed with the FCA.<sup>17</sup> The investigation's findings were set out in a report delivered to the FCA on 23 November 2020, with a revised version published on 10 December 2020.

10. The investigation concluded that "the FCA did not discharge its functions in respect of LCF in a manner which enabled it effectively to fulfil its statutory objectives." The failings were attributed to "significant gaps and weaknesses in the FCA's policies and practices."<sup>18</sup>

11. Dame Elizabeth made 13 recommendations in the light of the investigation's findings. Nine of these were targeted at the FCA's policies and practices, and four were targeted at the regulatory regime. See Appendix 1 to this Report for a list of Dame Elizabeth's recommendations.

11 Treasury Committee, Letter from the Chair of the Treasury Committee to the Economic Secretary to the Treasury, [Chair-to-Economic-Secretary-re-LCF-190319.pdf \(parliament.uk\)](#), 19 March 2019 (accessed 3 June 2021)

12 Financial Conduct Authority, Letter to the Chair of the Treasury Committee from the Chair of the Financial Conduct Authority, [London Capital & Finance](#), 1 April 2019 (accessed 3 June 2021)

13 HM Treasury, Letter from the Economic Secretary to the Treasury to the Chair of the Financial Conduct Authority, [EST-to-Charles-Randell-FCA-010419.pdf \(parliament.uk\)](#), 1 April 2019 (accessed 3 June 2021); [Q386](#)

14 HM Treasury, '[Direction to the Financial Conduct Authority to investigate events and circumstances surrounding the failure and placing into administration of London Capital & Finance plc](#)', 22 May 2019, accessed 3 June 2021

15 (Biography source: Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Appendix 3, page 318)

16 GOV.UK, '[Independent investigation into the FCA's supervision of London Capital & Finance](#)', 19 October 2020, accessed 3 June 2021

17 Financial Conduct Authority, '[Protocol](#)', accessed 3 June 2021

18 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 31

12. The FCA<sup>19</sup> and HM Treasury<sup>20</sup> accepted Dame Elizabeth's recommendations in full and have begun to implement reforms.

## Our inquiry

13. We launched our inquiry into the Financial Conduct Authority's Regulation of London Capital & Finance plc on 1 February 2021. This followed the publication of Dame Elizabeth's report, and of the FCA and HM Treasury's responses to that report's findings.

14. Drawing on Dame Elizabeth's findings and on evidence received during our inquiry, this Report examines changes that have been made since the publication of Dame Elizabeth's report, and we make further recommendations to the FCA and HM Treasury, on how to work to ensure that we have a proactive regulator and a regulatory regime that serves its purpose.

15. We held oral evidence sessions with the following witnesses:

- **1 February 2021:** Rt Hon Dame Elizabeth Gloster DBE, Independent Investigator into the Financial Conduct Authority's Regulation of London Capital & Finance plc; Dorothy Cory-Wright, Partner, Head of London Disputes Practice, Dechert LLP; Richard Frase, Partner, Financial Services Group, Dechert LLP; James Petkovic, Junior Counsel, One Essex Court.
- **8 February 2021:** Andrew Bailey, Governor of the Bank of England and former Chief Executive of the Financial Conduct Authority.
- **1 March 2021:** Charles Randell CBE, Chair, Financial Conduct Authority; Nikhil Rathi, Chief Executive, Financial Conduct Authority.
- **25 March 2021:** Jonathan Davidson, Senior Adviser, Financial Conduct Authority;<sup>21</sup> Megan Butler, Executive Director for Transformation, Financial Conduct Authority.
- **21 April 2021:** John Glen MP, Economic Secretary to the Treasury, HM Treasury; Katharine Braddick, Director-General for Financial Services, HM Treasury.

16. We would like to thank Dame Elizabeth for her excellent and very thorough report, which exposed a litany of regulatory shortcomings in the FCA's regulation of LCF and provided us with an insight into the wider implications for the current regulatory regime.

17. We would also like to thank all those who provided oral and written evidence during this inquiry.

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19 Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital and Finance plc—The FCA Response](#), (December 2020), page 10

20 [Financial Services Update, Statement made on 17 December 2020](#), Statement UN HCWS678, Statement made by John Glen Economic Secretary to the Treasury, accessed 3 June 2021

21 Jonathan Davidson has since left the FCA

## Report structure

18. This report is structured as follows:

- a) Chapter 1 examines Dame Elizabeth's findings of responsibility;
- b) Chapter 2 explores the culture at the FCA during the relevant period of Dame Elizabeth's investigation and sets out what changes we expect to see going forward;
- c) Chapter 3 considers the perimeter of regulation and the scope of the FCA's remit as well as the case for expanding the remit;
- d) Chapter 4 examines consumer responsibility and the compensation available for LCF bondholders; and
- e) Chapter 5 covers the government's ongoing consultation on financial promotions, steps taken by the FCA to address deficiencies in its financial promotions policies, and the Online Safety Bill which could be a medium to tackle fraud via online advertising.

19. We have not covered all aspects of Dame Elizabeth's report: rather, we have chosen to focus on key themes which we have previously explored with the FCA such as the perimeter, culture of the FCA and consumer responsibility. We will follow the FCA's and HM Treasury's implementation of Dame Elizabeth's recommendations very closely.

# 1 Individual responsibility of FCA senior management

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## Responsibility vs culpability

20. In line with the scope of HM Treasury's Direction, Dame Elizabeth's report made certain findings of individual responsibility in relation to the FCA's regulation of LCF. Her report noted that "the term "responsibility" [...] refers to a sphere of activities or functions of the FCA for which a senior manager bears ultimate accountability." Dame Elizabeth made clear, however, that "the findings of individual responsibility ... are not conclusions about the personal culpability of any individuals or groups of individuals."<sup>22</sup>

21. The investigation did not seek findings of personal culpability. Dame Elizabeth told us that:

[...] I did not find it necessary to deal with this, particularly because, if I had had to address, in legal liability terms, the personal culpability of a particular person, I considered [...] that it would have involved my looking, first of all, at the particular event or circumstance for which I was wishing to hold the person personally culpable. Secondly, it would have involved my looking at what that person was doing on a daily basis in relation to other matters. I would have to get an estimate or an analysis of his or her workload, and I would have to decide whether the blame, the liability, really lay with that person given what he or she was doing in the period [...] and I did not think it was necessary for me to do that to answer the questions that the Treasury had raised.<sup>23</sup>

22. John Glen MP, Economic Secretary to the Treasury, explained why personal culpability was not in the scope of the Direction, telling us that:

[...] because we wanted to get to the heart of where that regulatory failure was as quickly as possible, [...] the nature of the inquiry would have been significantly different [if findings of personal culpability were to be made]. It would have involved even more scrutiny of who did or did not receive the anonymous letter and the 15 telephone calls, et cetera, during that period of 2017–19.<sup>24</sup>

## Named individuals

23. Dame Elizabeth's report made certain findings of responsibility in the FCA's regulation of LCF. The FCA Executive Committee was identified as bearing responsibility, and the following individuals were named in the report: Andrew Bailey, Governor of the Bank of England and former Chief Executive of the FCA; Megan Butler, Executive

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22 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 26

23 [Q2](#)

24 [Q331](#)

Director for Transformation and former Executive Director for Supervision—Investment, Wholesale and Specialist (“SIWS”); and Jonathan Davidson, former Senior Adviser, and former Executive Director for Supervision—Retail and Authorisation Division (“SRA”).

### **Andrew Bailey**

24. Dame Elizabeth’s report was submitted in draft to those who were criticised in the draft, under the Maxwellisation process, so as to give them an opportunity to make representations in respect of those criticisms.

25. In her report, Dame Elizabeth noted that a number of participants in the representations process had asked the Investigation not to make findings about individual responsibility for the FCA’s deficiencies in regulating LCF. Representations to this effect were made on behalf of Andrew Bailey. Dame Elizabeth expressed her disappointment to us that such representations had been made. She said that putting them forward showed “a lack of judgment”.<sup>25</sup> The investigation did not accept the argument underlying those representations.<sup>26</sup>

26. Andrew Bailey was the Chief Executive of the FCA from July 2016 to March 2020.<sup>27</sup> On the failings attributed to his responsibilities as CEO in respect of LCF, Mr Bailey told us that “as [then] CEO, I was responsible for everything”.<sup>28</sup> But he also said that “there was an element of ambiguity in the original draft of Dame Elizabeth’s report about the difference between culpability and responsibility”.<sup>29</sup> Mr Bailey made representations seeking changes to the draft report and in particular to “delete the reference to “responsibility” resting with specific identified/identifiable individuals, whether the Executive Directors of Supervision or Mr Bailey”.<sup>30</sup>

27. Mr Bailey’s representations offered three reasons for the removal of the references to responsibility resting with specific identifiable individuals from Dame Elizabeth’s original draft report. Those reasons were that:

- The scope of the Investigation, as set out in para 3 of the Treasury Direction, did not require the attribution of “responsibility” to particular individuals within the FCA, but rather was directed at whether the FCA (as an organisation) “discharged its functions”. His representation stated that “this is a freestanding reason for the removal of the references to Mr Bailey’s responsibility”;
- There was an inherent ambiguity in the use of the word “responsibility”; and

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25 [Q9](#)

26 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), para 11.1, page 26

27 Bank of England, Andrew Bailey: Governor, Bank of England, ‘[Biography](#)’, accessed 3 June 2021

28 [Q76](#)

29 [Q66](#)

30 See extracts of Mr Bailey’s representations in letter from the Rt Hon Dame Elizabeth Gloster DBE to the Chair of the Treasury Committee <https://committees.parliament.uk/publications/5305/documents/52931/default/>, 25 March 2021, page 7, accessed 3 June 2021

- Certain wording in Chapter 5 [of the draft report] suggested (or might be taken to suggest) that there was a causal link between what Mr Bailey did (or failed to do) and the specific failures of regulation in relation to LCF, with the consequent loss suffered by the Bondholders.<sup>31</sup>

28. There had been a clear difference of opinion between Dame Elizabeth and Mr Bailey on the use of the term “responsibility” in the draft report. As well as stating that there was a “fundamental misunderstanding” with regard to the Maxwellisation process and that it was incorrect for Dame Elizabeth to present the point made in his representations as an “unconditional statement”<sup>32</sup> that he did not want his name mentioned in the report, especially with regard to responsibility, Mr Bailey told us that:

The term “responsibility” can be used with two very different meanings. One meaning is accountability... the other meaning is personal culpability. I continue to believe that it was crucial for Dame Elizabeth’s draft report to be clear whether it was making statements about accountability or whether it was doing so about personal culpability. In my view, and that of others who read it, this was not the case in the draft report ...<sup>33</sup>

Mr Bailey also noted that:

[...] I also accept that Dame Elizabeth was free to criticise individuals if the evidence justified such criticism and doing so advanced the purposes of her report. However, any suggestion of culpability by me or other individuals concerned was not supported by evidence presented in the draft report. In my view, it was therefore wrong to name individuals in the draft report as it then stood because this would inevitably result in misinterpretation, leading to unjustified accusations of personal culpability... I did include the point that naming individuals was not a requirement of the terms of reference, and that this was a free-standing point—in other words, its validity was not specific to my representations about clarity on responsibility. However, I would not have been compelled to make this point if the draft report had been clearer.<sup>34</sup>

29. In a letter to the Chair of our Committee, Dame Elizabeth told us that she disagreed that there had been a “fundamental misunderstanding” during the Maxwellisation process, and she explained that the argument of personal culpability versus responsibility had been “merely one argument in support of” the position that references to Mr Bailey or other named individuals should be deleted from the report.<sup>35</sup> In a subsequent letter to the Chair responding to Mr Bailey’s claims, she told us that:

Mr Bailey accepts that his first representation on this issue (i.e. that my report should not include reference to individual responsibility because (in his view) the Direction did not require it) was a “free-standing point”. Indeed, as I have highlighted, it was the first (and, in my view, primary)

31 Ibid.

32 Q76

33 Letter from Andrew Bailey to Chair of Treasury Committee, <https://committees.parliament.uk/publications/5304/documents/52929/default/>, 22 March 2021, accessed 3 June 2021

34 Ibid.

35 Letter from the Rt Hon Dame Elizabeth Gloster DBE to the Chair of the Treasury Committee <https://committees.parliament.uk/publications/4634/documents/46856/default/>, 8 February 2021, accessed 3 June 2021

argument in his representations as to why I should delete reference to individual responsibility in the final report. Only after making this point did his representations make the separate argument that alleged uncertainty in the use of the term “responsibility” in the draft report was a further reason that references to individual responsibility should be deleted.<sup>36</sup>

30. The public disagreement between Dame Elizabeth Gloster and Andrew Bailey effectively raised the question as to whether Andrew Bailey had misled the Committee when giving evidence on this matter.

**31. It is not immediately clear that Mr Bailey’s concerns about the distinction between “responsibility” and “culpability” in Dame Elizabeth’s draft report would have “compelled” him to make his “free-standing” objection. However we accept that it is likely that his strong concerns over the “responsibility” vs “culpability” point may have led him to make his “free-standing” objection to the inclusion of named responsible individuals, and that in the absence of his concerns about the distinction between “responsibility” and “culpability” he might not have put forward his “free-standing” objection. We cannot of course be certain about this and if we were satisfied that there was strong and clear evidence that Mr Bailey had misled the Committee on this point, it would be a serious matter. But the evidence does not support that particular conclusion, and we do not believe that Mr Bailey misled the Committee. We note that the revisions made by Dame Elizabeth to the draft report, clarifying that an identification of responsibility was not an attribution of culpability, met the essence of Mr Bailey’s request, and we believe that it is in the wider interest to regard this issue as closed.**

### **Jonathan Davidson**

32. Jonathan Davidson was the former Executive Director for Supervision (SRA) from September 2015 until December 2020. Dame Elizabeth found that Mr Davidson had responsibility for areas where failings were found including: “responsibility for inadequacies in the training framework for staff within the Authorisations Division (and the relevant staff within the Supervision Division),”<sup>37</sup> and policy deficiencies in respect of financial promotions.<sup>38</sup>

33. Mr Davidson apologised for the failings in respect of LCF.<sup>39</sup> After his role as the Executive Director for Supervision (SRA), Mr Davidson held a Senior Adviser position at the FCA, before leaving the organisation following a restructure of the Executive Committee.<sup>40</sup>

36 Letter from the Rt Hon Dame Elizabeth Gloster DBE to the Chair of the Treasury Committee <https://committees.parliament.uk/publications/5305/documents/52931/default/>, 25 March 2021, accessed 3 June 2021

37 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 9, page 199

38 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 11, page 231

39 [Q276](#)

40 [Q182](#)

## Megan Butler

34. Megan Butler was appointed Executive Director for Transformation at the FCA in November 2020.<sup>41</sup> Prior to this role, she was Executive Director for Supervision (SIWS), a role she took up on secondment from the Prudential Regulation Authority (PRA) in September 2015 and permanently in May 2016.<sup>42</sup>

35. Dame Elizabeth's report found that Ms Butler, in her capacity as Executive Director for Supervision (SIWS), had responsibility for areas where failings were found during the investigation's Relevant Period.<sup>43</sup> These include responsibility for a lack of operational awareness of the perimeter as it affected the authorisation and supervision of LCF,<sup>44</sup> and responsibility for policy failings with regard to interrogating a firm's financial information following an allegation of fraud made against the firm.<sup>45</sup>

36. On the failings attributed to her areas of responsibility, Ms Butler told us that she "take[s] full responsibility for the supervision model that was designed and rolled out" as well as "full responsibility for judgements and decisions taken by individuals within [her] areas of responsibility," but that she had not considered resigning from the FCA.<sup>46</sup> Ms Butler explained that there was a "collective responsibility" and "collective response" with regard to the FCA's failure to adequately regulate LCF.<sup>47</sup>

37. The FCA Board concluded that the failings attributed to Ms Butler's area of responsibility did not amount to serious culpability that would lead to her leaving the organisation, but considered what the consequences should be for individuals. This resulted in the cancellation of performance-related pay for the Executive Committee for the 2019–20 year and no future performance-related pay for the Executive Committee.<sup>48</sup> Charles Randell CBE, Chair of the FCA since April 2018, explained the Board's view on the consequences of the FCA's failings in respect of LCF. He told us that:

We decided that the consequences that flow from this should be collective. It was clearly the case that the FCA wasn't sufficiently joined up across its various activities, including its policy and supervision functions, its systems and technology. That is why we decided that it was important to take actions that were collective, because the last thing we want to come out of this LCF review is a culture where FCA Executive Directors try to avoid responsibility through silo working, or try to avoid high-risk responsibility, such as supervision, altogether. We want our Executive Directors to embrace a culture of collective delivery, working as a joined-up team, and to be motivated by public service.<sup>49</sup>

41 Financial Conduct Authority, '[Megan Butler](#)', accessed 3 June 2021

42 Financial Conduct Authority, '[Megan Butler appointed permanent Director of Supervision – Investment, Wholesale and Specialists](#)', 27 May 2016, accessed 3 June 2021

43 The Relevant Period is between 1 April 2014 and 30 January 2019

44 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 6, page 111

45 *Ibid.*, Chapter 12, pages 249–250

46 [Q262](#)

47 [Q263](#)

48 [Q182](#)

49 [Q182](#)

38. On the question of whether Ms Butler was the right person to be leading the FCA's ongoing Transformation programme following the failings attributed to her areas of responsibility in Dame Elizabeth's report, Nikhil Rathi, Chief Executive of the FCA, told us that "[...] transformation of the FCA is and has been a priority for me, and I wanted to get moving quickly. In order to do that I chose to recruit an Executive Director for transformation from within the current Executive team [...]"<sup>50</sup> Mr Rathi also said that:

Transformation is a team effort. Of course, Megan is playing an important role, but transformation is something that is going to be the objective of every single Executive Director, every single Director, across the Financial Conduct Authority. Everyone will be held to account for their contribution.<sup>51</sup>

39. We heard that a number of recruitment campaigns for a range of roles, including operating roles, chief data officer and a number of other senior executive positions, were launched and run through global searches, internally and externally.<sup>52</sup> However, the recruitment for the transformation director role was internal, with only two candidates, and Megan Butler was considered the better of the two.<sup>53</sup> Charles Randell CBE, Chair of the FCA, told us that:

It was my judgment that if we [engaged in a wider recruitment search for the Executive Director for Transformation role] it would put back our momentum to change the FCA by somewhere between six and 12 months... We would have lost the lessons of this episode, and 30 years of other lessons about where things have not gone well in the FCA, which Megan has lived through.<sup>54</sup>

Mr Randell also said that:

When we were having conversations about Megan at the board, I knew that it would end in a conversation like this with you, Mr Stride, and I felt that it was really important that I did what I believed was in the interests of the FCA and not what would give me an easy ride in this conversation. And it is my belief that that is what we have done. I absolutely understand that people who are extremely angry about the failure of LCF will feel the way that they do, and I am really sorry about that, but my commitment is to try to make things change as quickly as possible.<sup>55</sup>

40. The Economic Secretary to the Treasury, John Glen MP, said that "it would not be appropriate for the Treasury to intervene in the staffing decisions taken by the FCA Board" but he "fully stand[s] behind the FCA leadership, and ha[s] full confidence in the Chairman, CEO, and the Executive Team at the FCA to implement their ambitious programme of reform."<sup>56</sup>

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50 [Q171](#)

51 [Q231](#)

52 [Q171](#)

53 [Qq175-178](#)

54 [Q183](#)

55 [Q184](#)

56 HM Treasury, [Letter from Economic Secretary to the Treasury to the Chair of the Treasury Committee](#), 23 April 2021, (accessed 3 June 2021)

41. We welcome the FCA's approach to recruitment for some senior executive roles, which involved global searches, but we believe that the FCA was wrong not to have engaged in a fuller recruitment programme for the Executive Director for Transformation role, including the consideration of potential recruits from outside the FCA. It appears that there was a missed opportunity to consider fresh leadership for the Transformation programme. We also question whether there would have been a significant slowdown in the progress of the Transformation programme had Megan Butler not been recruited to oversee it. Another recruit might have been supported by Megan Butler for at least a period to help assist with this role, or Megan Butler might have taken on that role on a temporary basis whilst the recruitment process was conducted.

42. Given that Dame Elizabeth's report cited Megan Butler as bearing responsibility for important areas of failure and that her recruitment was conducted internally with just one alternative candidate, we understand why many will feel that "a buck that does not stop with an individual stops nowhere"<sup>57</sup> when it comes to the personal consequences for those involved with the failings at the FCA in relation to LCF.

43. *We recommend that the default position should be that the FCA take a holistic approach when recruiting for critical roles, rather than engaging in a restricted recruitment process. For time-critical appointments, the FCA should consider appointing on an interim basis until a wider search, considering where appropriate both internal and external candidates, has been completed.*

## Responsibility at the FCA

44. The 2013 Parliamentary Commission on Banking Standards (PCBS) report *Changing Banking for Good* noted that "... responsibility that is too thinly diffused can be too readily disowned: a buck that does not stop with an individual stops nowhere".<sup>58</sup> We asked Mr Randell where the buck stops with regard to the failings identified in the case of LCF. He told us that:

I think the buck stops with me. I am accountable for the organisation overall; as Chair, I am accountable for it. And the Chief Executives are accountable for it and so are the Executive Directors of Supervision. That's where the buck stops [...]<sup>59</sup>

45. The Senior Managers Regime ("SMR"), which applies to FCA-regulated firms, was introduced by the Financial Services (Banking Reform) Act 2013 in response to a PCBS recommendation. The FCA states that the aim of the SMR is to "reduce harm to consumers and strengthen market integrity by making individuals more accountable for their conduct and competence", as well as being "a catalyst for change—an opportunity to establish healthy cultures and effective governance in firms by encouraging greater individual accountability and setting a new standard of personal conduct."<sup>60</sup>

57 Parliamentary Commission on Banking Standards, First Report of Session 2013—14, [Changing banking for good](#), HL Paper 27-I/HC 175-I, para 616

58 Parliamentary Commission on Banking Standards, First Report of Session 2013—14, [Changing banking for good](#), HL Paper 27-I/HC 175-I, para 616

59 [Q185](#)

60 Financial Conduct Authority, [Senior Managers and Certification Regime](#), accessed 3 June 2021

46. As Dame Elizabeth highlighted in her report,<sup>61</sup> this Committee previously recommended:

that the FCA [...] draw up a 'Responsibilities Map' which allocates key responsibilities to individuals in their respective organisations. This document should be published. It should be compliant as far as possible with the SMR that the regulators require of banks.<sup>62</sup>

47. During the relevant period, there was a responsibilities map as shown by Appendix 10 of Dame Elizabeth's report which captures the FCA's assignment of senior managers responsibilities.<sup>63</sup>

**48. We accept that a degree of shared responsibility is desirable and necessary in an organisation such as the Financial Conduct Authority. However, it is not readily justifiable for the FCA to require the firms that it regulates to adhere to the principles of the Senior Managers Regime but seemingly not to apply similar principles internally when there are failings of practice and culture in the organisation. The FCA Board should reflect on whether it has, in this case, met the standards which it seeks to impose upon others. We believe that there are doubts as to whether it has.**

**49. We recognise that the demands of some of these senior executive positions at the Financial Conduct Authority are heavy, and that individual accountability for organisational failings may deter strong candidates from applying for them. But an over-reliance on collective responsibility may deny visible accountability and could lessen confidence in the organisation as a result. We are not wholly persuaded that the balance struck by the FCA on this occasion has strengthened its standing in the eyes of those it regulates or the wider public.**

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61 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 1, page 29

62 Treasury Committee, Thirteenth Report of Session 2014—2015, [Press briefing of the FCA's Business Plan for 2014/15](#), HC 881, para 184

63 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Appendix 10, pages 431–441

## 2 Culture at the FCA

### Reactive and siloed culture

50. The culture at the FCA has been an ongoing topic of concern for the Treasury Committee. In relation to a different failing relating to the press briefing of the FCA's business plan for 2014/15, a previous Committee recommended that:

The non-executive members of the FCA Board should assess the extent to which the FCA may suffer from a culture of working in silos and of inadequate information sharing. It should take steps to ensure that staff at all levels across the organisation have a good knowledge of the objectives of other divisions of the regulator, and some familiarity with the areas of expertise of those divisions [...]<sup>64</sup>

51. Dame Elizabeth's report also noted the siloed and lack of joined-up approach at the FCA in relation to the supervision of LCF. The investigation found that "the FCA failed to consider LCF's business holistically."<sup>65</sup> For example, repeated breaches of the financial promotions rules by LCF did not result in a referral to the Supervision or Enforcement division for further review.<sup>66</sup> Also, "call-handlers on many occasions failed to refer allegations of fraud or irregularity regarding LCF's non-regulated bond business to the Supervision Division,"<sup>67</sup> due to unclear FCA contact centre policy documents.

52. A 2016 report by PA Consulting (the "PA report"), commissioned by the former FCA Executive Directors for Supervision, Megan Butler and Jonathan Davidson<sup>68</sup> to assess the effectiveness of the FCA's approach to flexible firm<sup>69</sup> supervision, found that interactions between teams and divisions across the FCA were largely informal and unstructured.<sup>70</sup> While there were some positive aspects to this, it also resulted in a lack of co-ordinated and consistent collaboration and knowledge sharing, with "key areas of the supervisory divisions being left out of important risk and planning discussions."<sup>71</sup>

64 Treasury Committee, Thirteenth Report of Session 2014—2015, [Press briefing of the FCA's Business Plan for 2014/15](#), HC 881, para 135

65 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 33

66 Ibid.

67 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, pages 32–33

68 [Q72](#); [Q278](#)

69 Flexible firms are a portfolio of firms in the FCA overseen by the monitoring of market-based risks and crystallised risk events. (Source: PA Consulting, [Effectiveness assessment of the FCA approach to flexible firm supervision](#), 27 July 2016, page 1)

70 PA Consulting, [Effectiveness assessment of the FCA approach to flexible firm supervision](#), 27 July 2016, page 22–23

71 Ibid.

53. The FCA developed the Delivering Effective Supervision (“DES”) programme<sup>72</sup> “in response to, among other things, the draft mission<sup>73</sup> and the PA report.”<sup>74</sup>

54. We sought witnesses’ views on the culture at the FCA. Andrew Bailey, former Chief Executive of the FCA, told us that upon his arrival in 2016, he was faced with a choice of changing the structure and culture of the organisation or fixing the approach to supervision [as identified by the PA report] and staff training. He chose to do the latter first, due to the scale of problems to be dealt with, as well as the fact that changes to management structure and organisational changes had already been made.<sup>75</sup>

55. In his response to Dame Elizabeth’s report, Mr Bailey apologised for not having introduced changes to the FCA’s culture in time to prevent the failures that occurred over LCF: “The required changes in culture, mind-set and systems was a major programme of work across the organisation, which took some time to put into effect. I am sorry those changes did not come in time for LC&F bondholders.”<sup>76</sup>

56. Commenting on Mr Bailey’s apology, Dame Elizabeth acknowledged the difficult situation that he had inherited but told us that:

[...] the problems that were there were not so fundamental that they could not [...] have been fixed by specific, focused changes. My view is that it is not an adequate reason or excuse to say, “If only LCF had happened a bit later, all the changes we would have put in place would have stopped it happening.” These were defects that we did not think were in fact being picked up by the change programmes.<sup>77</sup>

Mr Bailey disagreed with this view, telling us that:

I agree with Dame Elizabeth on a lot of things, but I do not agree on this point. She sort of suggested to you that, if only we had told the staff to pull their socks up, the problem would have gone away. At one point in the report, she even suggested that maybe it was a mistake to do the programmes of change, which I fundamentally disagree with.<sup>78</sup>

57. There is an appreciation from the current FCA senior management that the culture at the FCA needs to improve. Charles Randell CBE, Chair of the FCA, said of the FCA’s current culture:

... there is still too much process, some of which is a bit repetitive, and there is still a risk aversion, particularly around legal risks, which conceals the true risk. It is absolutely clear in case after case that where we have been

72 The DES programme sought to overhaul the way in which the FCA supervised the firms it regulated

73 On starting his role as CEO in July 2016, Andrew Bailey immediately determined that it was necessary for the FCA to prepare a mission statement that defined the FCA’s role and objectives (something he described as getting “back to the real basics”), see footnote 551, page 149 of Dame Elizabeth’s report

74 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 8, page 149

75 [Q105](#)

76 Bank of England, [‘Statement from Governor Andrew Bailey on Dame Elizabeth’s Report’](#), (17 December 2020), accessed 3 June 2021

77 [Q6](#)

78 [Q74](#)

averse to acting because of our perception of risk, we have ended up with a much bigger risk than we would have had if we had acted. That is the message that we get again and again from these reports.<sup>79</sup>

Mr Randell said that while some colleagues demonstrate proactive behaviours, this was not always the case. He would like to see an FCA “where people in the frontline are curious, impatient, agile and decisive. I think if we can drive that more broadly across the organisation, we will end up with an FCA that is quite close to being as good as it can be.”<sup>80</sup>

58. Nikhil Rathi, Chief Executive of the FCA, told us that “The FCA is a purposeful, committed organisation as I have arrived. I would like to turn it into a proactive, operationally excellent organisation during my tenure,”<sup>81</sup> but he also admitted “We do need to make changes, though, in terms of our operational systems and our culture around risk—in particular, legal risk.”<sup>82</sup>

59. The FCA is undertaking a transformation programme which is seeking to improve its databases and technology as well as its people, culture and capabilities.<sup>83</sup> The programme aims to “ensure the FCA can make fast and effective decisions and can prioritise the right outcomes for consumers, markets and firms.”<sup>84</sup>

60. In response to Dame Elizabeth’s findings, the FCA said that:

The failures that the LCF Review identifies suggest we need a wider cultural change. To lead by example, it is essential that we hold ourselves to account on our own culture. Fast-tracking a more unified FCA and greater pace and agility in addressing harm are overarching priorities for our transformation programme. This requires a cultural and behavioural shift to enable us to anticipate issues, scrutinise intelligence and challenge business models with a sceptical mindset—and respond at pace.”<sup>85</sup>

61. On what can be done to improve the FCA’s culture, Dorothy Cory-Wright, Partner, Head of London Disputes Practice at Dechert LLP (a member of Dame Elizabeth’s investigation team), made two observations. First, she highlighted that the FCA had seen numerous changes in its structure since its inception, and that further operational and structural changes are expected as part of the FCA’s plans to address Dame Elizabeth’s recommendations. But she said that “at some time the change has to stop and the functioning organ has to appear. We noted that there was not an end date suggested for the programmes in the FCA’s response.”<sup>86</sup> Secondly, Ms Cory-Wright observed that the FCA had some competent staff who were “interested and enthusiastic” and would be able to drive forward a culture change and help address issues such as alleged fraud.<sup>87</sup>

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79 [Q216](#)

80 [Q215](#)

81 [Q214](#)

82 [Q210](#)

83 [Q248](#)

84 Financial Conduct Authority, Letter to the Economic Secretary to the Treasury from the Chair of the Financial Conduct Authority, [Progress of the FCA's Transformation Programme](#), 16 April 2021, (accessed 3 June 2021)

85 Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital and Finance plc—The FCA Response](#), (December 2020), page 16

86 [Q48](#)

87 [Ibid.](#)

62. John Glen MP, Economic Secretary to the Treasury, said that a way to address the risk aversion culture at the FCA would be for the Treasury to encourage the delivery of the transformation programme as quickly as possible, support the FCA Chief Executive in his quest to be more interventionist, and discuss the FCA's remit and perimeter evolution.<sup>88</sup>

**63. The FCA plays a vital role as the UK's financial conduct regulator and prudential regulator for most financial services firms. Its work affects millions of financial services customers and it is important that it has the right culture to facilitate its objectives. We support the views of the current FCA senior leadership team that the organisation needs to become a more "proactive", "agile", "decisive" and joined-up regulator that is willing to act, including in the face of uncertainty, to protect consumers and financial markets.**

*64. We welcome the FCA's ongoing transformation programme which has cultural change as one of its priorities. We however note that the FCA has undergone numerous structural and operational changes since its inception, with more changes expected as part of the ongoing transformation. We recognise that culture change takes time but recommend that the FCA Board sets itself an end date for the transformation programme and that it creates milestones at which improvements and evidence of changes in culture can be reviewed. These milestones and reviews should be put into the public domain. At the completion of the transformation programme, the FCA should ensure it has in place measures that will ensure that its improved culture is maintained and embedded.*

## Contact centre and third-party correspondence

65. One of Dame Elizabeth's recommendations was that:

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.<sup>89</sup>

66. Dame Elizabeth's report highlights the failures of the FCA's contact centre team to escalate allegations of possible fraud at LCF, as well as some of the ways the FCA failed to effectively deal with third-party correspondence received on LCF: "The root cause of the FCA's failure to handle third-party information regarding LCF properly was an absence of appropriate internal policies."<sup>90</sup>

88 Q387

89 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 47

90 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 38

67. There were no clear policies in place on how to respond to information provided by third parties, or how allegations of fraud should be pursued. This meant that call-handlers did not refer allegations against LCF on a number of occasions, and that allegations of fraud were not pursued.<sup>91</sup>

68. The investigation also found it “wholly inappropriate” that call-handlers sometimes reassured callers as to the reputability of LCF’s bond issues based on its authorisation by the FCA; and in some instances, call-handlers incorrectly advised that LCF’s bond issues benefited from FSCS protection.<sup>92</sup>

69. Putting into context some of the problems with the contact centre at the FCA, Andrew Bailey, former Chief Executive of the FCA told us that “We had no system. We inherited no system for extracting information out of the contact centre calls” and “the red flags were buried ... in the 200,000 calls and there was not a system for extracting them.”<sup>93</sup> He explained that Dame Elizabeth “benefited from the fact that the LCF calls were extracted for her team, because that is what the FCA had to do and did do.”<sup>94</sup> There were also issues to do with high staff turnover and high staff sickness rates, both of which made continuity challenging.<sup>95</sup>

70. When asked what temporary measures were put in place to extract call centre information in the absence of a system, Mr Bailey explained that a number of steps were taken between September 2016 and May 2019, including introducing speech and text analysis that allowed for searches of calls, emails and web forms, which enabled analysis of themes and root causes.<sup>96</sup>

71. The FCA has begun making changes in an attempt to address concerns about the contact centre and third-party correspondence not being appropriately dealt with or escalated. Nikhil Rathi, Chief Executive of the FCA, told us that “[...] the level of risk we carry in the authorisations function and the contact centre is quite high for our organisation, which is why I have appointed a specific Executive Director for Authorisations with strong operational experience [...]”<sup>97</sup> He added that:

We have taken further steps—so, within the database of escalation, the issue of financial crime is a specific field that then gets escalated into supervisory teams for further triage and further examination. We have changed our policies around the communication to consumers about FSCS coverage, to make sure that consumers are not incorrectly assured when there is lack of clarity about whether something is covered or not, and also that they are not incorrectly assured about a firm that is doing unregulated activity, although it has a regulatory badge for another type of activity. Some training has been introduced as well [...]<sup>98</sup>

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91 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 12, page 243

92 Ibid.

93 [Q71](#)

94 Ibid.

95 [Q81](#)

96 Letter from Andrew Bailey to Chair of the Treasury Committee, <https://committees.parliament.uk/publications/5304/documents/52929/default/>, 22 March 2021, page 3, accessed 3 June 2021

97 [Q250](#)

98 Ibid.

72. In a letter to John Glen MP, Economic Secretary to the Treasury, providing a progress update on the transformation programme and implementation of Dame Elizabeth's recommendations, Charles Randell CBE, Chair of the FCA, noted that:

We have made changes to our Consumer Hub 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.<sup>99</sup>

73. As well as the need for call-handlers to have clear guidance and policies in place,<sup>100</sup> we heard about the importance of having the right technology and data analytics to analyse contact centre and third-party correspondence in support of supervision work. Dame Elizabeth told us that “[...]Part of the problem here is not just training and clear instructions being given to call-handlers but also having appropriate data analytics or the appropriate technology to ensure this information is harvested, gathered and then available for people in supervision.”<sup>101</sup>

74. In a letter to John Glen MP, Economic Secretary to the Treasury, on 16 April 2021, Charles Randell noted that the FCA will—as part of the transformation programme—invest in technology to support better use of data, which will enable the regulator to deliver more effective supervision.<sup>102</sup>

**75. The FCA accepts that there were failings in the contact centre during the Relevant Period as identified in Dame Elizabeth's report, and has begun taking steps to address these. We welcome the operational improvements that have been made since the publication of Dame Elizabeth's report, including the training of call-handlers and changes to contact centre policies.**

**76. *The FCA should ensure that it keeps its contact centre policies and training up to date to ensure clarity and consistency, not just in relation to firms such as LCF but to the wider organisation.***

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99 Financial Conduct Authority, Letter to the Economic Secretary to the Treasury from the Chair of the Financial Conduct Authority, [Progress of the FCA's Transformation Programme](#), 16 April 2021, (accessed 3 June 2021)

100 [Q26](#)

101 [Q24](#)

102 Financial Conduct Authority, Letter to the Economic Secretary to the Treasury from the Chair of the Financial Conduct Authority, [Progress of the FCA's Transformation Programme](#), 16 April 2021, (accessed 3 June 2021)

## 3 The regulatory perimeter and the scope of the FCA's remit

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### Perimeter of regulation

77. The perimeter of regulation determines what the FCA can and cannot regulate. It is an area that this committee and its predecessors have frequently explored with the FCA. Some examples of previous topics considered by the Committee that touch on perimeter issues include the Royal Bank of Scotland's Global Restructuring Group (GRG) and the wider issue of SME lending; and 'mortgage prisoners' (those who face barriers to switching their mortgage).

78. A previous Treasury Committee report on the FCA's perimeter of regulation concluded that "care needs to especially be taken where regulated financial institutions are undertaking an activity that is itself unregulated."<sup>103</sup>

79. In the case of LCF, the investigation found that the FCA's approach to the perimeter played a key role in how it regulated the firm. This is because LCF operated both within and outside the perimeter. Dame Elizabeth's report stated that:

On the one hand, LCF, as a firm, was clearly within the perimeter because it was FCA-authorized. In addition, LCF's financial promotions in respect of its issuing of bonds were also within the FCA's perimeter and subject to the FCA's financial promotions rules. On the other hand, LCF's issuing of bonds [in the investigation's view] did not constitute regulated activity and LCF, in that sense, operated outside the perimeter.<sup>104</sup>

80. LCF was able to benefit from what Dame Elizabeth calls the "halo effect" or the "imprimatur of respectability that regulation gives a firm," by using its FCA-authorized status to promote risky and potentially fraudulent products in order to attract investors for an unregulated activity.<sup>105</sup> On what could be done to address the "halo effect" problem, Dame Elizabeth noted that more clarity is needed. She said that "an authorized firm that is selling an unregulated product has to be much clearer about what it says, about not having the protection. How that is implemented is another question, and that is for the FCA."<sup>106</sup>

81. Our predecessor committee's report on the perimeter, published in 2019, identified the risks of regulated firms undertaking unregulated activities. It recommended that:

[...] where regulated financial institutions undertake unregulated activity, the regulatory system should ensure that clear and explicit warnings are

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103 Treasury Committee, Thirty-Fifth Report of Session 2017—19, [The work of the Financial Conduct Authority: the perimeter of regulation](#), HC 2594, para 17

104 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 6, page 95

105 [Q29](#)

106 [Q39](#)

provided at that point, with the potential consequences of the lack of regulatory cover clearly explained, with sanctions for firms that fail to do so.<sup>107</sup>

82. Dame Elizabeth's investigation concluded that the way that the FCA approached the perimeter was deficient, and that this had had an impact on the regulation of LCF. Red flags were missed (due to issues raised in LCF's unregulated bond business not being pursued by staff). Also, while there had been an awareness among senior managers that there were risks associated with the perimeter, an appropriate level of awareness of such risks had not been passed down to lower levels of the organisation.<sup>108</sup>

83. Commenting on the FCA's approach to the perimeter, Dame Elizabeth told us that:

The FCA had an approach to the perimeter, a really cultural approach to the perimeter, that meant it really was not enthused or enquiring. The operational people on the ground were not motivated to look at activity outside the perimeter. They looked at financial promotions, yes, but there did not seem to be any appetite or enthusiasm for looking at the non-regulated business, even just to see whether LCF was a fit and proper person to be authorised at all.<sup>109</sup>

84. One of the things that Andrew Bailey, former Chief Executive at the FCA, said that he sought to do when he joined the FCA in 2016 was to tackle the problem of the FCA not looking beyond the perimeter. There was previously no mechanism for doing that, and to address the issue, Mr Bailey produced a mission statement which "stated very clearly that, where we saw the case to do so, we would go beyond the perimeter."<sup>110</sup> The mission also stated that where the FCA cannot act, it will clarify publicly why the issues fall outside the perimeter, or why it has limited powers, and then raise this with the Government and relevant bodies.<sup>111</sup>

85. The perimeter of regulation is set by Parliament and not by the FCA. The FCA's 2018/19 perimeter report states that "We have some powers over FCA authorised firms when they conduct unregulated activities, but they are generally more limited than our powers with respect to firms' regulated activities."<sup>112</sup> The perimeter report goes on to state that "[...] we do not actively supervise or intervene in activity or markets outside the perimeter to the same extent as we do inside it. Doing so would ignore the clear choice expressed in legislation, by successive parliaments and governments, about the degree of regulatory scrutiny expected, and would be an inappropriate use of our resources."<sup>113</sup>

107 Treasury Committee, Thirty-Fifth Report of Session 2017—19, [The work of the Financial Conduct Authority: the perimeter of regulation](#), HC 2594, para 18

108 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 6, pages 95–96

109 [Q30](#)

110 [Q67](#)

111 Financial Conduct Authority: [Our Mission 2017](#), How we regulate financial services, Chapter 4, page 20

112 Financial Conduct Authority, [Perimeter report 2018/19](#), (June 2019), p6, para 2.4

113 *Ibid.*, para 2.5

86. As discussed below, the scope of the FCA's remit is broad. The resulting potential workload means the regulator has to prioritise. Andrew Bailey, former Chief Executive at the FCA told us that “The FCA cannot do everything that is within its perimeter. It has to make prioritisation decisions. I have to be honest with you: if Government and Parliament do not like that, the FCA is going to be a very different organisation”.<sup>114</sup>

87. On the complexity associated with the perimeter, Megan Butler, former Executive Director for Supervision (SIWS) and now Executive Director for Transformation, also told us that:

[The perimeter] is inherently complicated [...] There are different sorts of ways to get inside the perimeter. You sometimes may get registered for money-laundering purposes. Sometimes you have different sorts of permissions [...] It keeps moving. We are introducing funeral plans and we are probably going to have “buy now, pay later” come in.<sup>115</sup>

88. Charles Randell CBE, Chair of the FCA, spoke of two principles. Firstly, the perimeter “needs to be clear to consumers [in terms of] what they can expect of the FCA in relation to an activity, and whether it sits inside the perimeter, or sits outside the perimeter [...]” and secondly “[...]similar activities should be regulated in the same way [...]”<sup>116</sup>

89. In addition, Jonathan Davidson, former Executive Director for Supervision (SRA), told us that aligning the perimeters across the FCA, Financial Ombudsman Service and Financial Services Compensation Scheme, to create a very clear and simple perimeter, would have made his job easier.<sup>117</sup>

90. The previous Treasury Committee's report on the perimeter recommended that the FCA have a formal power to recommend to the Treasury changes to the perimeter of regulation, where that would enhance its ability to meet its objectives, in particular to prevent consumer harm.<sup>118</sup> However, in its response, the Government argued that, based on its monitoring of the perimeter and its regular dialogue with financial regulators including the FCA, it did not see the case for providing a formal power for the FCA to request changes to the perimeter.<sup>119</sup>

91. John Glen MP, Economic Secretary to the Treasury, told us that he seeks effective regulation and has always been open to extending the perimeter.<sup>120</sup> He said that he is in regular dialogue with the Chief Executive of the FCA, including a recent meeting in January 2021 to discuss the FCA's annual perimeter report.<sup>121</sup> The Economic Secretary said that the reasons for any proposed or potential changes to the perimeter would have to be considered.<sup>122</sup>

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114 [Q113](#)

115 [Q307](#)

116 [Q193](#)

117 [Q308](#)

118 Treasury Committee, Thirty-Fifth Report of Session 2017—19, [The work of the Financial Conduct Authority: the perimeter of regulation](#), HC 2594, para 31

119 [The work of the Financial Conduct Authority: the perimeter of regulation: Government Response to the Committee's Thirty-Fifth Report](#), 1 October 2019, para 2.10

120 [Q370](#)

121 HM Treasury, HM Treasury and Financial Conduct Authority Regulatory Perimeter Meeting January 2021, [HM Treasury and Financial Conduct Authority Regulatory Perimeter Meeting January 2021 - GOV.UK \(www.gov.uk\)](#), (published 25 February 2021), accessed 3 June 2021

122 [Q354](#)

92. The case of LCF illustrates how important it is that the FCA looks at a regulated firm's activities both within and outside the perimeter of regulation. The FCA's failure to consider issues raised in LCF's unregulated bond business led to red flags being missed.

93. *The "halo effect" appears to be inevitable as long as authorised firms also carry out unregulated activities. We reiterate the recommendation made by our predecessors that the FCA should ensure that it requires authorised firms to make clear explicitly the risks to customers associated with their unregulated activities.*

94. *In future, the FCA should set out in its annual perimeter report how its supervisory strategies and policies reflect the activities of authorised firms both within and outside the perimeter.*

95. The perimeter is complex, and while the FCA has some limited powers to act beyond the perimeter, it does not have the remit to actively monitor or intervene outside the perimeter. We recognise the need for the FCA to make prioritisation decisions as its resources are finite.

96. We welcome the ongoing dialogue between the Treasury, the FCA, and other financial regulators on the perimeter, but the failings in the FCA's regulation of LCF and constant movement of the perimeter are signs that further action is required.

97. *We therefore reiterate a recommendation made by a previous Treasury Committee, that the FCA be given the formal power and remit to be able to recommend formally to the Treasury changes to the perimeter of regulation, where that would enhance its ability to meet its objectives, in particular to prevent consumer harm. The FCA should set out any costs, both to firms and consumers. It would then be for the Treasury to consider such a recommendation promptly. All such recommendations and Treasury responses should be publicly disclosed.*

## The scope of the FCA's remit

98. Dame Elizabeth recommended that "HM Treasury should consider the optimal scope of the FCA's remit."<sup>123</sup> The investigation heard from the FCA that "the transfer of consumer credit regulation from the [Office of Fair Trading] to the FCA had brought particular challenges, with the number of firms regulated by the FCA increasing from 26,000 in 2014 to 59,000 in 2019."<sup>124</sup> Andrew Bailey, former Chief Executive of the FCA told us that the influx of firms "swamped the FCA's capacity to supervise, particularly to supervise small firms. That was the big problem."<sup>125</sup>

99. The size and scope of the FCA's remit was also increasing during the Relevant Period of Dame Elizabeth's report, with the regulator taking on "priority work on high cost consumer credit, high risk investments and the impact of Brexit, [...] additions to its

123 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 49

124 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 306

125 [Q161](#)

remit as the new regulator for claims management companies and the formation of [...] a new body within the FCA with oversight of anti-money laundering and anti-terrorist-financing regimes.”<sup>126</sup>

100. The FCA's remit is still increasing, as it will become the regulator for funeral plans from July 2022.<sup>127</sup> When asked about the increasing scope of the FCA's remit including the likelihood of cryptoassets and buy-now-pay-later being brought within the perimeter, John Glen MP, Economic Secretary to the Treasury told us that:

I make no apologies for the extension of the responsibilities that we ask of the FCA. We live in a very sophisticated financial services economy in the UK [...]

[...] When parliamentarians and all-party parliamentary groups bring issues to me, I look very carefully at them. When we think about buy-now-pay-later, which is an evolution in the provision of financial services and a new credit product, it is right that we ask the FCA to regulate. The same is true with funeral plans. Obviously, we are going through a significant period of change in terms of digital assets, blockchain, crypto-assets and so on. It is important that we get that right and that the FCA has the responsibility to do that [...]<sup>128</sup>

101. Addressing Dame Elizabeth's recommendation on the scope of the FCA's remit, the Economic Secretary to the Treasury noted in a ministerial statement that “the Government agrees that it needs to consider whether this scope is manageable, but it would be premature to do so before the ongoing FCA Transformation Programme has been delivered. I have discussed this reform programme with the Chair and Chief Executive and I am convinced it is the best means to address the recommendations”.<sup>129</sup>

102. When asked for a deadline for the FCA transformation programme, Nikhil Rathi, Chief Executive of the FCA, did not commit to a timeframe but instead suggested that the FCA would have to adapt to the constant disruptions in the world of financial services as part of its transformation.<sup>130</sup>

**103. Both the FCA and the Treasury accept that the scope of the FCA's remit is broad and continues to increase. The breadth of the scope has had some operational impacts on the FCA's ability to carry out its work. We note that the Treasury's intention is to consider the scope when the ongoing FCA transformation programme has been delivered; but the timescales for delivery of the transformation programme are unclear.**

**104. If the FCA Board were to set itself an end date for the transformation programme, as we recommend in Chapter 2, the Treasury would have a clear indication of when to begin its consideration of the scope of the FCA's remit.**

126 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 306, Footnote 1089

127 Financial Conduct Authority: ['Regulating the funeral plans sector: what you need to know'](#), accessed 3 June 2021

128 [Q354](#)

129 [Financial Services Update, Statement made on 17 December 2020](#), Statement UN HCWS678, Statement made by John Glen Economic Secretary to the Treasury, accessed 3 June 2021

130 [Q248](#)

105. *Any changes to the perimeter must be matched with appropriate changes in the FCA's resources, and the FCA should republish its priorities. The Treasury should publish a policy statement on how it will analyse changes to the FCA's perimeter and what factors it will take into account.*

## The FCA's attitude to combatting fraud

106. Dame Elizabeth recommended that “the FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.”<sup>131</sup>

107. The FCA has a role to play in combatting fraud. On its website, the FCA notes that “fraud falls within the FCA's objective of reducing the risk of financial crime and also impacts on our consumer protection objectives.”<sup>132</sup> Dame Elizabeth's report recognised that protecting customers from fraud falls within the FCA's remit especially “when a firm, such as LCF, is using its FCA-authorised status to attract investors to its non-regulated business.”<sup>133</sup>

108. The investigation found that while there was an awareness that LCF used mini-bonds in an unusual manner,<sup>134</sup> this did not trigger a detailed review of the business or lead to an escalation of this fact about LCF to teams within the FCA that had identified mini-bonds as risky and having the potential to be used fraudulently.<sup>135</sup>

109. The investigation team was repeatedly told by FCA staff that fraud was a matter for the police and not the FCA, which appears to be why clear allegations of improprieties regarding LCF were not pursued when reported.<sup>136</sup> Commenting on the FCA's approach to the perimeter, James Petkovic, Junior Counsel at One Essex Court, told us that:

There were quite stark instances where the FCA was warned about potential improprieties in respect of LCF's non-regulated bond business. For example, you have an anonymous letter sent to the FCA while LCF is going through an authorisations process. You also have the examples, of course, given to the contact centre where there are allegations, again, of impropriety ... What seems to occur is either, as in the case of this anonymous letter, FCA staff members conclude that it is primarily a matter for the police and do not follow up to investigate whether there might be improprieties going on as alleged [...].<sup>137</sup>

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131 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 48

132 Financial Conduct Authority, 'Fraud', 20 May 2016, accessed 3 June 2021

133 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 299

134 See para 129 below

135 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 7, pages 129–132

136 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 299

137 [Q30](#)

110. On why the FCA was not more effective at protecting users of financial services from fraud, Dame Elizabeth told us that “it was a cultural feeling that the FCA was not really there to be a policeman, discovering and prosecuting fraud.” She said that Andrew Bailey, former Chief Executive of the FCA, had sought to change this approach, “but it took a long time.”<sup>138</sup> Dame Elizabeth acknowledged that the regulator “cannot regulate fraud across the world, but what it can do within its jurisdiction is protect the retail consumer, whether it is from phoenix companies, Ponzi schemes or whatever it is.”<sup>139</sup> She said “It is important that the FCA should appreciate that it has a remit and a job, under its existing powers [...] to be the first level of protection for retail investors.”<sup>140</sup>

111. On the FCA’s approach to dealing with fraud on LCF, Andrew Bailey, former Chief Executive of the FCA explained that:

It is [an] aspect of the [regulatory] perimeter issue. If at that time you had asked FCA, “Do you regard yourself as responsible for fraud within the perimeter?”, it would have said yes. That shaped a number of prioritisation decisions that were taken. If you go outside the perimeter, the answer was “not really”, with a great reluctance to take on cases outside the perimeter [...]<sup>141</sup>

112. We heard from our witnesses about some of the challenges relating to enforcement and fraud prosecution. Richard Frase, Partner, Financial Services Group at Dechert LLP (a member of Dame Elizabeth’s investigation team), told us that:

I know it was a matter of concern to at least one of the senior interviewees [at the FCA] that the police do not have the resources to prosecute fraud. There was a recent City of London report I recall from 2020 that seemed to come to a similar conclusion. There was a concern that this would all become yet another job for the FCA. While they are capable of doing it, the amount of resources that it would mop up would be enormous.<sup>142</sup>

113. Commenting on the availability of resources for fraud prosecution, Dame Elizabeth said “There is a real resource issue. Do we want to have something equivalent to other countries’ regulators, where they might be more enthusiastic to prosecute fraud? Just because I have read the papers, I know it is difficult to get the police to prosecute fraud.”<sup>143</sup> Dame Elizabeth however said that the issue of limited resources was not the reason why the red flags about LCF went undetected. This was more to do with “failure to look at the matter holistically, lack of enthusiasm to look beyond the perimeter, not joining up the dots between the information, not having the adequate technology to put all the things together and not having adequate policies in place.”<sup>144</sup>

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138 [Q32](#)

139 [ibid.](#)

140 [Q33](#)

141 [Q111](#)

142 [Q35](#)

143 [Q36](#)

144 [Q37](#)

114. Nikhil Rathi, Chief Executive at the FCA told us that “[...] last year there were 822,000 reports to Action Fraud. [Fraud] is the single biggest reported crime in the country, and only 1% of police are devoted to it. By any definition, you are not going to be able to use regulation to stop all that.”<sup>145</sup>

115. This is consistent with what we heard from Graeme Biggar, Director-General at the National Economic Crime Centre, National Crime Agency (NCA), one of the witnesses who has given evidence to our current inquiry into Economic Crime. Mr Biggar told us that the problem of fraud in the UK is on the rise and that there are limited police resources and personnel devoted to tackle fraud.<sup>146</sup> He also told us that the NCA was doing a lot of work with the FCA on investment fraud.<sup>147</sup>

116. Mr Rathi also explained the importance of working collaboratively with other relevant bodies to tackle financial crime, noting that:

On this question of financial crime, we are one of many partners [...] [Fraud] involves the police, the Serious Fraud Office and many other agencies, there is an importance that needs to be attached to economic crime collectively across the system that historically has perhaps not been there to the extent it has needed to be, either in terms of funding or focus.<sup>148</sup>

117. The FCA says that it has taken a number of steps to address the mindset that fraud was a matter for the police. Nikhil Rathi, Chief Executive of the FCA, told us that training had been rolled out to staff and that investigative capability was being brought into the organisation.<sup>149</sup> An enterprise-wide risk management system had also been developed “to help log the risks and make sure that we can look at them more strategically than has been the case in the past.”<sup>150</sup>

118. In a letter to John Glen MP, Economic Secretary to the Treasury, on 16 April 2021, the Chair of the FCA noted that:

We have launched the next phase of our Scamsmart Investment campaign which warns consumers of the increased threat of clone investment fraud, alerting them to the key warning signs and driving investors to the FCA’s warning list of firms to avoid and the Financial Services Register of authorised firms.<sup>151</sup>

119. On how he would encourage cultural change and facilitate enforcement in a more effective way at the FCA, the Economic Secretary told us that the FCA’s ongoing transformation programme would help put the right structures in place, and empower staff to take action and intervene where necessary.<sup>152</sup> He added that “My job as Minister

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145 [Q195](#)

146 [Oral evidence taken on 25 January 2021](#), HC (2019—2021) 917, Q2 [Mr Graeme Biggar]

147 *Ibid.* Q37

148 [Q212](#)

149 [Q219](#)

150 *Ibid.*

151 Financial Conduct Authority, Letter to the Economic Secretary to the Treasury from the Chair of the Financial Conduct Authority, [Progress of the FCA’s Transformation Programme](#), 16 April 2021, (accessed 3 June 2021)

152 [Q372](#)

will be to challenge the Chief Executive in regular dialogue over process towards those goals, respecting the fact that this is where the gap existed that Dame Elizabeth highlighted in her report.”<sup>153</sup>

120. We heard from Andrew Bailey that the FCA does not have the full powers of a law enforcement body. Commenting on financial crime, he said that:

I remember saying before to a hearing, probably back again in 2019, that one of my concerns with the FCA was because of the lack of law enforcement support below the [Serious Fraud Office]. The SFO was very engaged. The FCA was increasingly having to take these cases on as a law enforcement body, but it does not have the full powers.<sup>154</sup>

121. The Government launched an Economic Crime Plan in July 2019 which sets out its response to a range of economic crimes impacting the UK, including fraud.<sup>155</sup>

**122. The FCA recognises that it has a statutory duty to protect customers from fraud. In the case of LCF, the regulator fell short, due to a culture that saw fraud as principally a matter for the police, and its lack of enthusiasm to look beyond the perimeter. Dame Elizabeth recommended that “the FCA should ensure that its training and culture reflect the importance of the FCA’s role in combatting fraud by authorised firms.” We note the steps the FCA has taken to address the culture of dealing with fraud, including training staff and launching another phase of its Scamsmart campaign.**

*123. The FCA should develop a strategy for how it will approach fraud risks that are outside the perimeter of regulation but involve authorised firms. That strategy should be set out in the next perimeter report.*

**124. The FCA’s work to prevent fraud is done in partnership with other bodies such as the National Crime Agency and Serious Fraud Office. But the police have limited resources and personnel devoted to tackling fraud, and the FCA currently does not have the full powers of a law enforcement body.**

*125. There may be scope for the Government to consider whether the FCA should be given more powers to enable it to investigate fraud and financial crime. We will continue to consider this as part of our Economic Crime inquiry.*

## Regulation of mini-bonds

126. According to the FCA, there is no legal definition of a mini-bond, but the term refers to illiquid debt securities marketed to retail investors. According to the FCA, “it is essentially an IOU issued by a company (the issuer) to an investor, in exchange for a fixed rate of interest over a set period. At the end of this period, the investor’s money is due to be repaid. The return on investors’ money depends on the success and proper running of the issuer’s business. If the business fails, investors may get nothing back.”<sup>156</sup>

153 Ibid.

154 [Q106](#)

155 HM Government & UK Finance, [Economic Crime Plan: 2019—22](#), (July 2019)

156 Financial Conduct Authority, [‘Minibonds’](#), accessed 3 June 2021

127. Mini-bonds are also referred to as non-transferable securities. The FCA notes that “issuing non-transferable securities is an unregulated activity, including when they are issued by a firm like LCF which was initially authorised for credit related activities.”<sup>157</sup>

128. A London Economics and YouGov report has noted that the issuance of non-transferable debt securities increased steadily after 2009 following the financial crisis, when there was a reduction in the lending from banks to small and medium-sized businesses. The non-transferable debt securities market is however now in decline, following recent failures of several large issuers. These failings reflect the high risk nature of mini-bonds investments and the exposure of potentially deceptive practices used by some of the failed issuers.<sup>158</sup>

129. Dame Elizabeth found that LCF was using mini-bonds in an unusual way. The common use of mini-bonds encountered by the FCA was one whereby companies issued bonds:

to fund their own business, often with a pre-existing customer base whose pre-existing brand loyalty could be used to attract investment for their bond issuances. The mini-bonds such companies issued were designed to raise capital for themselves in order to finance their wider commercial operations.<sup>159</sup>

LCF, however, did not have a pre-existing brand loyalty. LCF bonds “raised capital ostensibly to lend onward to SMEs rather than for LCF to use for general working capital in its own business ...”<sup>160</sup>

130. We heard the Economic Secretary to the Treasury draw this distinction in the types of mini-bonds. He explained that:

You have minibonds that, say, Hotel Chocolat and BrewDog would issue as part of everyday financing. Those would be appropriate and understood to be part of everyday financing.

The distinction here is between that sort of minibond and one that involves on-lending. What you saw with LCF was people putting money into a bond and that money being lent on to a third party where there was no oversight of what was actually going on there.<sup>161</sup>

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157 Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital and Finance plc—The FCA Response](#), (December 2020), page 10, para 2.1

158 London Economics & YouGov, [Research into Non-Transferable Debt Securities: A report by London Economics and YouGov for HM Treasury](#), [Research\\_into\\_Non-Transferable\\_Debt\\_Securities.pdf \(publishing.service.gov.uk\)](#) November 2019, page iv

159 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 7, pages 129—130

160 *Ibid.*, page 130

161 [Q344](#)

131. The FCA did undertake work to identify whether there were any other LCF-type cases in the organisation following the failure of LCF. Andrew Bailey, former Chief Executive at the FCA told us that “[...] there was a very large amount of work on mini-bonds. Mini-bonds is a bit of a catch-all phrase for a lot of things.”<sup>162</sup> Charles Randell CBE, Chair of the FCA, also told us that there was now more focus on firms promoting mini-bonds:

In the area that Dame Elizabeth is looking at—firms that were promoting mini-bonds—we have a lot of resource focused on it. We started in the first quarter of 2019, when we brought together a dedicated team to look at the whole mini-bonds area and work out which things it should be trying to close down. That team then transitioned into ... the joint supervision and enforcement taskforce, which is a faster-reaction team, to target this particular type of harm.<sup>163</sup>

132. On whether a failure such as that of LCF could happen again, Nikhil Rathi, Chief Executive of the FCA did not provide assurance. Rather he told us:

[...] Can I give you the assurance that we are not going to see significant issues? Not at this stage; I don't want to give the Committee that complete assurance. We are building the systems. We are developing the capability, but these things take time [...]<sup>164</sup>

133. In May 2019, John Glen MP, Economic Secretary to the Treasury, announced that the Treasury would review policy on non-transferable debt securities. In a letter to the Chair of our predecessor Committee in June 2019, the Economic Secretary stated that:

The Treasury will consider the regulatory arrangements currently in place for the issuance of non-transferable debt securities issued by companies to consumers—and similar products—including the financial promotions regime which governs the marketing of those investments. This will be supported by broader research into these investments and their role in the economy ...<sup>165</sup>

134. In that letter the Economic Secretary noted that the work would be likely to be completed by early 2020, but he only announced a consultation on the review of non-transferable debt securities on 19 April 2021. On the reason for the delay, the Economic Secretary told us that:

One of the challenges was related to the chronology of timings around Dame Elizabeth's report and the fact that we wanted her to complete that report. That report was unfortunately delayed, through no fault of her own or the FCA's [...] There was considerable value in us responding to her conclusions. She reported in the middle of November and we responded in December. There were a number of other legal processes underway. Those were resolved at the end of March, and that is why we have moved forward to where we are now.<sup>166</sup>

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162 [Q121](#)

163 [Q223](#)

164 [Q227](#)

165 HM Treasury, Letter from the Economic Secretary to the Treasury to the Chair of the Treasury Committee, [EST\\_to\\_TSC\\_-\\_LCF\\_240619.pdf](#) ([publishing.service.gov.uk](#)), 24 June 2019, accessed 3 June 2021

166 [Q350](#)

135. Dame Elizabeth recommended that “the Treasury should consider whether Article 4 of MiFID II<sup>167</sup> or section 85 of FSMA<sup>168</sup> should be extended to non-transferable securities.”<sup>169</sup> Specifically, she suggested that, following Brexit, the UK could extend to non-transferable securities the MiFID II regulation of “execution of orders on behalf of clients”, or alternatively certain provisions of the Prospectus Regulation.<sup>170</sup>

136. The consultation launched by the Treasury on 19 April 2021 sets out the existing regulatory arrangements for non-transferable debt securities and is seeking views on whether there is need for further regulation in this area. The consultation, which closes on 12 July 2021, sets out three options, including Dame Elizabeth’s two recommendations outlined above, and an option to rely on other FCA and Treasury measures.<sup>171</sup>

137. On timings and output, the Economic Secretary to the Treasury told us that the Treasury hoped to present plans in the autumn of 2021.<sup>172</sup> On the consultation, the Economic Secretary also said that:

We have to have some real clarity over minibonds where they can function as part of an everyday financing instrument and option versus something that seems pretty problematic, in terms of giving people a false impression of the accessibility of that investment when there is no control over where it has ended up.<sup>173</sup>

**138. The unusual way in which LCF used mini-bonds and the high level of risk associated with any such investments highlight the need for the Treasury’s intervention. We welcome the Treasury’s ongoing consultation on the regulation of non-transferable debt securities but note the delay in its launch.**

***139. In light of the recent failings of several mini-bond issuers and the nature of the existing regulatory arrangements, the Treasury should proceed with its analysis as soon as the consultation on the regulation of non-transferable debt securities closes, and it should aim to publish the outcome by the end of September 2021. In publishing its response, it should also publish a way forward that can be implemented rapidly.***

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167 Markets in Financial Instruments Directive II (See [Article 4 \(europa.eu\)](#) and [The MiFID 2 Guide](#))

168 Financial Services and Markets Act 2000 (See [Financial Services and Markets Act 2000 \(legislation.gov.uk\)](#))

169 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 49

170 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, pages 304–305

171 HM Treasury, [Regulation of non-transferable debt securities \(mini-bonds\): A consultation](#), April 2021, accessed 3 June 2021

172 [Q344](#)

173 [Q346](#)

## 4 Consumer responsibility and compensation

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### Consumer responsibility

140. The Financial Services and Markets Act 2000 notes that in considering what degree of protection for consumers may be appropriate, one of the matters that the FCA must have regard to is “the general principle that consumers should take responsibility for their decisions.”<sup>174</sup> On how this influenced his work as the former Chief Executive, Andrew Bailey told us that “It was a very important thing [...]The non-readily realisable securities rules<sup>175</sup> are exactly, in a sense, in line with that, which is to say investors should say whether they are sophisticated or high net worth [...]”<sup>176</sup> Mr Bailey, also told us that the general view on the personal responsibility of investors had probably changed over time, with a greater emphasis being placed on a need for protection.<sup>177</sup>

141. The FCA accepts that it made mistakes in the balance between consumer responsibility and protection in the case of LCF. On the one hand, on consumer responsibility, the Chair of the FCA said that:

It 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 they were given, which included warnings that they were not covered by the Financial Services Compensation Scheme and that they were not products that we regulated. The fact of the matter is that, in the world in which we operate, we see consumers taking decisions that are not always calm, rational and well-informed. Some of them are very vulnerable when they take those decisions [...]<sup>178</sup>

On the other hand, Mr Randell also told us about the need for the FCA to engage in better consumer education:

[...] I don't think the decision-making pathways that firms have to go through to comply with our rules are always pathways that really give consumers good information that they can act on. We need to be better at that. We have to assume that the long-term task of consumer education and changing consumer behaviour is a very long-term task, and that we have to deal with today.<sup>179</sup>

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174 [Financial Services and Markets Act 2000, Section 1C](#), accessed 3 June 2021

175 Andrew Bailey told us that the FCA put in place back in 2014, non-readily realisable securities rules which extended outside the perimeter of regulation. The rules outlined that, when selling high risk products to an investor, there must be a process by which the investor signs to say that they have been given a risk warning. (See [Q116](#))

176 [Q149](#)

177 [Q151](#)

178 [Q234](#)

179 *Ibid.*

142. In addition to Mr Randell's point, Nikhil Rathi, Chief Executive of the FCA, said that the level of regulatory safety that the FCA should be looking to secure for different types of consumers is a conversation the regulator will have to have with Parliament. He said that one issue was whether the FCA needed to put in the same level of effort into sophisticated and high net worth consumers or whether they could make their own decisions.<sup>180</sup>

143. In a subsequent hearing, Mr Rathi said that:

It is a real challenge, and this is one area [...] where we are engaging with the Government. We believe the thresholds in the UK around the definitions of “high net worth” and “sophisticated” are outdated... and that exemption needs to be looked at, both in terms of the threshold and the ability to self-certify, which can be done very quickly—momentarily—online ...<sup>181</sup>

144. On vulnerable customers incorrectly self-certifying as sophisticated, Mr Rathi reiterated the need for the Online Safety Bill (currently published in draft) to extend to online advertising (see Chapter 5), noting that “In the context of LCF and in other cases too, we have seen that there is the ability for vulnerable people to be coached through the system, to tick that they are sophisticated, and then they get access to these investments.”<sup>182</sup>

145. ***The FCA should consider how it can improve its customer information so as to help equip customers with the ability to deal with the important financial decisions that they will have to take, and the risks that are attached to those decisions.***

## Compensation

146. Following the collapse of LCF and the publication of Dame Elizabeth's report, the Government announced in December 2020 that a compensation scheme would be set up for LCF bondholders. In a ministerial statement on 17 December 2020, the Economic Secretary to the Treasury stated that “the Government cannot, and should not be expected to, step in and compensate for every failure and every loss”; but in the case of LCF, there was a specific and complex set of circumstances that had led to the Government's intervention.<sup>183</sup>

147. Expanding on why LCF was an exception, John Glen MP, Economic Secretary to the Treasury told us that:

There are three broad reasons. The first is the business model of LCF and the scale and structure of what was going on. There are also issues around LCF being the only failed mini-bonds for which the FCA authorisation failed where on-lending was involved, so people were essentially buying a financial instrument and product where the underlying assets were lent on through another entity. The third factor I had to weigh up was the halo effect of a firm being authorised but conducting unregulated activity.<sup>184</sup>

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180 [Q236](#)

181 [Oral evidence taken on 12 May 2021](#), HC (2021—2022) 146, Q140 [Mr Nikhil Rathi]

182 [Oral evidence taken on 12 May 2021](#), HC (2021—2022) 146, Q141 [Mr Nikhil Rathi]

183 [Financial Services Update, Statement made on 17 December 2020](#), Statement UN HCWS678, Statement made by John Glen, Economic Secretary to the Treasury, accessed 3 June 2021

184 [Q332](#)

148. In a further Ministerial statement on 19 April 2021, the Economic Secretary noted that “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 [Financial Services Compensation Scheme] protection does not apply.”<sup>185</sup> On how the Government decides which failings deserve compensation and which do not, the Economic Secretary said in a letter to our Chair that:

Only three government compensation schemes have been established in the last three decades (for Barlow Clowes, Equitable Life and LCF), despite many investment firms failing over that period, demonstrating that this type of intervention is the exception, not the rule. The common feature in each of these three instances is the degree and scale of regulatory failure by the relevant authorities. While I have not seen evidence that the FCA's failures in the complex case of LCF were the primary cause of the losses for bondholders, they are a significant factor that the government has taken into account in deciding to establish the Scheme.<sup>186</sup>

149. Prior to the Government's announcement on the compensation scheme, a number of LCF bondholders had tried to seek compensation under the Financial Services Compensation Scheme (FSCS). The FSCS can only pay compensation where there has been evidence that a regulated activity took place i.e. where a customer received advice from LCF to invest in LCF bonds, rather than being simply shown information about them.<sup>187</sup>

150. The High Court recently heard a challenge by holders of LCF mini-bonds who claimed that the FSCS erred in not deeming them eligible for compensation because the product which they had been sold by LCF–minibonds–did not fall within a regulated activity. In a judgement issued on 29 March 2021, the High Court determined that the FSCS was right in its decision not to compensate these bondholders.<sup>188</sup>

151. As at 19 April 2021, the FSCS had paid out approximately £57.6 million to 2,871 bondholders who held 3,900 LCF bonds, following its review of evidence from LCF and Surge<sup>189</sup> which identified customers that were eligible for FSCS compensation.<sup>190</sup>

152. LCF bondholders who do not qualify for FSCS compensation will receive a one-off payment from the Government's compensation scheme. The Economic Secretary provided the following details on the scheme:<sup>191</sup>

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185 [London Capital and Finance, Statement made on 19 April 2021](#), Statement UN HCWS922, Statement made by John Glen, Economic Secretary to the Treasury, accessed 3 June 2021

186 HM Treasury, Letter from the Economic Secretary to the Treasury to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/5974/documents/67691/default/>), 13 May 2021, (accessed 3 June 2021)

187 Financial Services Compensation Scheme, [London Capital & Finance plc \(LCF\)](#), accessed 3 June 2021

188 See [High Court Judgment Template \(bailii.org\)](#), accessed 3 June 2021

189 SURGE is an online marketing company (used by LCF), which, facilitated information and application details received from prospective Bondholders (and re-investors), prior to the receipt of monies from an investor.

190 Financial Services Compensation Scheme, [London Capital & Finance plc \(LCF\)](#), accessed 3 June 2021

191 [London Capital and Finance, Statement made on 19 April 2021](#), Statement UN HCWS922, Statement made by John Glen Economic Secretary to the Treasury, accessed 3 June 2021; HM Treasury, Letter from the Economic Secretary to the Treasury to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/5974/documents/67691/default/>), 13 May 2021, (accessed 3 June 2021); [Q333](#)

- The scheme provides 80% of LCF bondholders' initial investment up to a maximum of £68k. The full principal value of bondholders' investments will be eligible for the scheme, regardless of the number of investments they have made, up to the £68k maximum for the Scheme.
- Where bondholders have received interest payments from LCF or distributions from the administrators, Smith & Williamson, these will be deducted from the amount of compensation payable.
- The scheme will be available to all LCF bondholders who have not already received compensation from the FSCS and represents 80% of the compensation they would have received had they been eligible for FSCS protection. The Government has chosen to cap compensation to LCF bondholders at 80% of the FSCS limit to reflect the fact that the Government will not sit behind risky investments, especially where those activities are unregulated. In the context of the LCF failings, the risk is being shared with the taxpayer and investors that lost out.
- 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.
- The Government expects to pay out around £120m in compensation in total and the scheme to have paid all bondholders within 6 months of securing the necessary primary legislation.

153. In a letter to our Chair, providing more details on the Government's compensation scheme, John Glen MP, Economic Secretary to the Treasury, noted that he had introduced into Parliament the primary legislation necessary to establish the LCF compensation scheme and that he was "hoping for a swift passage through Parliament." He added that "the Financial Services Compensation Scheme will administer the Scheme. They are a highly experienced and suitable delivery partner and are committed to ensuring that payments are made to all eligible LCF bondholders within 6 months of securing Royal Assent."<sup>192</sup>

154. Aside from the Government's compensation scheme, payouts by the FSCS, and any payments to bondholders from LCF administrators, the FCA is also considering claims for compensation from LCF bondholders through its Complaints Scheme, which is available to financial services consumers who believe they have suffered financial loss as a result of actions or inactions of the FCA. In evidence to us, the Chair of the FCA said that the complaints would be dealt with in the following way:

Our current complaints scheme, which is in essence the one that has been in place for about 20 years, since the Financial Services and Markets Act 2000 was passed, envisages that in cases where there are complaints against the regulators, obviously we will issue apologies when we fell short in what we did. In cases where we are the primary cause of the loss, we will also make compensatory payments—although we have always been clear that

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192 HM Treasury, Letter from the Economic Secretary to the Treasury to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/5974/documents/67691/default/>), 13 May 2021, (accessed 3 June 2021)

those compensatory payments would not attempt to reflect the totality of the financial loss that people have suffered. That is broadly the arrangement that Parliament debated back in 2012 as well.<sup>193</sup>

155. In a letter to our Chair providing more details on the FCA's approach to handling LCF complaints, Charles Randell advised that "as of 19 March 2021, the FCA had received 1,062 complaints in relation to the FCA's handling of LCF. We received 57 new complaints following the publication of Dame Elizabeth Gloster's Report." Mr Randell noted that the FCA will review each individual case on its own merits and come to a conclusion which may include a compensatory payment on an ex gratia basis.<sup>194</sup>

156. We are aware of the ongoing consultation on the regulators complaint scheme which is seeking to simplify the wording of the scheme to make it more accessible to users as well as provide a more detailed description on the approach to ex-gratia payments.<sup>195</sup>

**157. The collapse of LCF brought about a huge degree of uncertainty for bondholders, some of whom were faced with an anxious wait for the publication of Dame Elizabeth's report and further details of the Government's compensation scheme. We welcome the approach that the Treasury has taken to compensate LCF bondholders, a scheme that we believe will provide substantial assistance to a very large proportion of those who have lost out and who have not qualified under other forms of compensation available. The Government has taken a reasonable approach in striking the balance between consumer responsibility for their investment decisions and recognising the FCA's failure to discharge its functions in respect of LCF such that it fulfilled its statutory objectives. We support the principle of the Bill to provide compensation to LCF bondholders.**

**158. The Government has taken a positive step by introducing the primary legislation necessary to establish the LCF compensation scheme. If the Bill has a successful passage through Parliament, the Treasury should ensure a smooth running of the compensation scheme, without any further delays, making sure that eligible LCF bondholders are clear about the process, and can receive payment as soon as practicable.**

*159. 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' complaints scheme.*

**160. The FCA should provide us with an update on its resolution of LCF complaints by 30 September 2021.**

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193 [Q239](#)

194 Financial Conduct Authority, Letter from the Chair of the FCA to the Chair of the Treasury Committee, <https://committees.parliament.uk/publications/5318/documents/52976/default/>, 23 March 2021, accessed 3 June 2021

195 Financial Conduct Authority, [CP20/11: Complaints against the Regulators \(The Financial Conduct Authority, the Prudential Regulation Authority and the Bank of England\)](#), accessed 3 June 2021

## 5 Financial promotions

161. A financial promotion is a communication that contains an invitation or inducement to engage in a financial product or service. Financial promotions are overseen by the Financial Promotions Regime (as set out in the Financial Services and Markets Act 2000), which seeks to ensure that customers are provided with clear and accurate information that enables them to take decisions that are appropriate for their individual circumstances.<sup>196</sup>

### The ongoing government consultation on financial promotions

162. The Government launched a consultation on the “Regulatory Framework for Approval of Financial Promotions” in July 2020 in an attempt to address issues associated with the current regime. Currently, financial promotions by an unauthorised firm are required to be approved by an authorised firm (except for certain exemptions in the Financial Promotion Order 2005).<sup>197</sup> However, as explained in more detail below, the approval of financial promotions is not itself a regulated activity. The consultation suggests that it has become increasingly evident that this approach is flawed, especially in instances where authorised firms fail to undertake adequate due diligence to ensure that approved promotions meet FCA requirements; and also where authorised firms approve financial promotions that relate to products which are beyond their sphere of expertise and which, as a result, fail to comply with FCA rules.<sup>198</sup>

163. Commenting on the legislative framework, Charles Randell CBE, Chair of the FCA, said “[...] The financial promotions order is also a huge issue: I think far more harm is accruing through the financial promotions order, and the exemptions from it, than has been recognised.”<sup>199</sup>

164. In its consultation, the Government says it is proposing a new regulatory gateway that would enable the FCA to provide more effective oversight, prevention and intervention, and require approver firms to have the relevant expertise and facilitate improved due diligence. The two options set out are:

- Option 1–Restrict approval of the financial promotions of unauthorised firms through the imposition of requirements by the FCA.
- Option 2–Specify the approval of financial promotions communicated by unauthorised persons as a ‘regulated activity’ under FSMA.<sup>200</sup>

165. Mr Randell set out to us the implications of the approval of promotions not being a regulated activity:

[...] approving financial promotions isn’t an activity we regulate. The way that FSMA is set up, under section 21 anyone who is authorised can approve financial promotions, but it is not a regulated activity. That means

196 HM Treasury, Regulatory Framework for Approval of Financial Promotions Consultation, [Financial\\_Promotions\\_Unauthorised\\_Firms\\_Consultation.pdf](#) ([publishing.service.gov.uk](#)) July 2020, accessed 3 June 2021

197 See [The Financial Services and Markets Act 2000 \(Financial Promotion\) Order 2005](#)

198 HM Treasury, Regulatory Framework for Approval of Financial Promotions Consultation, [Financial\\_Promotions\\_Unauthorised\\_Firms\\_Consultation.pdf](#) ([publishing.service.gov.uk](#)) July 2020, accessed 3 June 2021

199 [Q194](#)

200 HM Treasury, Regulatory Framework for Approval of Financial Promotions Consultation, [Financial\\_Promotions\\_Unauthorised\\_Firms\\_Consultation.pdf](#) ([publishing.service.gov.uk](#)) July 2020, accessed 3 June 2021

that we don't get returns saying how many financial promotions have been approved, and we don't get a regular supply of information from the firms who are doing this business [...] So bringing this into the regime in the way that I have suggested will be a huge help [...]"<sup>201</sup>

Andrew Bailey, the former Chief Executive of the FCA, said in a letter to our Chair that "this makes the task of regulating promotions inevitably reactive and thus less robust [...]"<sup>202</sup>

166. While we heard from witnesses the case for approving financial promotions communicated by unauthorised persons to become a regulated activity, the Government's consultation points out a challenge with this policy option, noting that "[...] It would fundamentally alter the regulatory treatment of financial promotions [...] It is arguably a disproportionate way to address the government's concerns and it could have unintended consequences for the regulation of financial promotions in general."<sup>203</sup>

**167. We welcome the Treasury's ongoing consultation on approving financial promotions. We trust that the results of the consultation will be published swiftly and the conclusions implemented as soon as possible.**

## LCF financial promotions

168. In the case of LCF, Dame Elizabeth found that, despite the FCA's financial promotions team raising concerns regarding LCF's correspondence on a number of occasions, the breaches identified were not referred to supervision or enforcement for further review. She told us that:

Where, in relation in particular to financial promotions, we thought the trouble lay was that, although they had a repeated financial promotion breaches policy, it was not sufficiently robust. One of the real wickednesses was that LCF was frequently breaching the financial promotion rules, but nothing was done about it. If that information had been put together with other information, something might have been done much earlier.<sup>204</sup>

169. Andrew Bailey, former Chief Executive of the FCA, partly disagreed with this view. He told us that the financial promotions team "followed up pretty diligently" the alerts they got. "They got LCF to change its promotions, but the problem is that LCF did not stick to it, so we got this repeat cycle."<sup>205</sup> He added that the siloed nature of the [FCA] at the time contributed to this as it meant that LCF's failure to change was not brought into the overall supervision of the firm.<sup>206</sup>

201 [Q209](#)

202 Letter from Andrew Bailey to Chair of Treasury Committee, <https://committees.parliament.uk/publications/5304/documents/52929/default/>, 22 March 2021, accessed 3 June 2021

203 HM Treasury, Regulatory Framework for Approval of Financial Promotions Consultation, [Financial\\_Promotions\\_Unauthorised\\_Firms\\_Consultation.pdf](#) ([publishing.service.gov.uk](https://publishing.service.gov.uk)) July 2020, page 21, accessed 3 June 2021

204 [Q25](#)

205 [Q91](#)

206 [Ibid.](#)

## The FCA's failure to use its powers on promotions

170. The FCA—under section 137S of the Financial Services and Markets Act 2000—is able to intervene in respect of breaches to financial promotions rules and can ban a promotion.<sup>207</sup> The FCA also has rules which require financial promotions to be fair, clear and not misleading.<sup>208</sup> However, in the case of LCF, the investigation found that the FCA did not have appropriate policies to allow it to intervene in LCF's financial promotions breaches. Dame Elizabeth recommended 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.”<sup>209</sup>

171. Megan Butler, former Executive Director for Supervision (SIWS), and Jonathan Davidson, former Executive Director for Supervision (SRA), told us that the FCA had failed to use its powers to intervene in the case of LCF due to a risk-averse culture.<sup>210</sup> Mr Davidson said that he pushed for the use of the power under section 137 of the Financial Services and Markets Act 2000 to be used on LCF in November 2018, as its use had been pushed back multiple times prior to his arrival.<sup>211</sup>

172. The FCA, in its response to Dame Elizabeth's recommendation, said that it had changed its approach to financial promotions, and that in future it would review its policies and approaches to ensure that they are sufficient for serious infringements and multiple breaches of the financial promotions rules.<sup>212</sup> The regulator has also introduced a “use it or lose it” programme where it is “committed to take action to remove permissions for regulated activities that are not being actively used and where the FCA consider out-of-date permissions may cause harm to consumers.”<sup>213</sup> The introduction of the programme should help prevent firms from using their FCA authorised status to promote unregulated activity.<sup>214</sup> The FCA said that first tranche of firms are in the process of being contacted.<sup>215</sup>

***173. We welcome the steps taken by the FCA to change its approach to financial promotions, as well as introducing the “use it or lose it” programme. In future, the FCA should be more interventionist and should make more frequent use of its powers rather than maintaining a culture of risk aversion.***

207 Financial Conduct Authority, ‘[Our powers to ban a promotion or advert](#)’, accessed 3 June 2021

208 Financial Conduct Authority Handbook, COBS 4.2 Fair, clear and not misleading communications, [COBS 4.2 Fair, clear and not misleading communications - FCA Handbook](#), accessed 3 June 2021

209 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 2, page 48

210 [Q275](#)

211 [Q287](#)

212 Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital and Finance plc—The FCA Response](#), (December 2020), page 15

213 Financial Conduct Authority, Letter from the Chief Executive of the FCA to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/6014/documents/68066/default/>), 11 May 2021, (accessed 3 June 2021)

214 [Q192](#)

215 Financial Conduct Authority, Letter from the Chief Executive of the FCA to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/6014/documents/68066/default/>), 11 May 2021, (accessed 3 June 2021)

## Speculative illiquid securities mass-marketing ban

174. Partly in response to the LCF failings, the FCA introduced temporary product intervention measures from 1 January 2020 to 31 December 2020, in order to address risks of consumer harm from the promotion of speculative mini-bonds to retail investors, who did not understand the level of risks or potential financial losses involved. A particular concern for the regulator was around the mass-marketing of speculative illiquid securities.<sup>216</sup> Following a consultation in June 2020,<sup>217</sup> the FCA made a decision to make the speculative mini-bond mass-marketing ban permanent, with the new rules applying from 1 January 2021.<sup>218</sup>

175. The FCA recently published a discussion paper on strengthening financial promotions rules for high-risk investments. The regulator is seeking views on areas in which further changes could be made to protect consumers from harm.<sup>219</sup>

## High net worth and sophisticated investor exemptions

176. The Financial Promotion Order includes an exemption for high net worth and sophisticated investors. The FCA said it was aware of unregulated companies, also known as introducers, which are separate from firms offering investments, coaching investors to self-certify as high-net worth or sophisticated so that the unregulated firm can assert their promotional activities are exempt from having to be approved.<sup>220</sup> These exemptions have allowed unauthorised firms to issue financial promotions to high net worth and sophisticated investors without having to comply with the FCA rules including the “clear, fair and not misleading requirements.”<sup>221</sup> Dame Elizabeth gave a similar view, telling us that:

There are a lot of problems around what I might call cowboys, who are not authorised at all, operating on websites and comparison websites. If you go on one, they are not necessarily obviously in breach of the financial promotions regulations, but when you get sucked into it you are asked to provide your details and then certify you are sophisticated and all these sorts of things.<sup>222</sup>

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216 Financial Conduct authority, Temporary intervention on the marketing of speculative mini-bonds to retail investors, [Temporary intervention on the marketing of speculative mini-bonds to retail investors \(fca.org.uk\)](https://www.fca.org.uk/publications/consultation-letters/Temporary%20intervention%20on%20the%20marketing%20of%20speculative%20mini-bonds%20to%20retail%20investors), November 2019, page 2

217 Financial Conduct Authority, High-risk investments: Marketing speculative illiquid securities (including speculative mini-bonds) to retail investors: Consultation paper, [CP20/8: High-risk investments: Marketing speculative illiquid securities \(including speculative minibonds\) to retail investors \(fca.org.uk\)](https://www.fca.org.uk/publications/consultation-letters/CP20/8:High-risk%20investments:Marketing%20speculative%20illiquid%20securities%20(including%20speculative%20minibonds)%20to%20retail%20investors), June 2020

218 Financial Conduct Authority, [‘FCA confirms speculative mini-bond mass-marketing ban’](https://www.fca.org.uk/publications/consultation-letters/FCA%20confirms%20speculative%20mini-bond%20mass-marketing%20ban), 10 December 2020, accessed 3 June 2021

219 Financial Conduct Authority, Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions: Discussion Paper DP21/1, [DP 21/1: Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions \(fca.org.uk\)](https://www.fca.org.uk/publications/discussion-papers/DP21/1:Strengthening%20our%20financial%20promotion%20rules%20for%20high-risk%20investments%20and%20firms%20approving%20financial%20promotions), April 2021, (accessed 3 June 2021)

220 Financial Conduct Authority, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital and Finance plc—The FCA Response](https://www.fca.org.uk/publications/reports/Report%20of%20the%20Independent%20Investigation%20into%20the%20Financial%20Conduct%20Authority's%20Regulation%20of%20London%20Capital%20and%20Finance%20plc), (December 2020), page 15—16

221 Financial Conduct Authority, Letter from the Chief Executive of the FCA to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/6014/documents/68066/default/>), 11 May 2021, (accessed 1 June 2021)

222 [Q31](#)

177. Nikhil Rathi, Chief Executive of the FCA, told us that as a result of the speculative illiquid securities mass-marketing ban “... what we are seeing is heavier use of the exemptions [...] the high net worth exemption, the self-certification that you are sophisticated, and people being coached through to an online click to access those securities.”<sup>223</sup>

178. Commenting on the Treasury's financial promotions consultation, John Glen MP, Economic Secretary to the Treasury told us that:

The issue is who is going to access what financial products. We have some challenges here with respect to getting that balance right while allowing high-net-worth and sophisticated investors who currently have certain criteria to be able to access certain products [...] I am nervous about saying, “Only extremely wealthy people can access certain products”, but I am equally unhappy about a situation where there is an inherent vulnerability built into a lack of restraint [...]<sup>224</sup>

**179. The Financial Promotion Order would benefit from reform due to the increasing risks associated with the exemptions that allow customers to self-certify as high net worth or sophisticated.**

**180. *The Treasury should—as a matter of priority—re-evaluate the Financial Promotion Order exemptions to determine their appropriateness and consider what changes need to be made to protect consumers.***

## Online platforms and the Online Safety Bill

181. Online platforms play a significant role in communicating financial promotions to consumers. The FCA told Dame Elizabeth about the practical difficulties of investigating unregulated, online sales channels which utilised search engines and social media for marketing purposes for example.<sup>225</sup>

182. The FCA told us that it is working closely with technology platforms such as Google<sup>226</sup> to identify and help prevent harm to consumers online.<sup>227</sup> In a letter to the Chair of the Committee, Nikhil Rathi stated that:

We provide alerts to Google once a week to enable them to remove Google Ads by firms which appear on our list. This work disrupts the actions of those behind the promotions and their ability to market to consumers, but the volume of new promotions being identified every week is high, so our focus is on challenging the online platforms to stop these promotions from being marketed in the first place to disrupt this flow.<sup>228</sup>

223 [Q207](#)

224 [Q382](#)

225 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 307

226 Google UK, Letter from Google Managing Director to Chief Executive and Chair of the FCA, [Google letter to the FCA - February 2021](#), 26 February 2021, (accessed 3 June 2021)

227 [Q188](#)

228 Financial Conduct Authority, Letter from the Chief Executive of the FCA to the Chair of the Treasury Committee, (<https://committees.parliament.uk/publications/6014/documents/68066/default/>), 11 May 2021, (accessed 3 June 2021)

183. The Government published its draft Online Safety Bill on 12 May 2021. The Bill would seek to establish a new regulatory framework to tackle harmful content online.<sup>229</sup> While the Bill makes provision to tackle harmful user-generated content such as romance scams and fake investment opportunities, it does not cover fraud via advertising, emails or cloned websites. Prior to the publication of the draft Bill, we heard from most of our witnesses on the importance of the Government bringing financial harm within the scope of the Bill.<sup>230</sup>

184. One of Dame Elizabeth's recommendations is that "the Treasury and other relevant Government bodies should work with the FCA to ensure that the legislative framework enables the FCA to intervene promptly and effectively in the marketing and sale through technology platforms, and unregulated intermediaries, of speculative illiquid securities and similar retail products," and that "serious consideration should be given to the coverage of financial harm in the proposed Online Harms Bill" [now the Online Safety Bill].<sup>231</sup>

185. Andrew Bailey told us that "In my time in the FCA, I argued with DCMS that the online harm legislation should include financial harm, and it has not."<sup>232</sup>

186. Nikhil Rathi told us that the FCA had recommended to the Government that investment fraud should be included in the Online [Safety] Bill, and that the FCA "do not think that the other solution being mooted, around the online advertising programme, really matches the urgency of the problem that we are dealing with [...]"<sup>233</sup> Speaking further on the need for the inclusion of investor fraud in the Bill, he said:

At the moment, we have to negotiate voluntarily with every single [online platform] to see how far we can get them to move, change their policies and help us [...] There is a lot of nefarious online activity going on out there, but this is a very big crime that is taking place in the UK every day and is costing people a lot of money. We think it deserves being in there, and we think it should not wait for an untested advertising programme that may come a few years down the line.<sup>234</sup>

187. When asked about his views on using the Bill to provide more consumer protection, John Glen MP, Economic Secretary to the Treasury, told us that:

[...] Dame Elizabeth's] report exposes the challenge that exists, with the fact that so many financial services products are marketed online. We are working very closely with DCMS on a separate piece of work around the online advertising programme [...] Subsequently, with the Online Safety Bill, in pre-legislative scrutiny we will look at the issue of fraud and how that should fit into that, or not.<sup>235</sup>

[...]

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229 [Draft Online Safety Bill](#), May 2021, accessed 3 June 2021

230 [Q97](#); [Q188](#); [Q289](#); [Q314](#)

231 Rt Hon Dame Elizabeth Gloster DBE, [Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc](#), 23 November 2020 (revised 10 December 2020), Chapter 14, page 308

232 [Q97](#)

233 [Q188](#)

234 [Q222](#)

235 [Q377](#)

If it is not, we will need to find another way of coming to deal with this really important challenge that we cannot let go by. That is why, in the meantime, in the advertising programme, we are having roundtables with the platforms, the tech companies and the Home Office, following conversations I have had with UK Finance, to get to grips with where responsibilities lie in this area. I have described where there are some gaps, and we need to come to terms with that.<sup>236</sup>

188. Aside from Dame Elizabeth and the FCA, a number of other organisations have called for the Government to consider including fake and fraudulent content that leads to scams in the Bill. About a week prior to the publication of the Government's draft Bill, a coalition of 17 organisations including UK Finance and the City of London Police signed a letter to the Government outlining the need for the Online Safety Bill intervention. According to the letter, "ONS data shows there were 3.7 million incidents of fraud between March 2019 and March 2020, making it the crime that adults are most likely to fall victim to in the UK, while Action Fraud figures show £1.7 billion was lost to scams in the last year."<sup>237</sup>

189. In a press release alongside the draft Bill, the Government said:

Fraud via advertising, emails or cloned websites will not be in scope because the Bill focuses on harm committed through user-generated content.

The Government is working closely with industry, regulators and consumer groups to consider additional legislative and non-legislative solutions. The Home Office will publish a Fraud Action Plan after the 2021 spending review and the Department for Digital, Culture, Media and Sport will consult on online advertising, including the role it can play in enabling online fraud, later this year.<sup>238</sup>

**190. It is very disappointing to see that despite the numerous representations made to the Government, measures to address fraud via online advertising have not been included in the draft Online Safety Bill. This is a missed opportunity to act and potentially help prevent another LCF-type event. The increasing frequency of fraudulent activity online that leads to scams and financial harm is alarming, and the Government must intervene as a matter of urgency.**

**191. We note the Government's intention to consider additional legislative and non-legislative solutions to tackle fraud via advertising, emails or cloned websites, including the online advertising programme, but we believe quicker action is required to protect consumers and help the FCA address the issue adequately.**

**192. We recommend that the Government should include measures to address fraud via online advertising in the Online Safety Bill, in the interests of preventing further harm to customers being offered fraudulent financial products.**

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236 [Q379](#)

237 [Coalition of organisations urges government to use Online Safety Bill to protect people from an avalanche of online scams](#), accessed 3 June 2021

238 [GOV.UK, Press release: Landmark laws to keep children safe, stop racial hate and protect democracy online published](#), 12 May 2021, accessed 3 June 2021

193. *Pending any legislative changes, the FCA should continue to work with online platforms such as Google to remove misleading and fraudulent adverts as quickly as possible, to protect customers from scams.*

194. We expect to revisit this subject as part of our inquiry into Economic Crime.

## Conclusions and recommendations

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### Individual responsibility of FCA senior management

1. It is not immediately clear that Mr Bailey's concerns about the distinction between "responsibility" and "culpability" in Dame Elizabeth's draft report would have "compelled" him to make his "free-standing" objection. However we accept that it is likely that his strong concerns over the "responsibility" vs "culpability" point may have led him to make his "free-standing" objection to the inclusion of named responsible individuals, and that in the absence of his concerns about the distinction between "responsibility" and "culpability" he might not have put forward his "free-standing" objection. We cannot of course be certain about this and if we were satisfied that there was strong and clear evidence that Mr Bailey had misled the Committee on this point, it would be a serious matter. But the evidence does not support that particular conclusion, and we do not believe that Mr Bailey misled the Committee. We note that the revisions made by Dame Elizabeth to the draft report, clarifying that an identification of responsibility was not an attribution of culpability, met the essence of Mr Bailey's request, and we believe that it is in the wider interest to regard this issue as closed. (Paragraph 31)
2. We welcome the FCA's approach to recruitment for some senior executive roles, which involved global searches, but we believe that the FCA was wrong not to have engaged in a fuller recruitment programme for the Executive Director for Transformation role, including the consideration of potential recruits from outside the FCA. It appears that there was a missed opportunity to consider fresh leadership for the Transformation programme. We also question whether there would have been a significant slowdown in the progress of the Transformation programme had Megan Butler not been recruited to oversee it. Another recruit might have been supported by Megan Butler for at least a period to help assist with this role, or Megan Butler might have taken on that role on a temporary basis whilst the recruitment process was conducted. (Paragraph 41)
3. Given that Dame Elizabeth's report cited Megan Butler as bearing responsibility for important areas of failure and that her recruitment was conducted internally with just one alternative candidate, we understand why many will feel that "a buck that does not stop with an individual stops nowhere" when it comes to the personal consequences for those involved with the failings at the FCA in relation to LCF. (Paragraph 42)
4. *We recommend that the default position should be that the FCA take a holistic approach when recruiting for critical roles, rather than engaging in a restricted recruitment process. For time-critical appointments, the FCA should consider appointing on an interim basis until a wider search, considering where appropriate both internal and external candidates, has been completed.* (Paragraph 43)
5. We accept that a degree of shared responsibility is desirable and necessary in an organisation such as the Financial Conduct Authority. However, it is not readily justifiable for the FCA to require the firms that it regulates to adhere to the principles of the Senior Managers Regime but seemingly not to apply similar principles

internally when there are failings of practice and culture in the organisation. The FCA Board should reflect on whether it has, in this case, met the standards which it seeks to impose upon others. We believe that there are doubts as to whether it has. (Paragraph 48)

6. We recognise that the demands of some of these senior executive positions at the Financial Conduct Authority are heavy, and that individual accountability for organisational failings may deter strong candidates from applying for them. But an over-reliance on collective responsibility may deny visible accountability and could lessen confidence in the organisation as a result. We are not wholly persuaded that the balance struck by the FCA on this occasion has strengthened its standing in the eyes of those it regulates or the wider public. (Paragraph 49)

### Culture at the FCA

7. The FCA plays a vital role as the UK's financial conduct regulator and prudential regulator for most financial services firms. Its work affects millions of financial services customers and it is important that it has the right culture to facilitate its objectives. We support the views of the current FCA senior leadership team that the organisation needs to become a more "proactive", "agile", "decisive" and joined-up regulator that is willing to act, including in the face of uncertainty, to protect consumers and financial markets. (Paragraph 63)
8. *We welcome the FCA's ongoing transformation programme which has cultural change as one of its priorities. We however note that the FCA has undergone numerous structural and operational changes since its inception, with more changes expected as part of the ongoing transformation. We recognise that culture change takes time but recommend that the FCA Board sets itself an end date for the transformation programme and that it creates milestones at which improvements and evidence of changes in culture can be reviewed. These milestones and reviews should be put into the public domain. At the completion of the transformation programme, the FCA should ensure it has in place measures that will ensure that its improved culture is maintained and embedded.* (Paragraph 64)
9. The FCA accepts that there were failings in the contact centre during the Relevant Period as identified in Dame Elizabeth's report, and has begun taking steps to address these. We welcome the operational improvements that have been made since the publication of Dame Elizabeth's report, including the training of call-handlers and changes to contact centre policies. (Paragraph 75)
10. *The FCA should ensure that it keeps its contact centre policies and training up to date to ensure clarity and consistency, not just in relation to firms such as LCF but to the wider organisation.* (Paragraph 76)

### The regulatory perimeter and the scope of the FCA's remit

11. The case of LCF illustrates how important it is that the FCA looks at a regulated firm's activities both within and outside the perimeter of regulation. The FCA's failure to consider issues raised in LCF's unregulated bond business led to red flags being missed. (Paragraph 92)

12. *The “halo effect” appears to be inevitable as long as authorised firms also carry out unregulated activities. We reiterate the recommendation made by our predecessors that the FCA should ensure that it requires authorised firms to make clear explicitly the risks to customers associated with their unregulated activities.* (Paragraph 93)
13. *In future, the FCA should set out in its annual perimeter report how its supervisory strategies and policies reflect the activities of authorised firms both within and outside the perimeter.* (Paragraph 94)
14. The perimeter is complex, and while the FCA has some limited powers to act beyond the perimeter, it does not have the remit to actively monitor or intervene outside the perimeter. We recognise the need for the FCA to make prioritisation decisions as its resources are finite. (Paragraph 95)
15. We welcome the ongoing dialogue between the Treasury, the FCA, and other financial regulators on the perimeter, but the failings in the FCA's regulation of LCF and constant movement of the perimeter are signs that further action is required. (Paragraph 96)
16. *We therefore reiterate a recommendation made by a previous Treasury Committee, that the FCA be given the formal power and remit to be able to recommend formally to the Treasury changes to the perimeter of regulation, where that would enhance its ability to meet its objectives, in particular to prevent consumer harm. The FCA should set out any costs, both to firms and consumers. It would then be for the Treasury to consider such a recommendation promptly. All such recommendations and Treasury responses should be publicly disclosed.* (Paragraph 97)
17. Both the FCA and the Treasury accept that the scope of the FCA's remit is broad and continues to increase. The breadth of the scope has had some operational impacts on the FCA's ability to carry out its work. We note that the Treasury's intention is to consider the scope when the ongoing FCA transformation programme has been delivered; but the timescales for delivery of the transformation programme are unclear. (Paragraph 103)
18. If the FCA Board were to set itself an end date for the transformation programme, as we recommend in Chapter 2, the Treasury would have a clear indication of when to begin its consideration of the scope of the FCA's remit. (Paragraph 104)
19. *Any changes to the perimeter must be matched with appropriate changes in the FCA's resources, and the FCA should republish its priorities. The Treasury should publish a policy statement on how it will analyse changes to the FCA's perimeter and what factors it will take into account.* (Paragraph 105)
20. The FCA recognises that it has a statutory duty to protect customers from fraud. In the case of LCF, the regulator fell short, due to a culture that saw fraud as principally a matter for the police, and its lack of enthusiasm to look beyond the perimeter. Dame Elizabeth recommended that “the FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.” We note the steps the FCA has taken to address the culture of dealing with fraud, including training staff and launching another phase of its Scamsmart campaign. (Paragraph 122)

21. *The FCA should develop a strategy for how it will approach fraud risks that are outside the perimeter of regulation but involve authorised firms. That strategy should be set out in the next perimeter report. (Paragraph 123)*
22. The FCA's work to prevent fraud is done in partnership with other bodies such as the National Crime Agency and Serious Fraud Office. But the police have limited resources and personnel devoted to tackling fraud, and the FCA currently does not have the full powers of a law enforcement body. (Paragraph 124)
23. *There may be scope for the Government to consider whether the FCA should be given more powers to enable it to investigate fraud and financial crime. We will continue to consider this as part of our Economic Crime inquiry. (Paragraph 125)*
24. The unusual way in which LCF used mini-bonds and the high level of risk associated with any such investments highlight the need for the Treasury's intervention. We welcome the Treasury's ongoing consultation on the regulation of non-transferable debt securities but note the delay in its launch. (Paragraph 138)
25. *In light of the recent failings of several mini-bond issuers and the nature of the existing regulatory arrangements, the Treasury should proceed with its analysis as soon as the consultation on the regulation of non-transferable debt securities closes, and it should aim to publish the outcome by the end of September 2021. In publishing its response, it should also publish a way forward that can be implemented rapidly. (Paragraph 139)*

### Consumer responsibility and compensation

26. *The FCA should consider how it can improve its customer information so as to help equip customers with the ability to deal with the important financial decisions that they will have to take, and the risks that are attached to those decisions. (Paragraph 145)*
27. The collapse of LCF brought about a huge degree of uncertainty for bondholders, some of whom were faced with an anxious wait for the publication of Dame Elizabeth's report and further details of the Government's compensation scheme. We welcome the approach that the Treasury has taken to compensate LCF bondholders, a scheme that we believe will provide substantial assistance to a very large proportion of those who have lost out and who have not qualified under other forms of compensation available. The Government has taken a reasonable approach in striking the balance between consumer responsibility for their investment decisions and recognising the FCA's failure to discharge its functions in respect of LCF such that it fulfilled its statutory objectives. We support the principle of the Bill to provide compensation to LCF bondholders. (Paragraph 157)
28. The Government has taken a positive step by introducing the primary legislation necessary to establish the LCF compensation scheme. If the Bill has a successful passage through Parliament, the Treasury should ensure a smooth running of the compensation scheme, without any further delays, making sure that eligible LCF bondholders are clear about the process, and can receive payment as soon as practicable. (Paragraph 158)
29. *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' complaints scheme. (Paragraph 159)*

30. *The FCA should provide us with an update on its resolution of LCF complaints by 30 September 2021. (Paragraph 160)*

### Financial promotions

31. We welcome the Treasury's ongoing consultation on approving financial promotions. We trust that the results of the consultation will be published swiftly and the conclusions implemented as soon as possible. (Paragraph 167)
32. *We welcome the steps taken by the FCA to change its approach to financial promotions, as well as introducing the "use it or lose it" programme. In future, the FCA should be more interventionist and should make more frequent use of its powers rather than maintaining a culture of risk aversion. (Paragraph 173)*
33. The Financial Promotion Order would benefit from reform due to the increasing risks associated with the exemptions that allow customers to self-certify as high net worth or sophisticated. (Paragraph 179)
34. *The Treasury should—as a matter of priority—re-evaluate the Financial Promotion Order exemptions to determine their appropriateness and consider what changes need to be made to protect consumers. (Paragraph 180)*
35. It is very disappointing to see that despite the numerous representations made to the Government, measures to address fraud via online advertising have not been included in the draft Online Safety Bill. This is a missed opportunity to act and potentially help prevent another LCF-type event. The increasing frequency of fraudulent activity online that leads to scams and financial harm is alarming, and the Government must intervene as a matter of urgency. (Paragraph 190)
36. We note the Government's intention to consider additional legislative and non-legislative solutions to tackle fraud via advertising, emails or cloned websites, including the online advertising programme, but we believe quicker action is required to protect consumers and help the FCA address the issue adequately. (Paragraph 191)
37. *We recommend that the Government should include measures to address fraud via online advertising in the Online Safety Bill, in the interests of preventing further harm to customers being offered fraudulent financial products. (Paragraph 192)*
38. *Pending any legislative changes, the FCA should continue to work with online platforms such as Google to remove misleading and fraudulent adverts as quickly as possible, to protect customers from scams. (Paragraph 193)*

## Appendix 1: Dame Elizabeth's Recommendations

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*Recommendation 1:* the FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically.

*Recommendation 2:* 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.

*Recommendation 3:* the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on: (i) how 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.

*Recommendation 4:* 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.

*Recommendation 5:* 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.

*Recommendation 6:* the FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.

*Recommendation 7:* 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 (e.g. artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.

*Recommendation 8:* the FCA should take urgent steps to ensure that all key aspects of the Delivering Effective Supervision ("DES") programme that relate to the supervision of flexible firms are now fully embedded and operating effectively.

*Recommendation 9:* the FCA should consider whether it can improve its use of regulated firms as a source of market intelligence.

*Recommendation 10:* HM Treasury should consider addressing the lacuna in the allocation of ISA-related responsibilities between the FCA and HMRC.

*Recommendation 11:* HM Treasury should consider whether Article 4 of MiFID II<sup>239</sup> or section 85 of FSMA<sup>240</sup> should be extended to non-transferable securities.

*Recommendation 12:* HM Treasury should consider the optimal scope of the FCA's remit.

*Recommendation 13:* HM Treasury and other relevant Government bodies should work with the FCA to ensure that the legislative framework enables the FCA to intervene promptly and effectively in marketing and sale through technology platforms, and unregulated intermediaries, of speculative illiquid securities and similar retail products.

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239 See [Article 4 \(europa.eu\)](#) and [The MiFID 2 Guide](#)

240 See [Financial Services and Markets Act 2000 \(legislation.gov.uk\)](#)

# Formal minutes

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**Monday 21 June 2021**

**Members present:**

Mel Stride, in the Chair

Rushanara Ali

Mr Steve Baker

Harriett Baldwin

Anthony Browne

Felicity Buchan

Angela Eagle

Emma Hardy

Julie Marson

Siobhain McDonagh

Alison Thewliss

Draft Report (*The Financial Conduct Authority's regulation of London Capital & Finance plc*), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 194 read and agreed to.

Summary agreed to.

*Resolved*, That the Report be the Fourth Report of the Committee to the House.

The Recommendations of the Independent Investigation by Dame Elizabeth Gloster were appended to the Report.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available (Standing Order No. 134).

**Adjournment**

Adjourned until Wednesday 23 June at 2.00 pm

## Witnesses

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The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

### Monday 01 February 2021

**Rt Hon Dame Elizabeth Gloster DBE**, Independent investigator into the Financial Conduct Authority's Regulation of London Capital & Finance plc; **Dorothy Cory-Wright**, Partner, Head of London Disputes Practice, Dechert LLP; **Richard Frase**, Partner, Financial Services Group, Dechert LLP; **James Petkovic**, Junior Counsel, One Essex Court

[Q1-63](#)

### Monday 08 February 2021

**Andrew Bailey**, Governor, Bank of England, Former Chief Executive, Financial Conduct Authority

[Q64-169](#)

### Monday 01 March 2021

**Nikhil Rathi**, Chief Executive, Financial Conduct Authority; **Charles Randell CBE**, Chair, Financial Conduct Authority

[Q170-260](#)

### Thursday 25 March 2021

**Jonathan Davidson**, Senior Adviser, Financial Conduct Authority; **Megan Butler**, Executive Director for Transformation, Financial Conduct Authority

[Q261-319](#)

### Wednesday 21 April 2021

**John Glen MP**, Economic Secretary to the Treasury, HM Treasury; **Katharine Braddick**, Director General for Financial Services, HM Treasury

[Q320-400](#)

## List of Reports from the Committee during the current Parliament

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All publications from the Committee are available on the [publications page](#) of the Committee's website.

### Session 2021–22

Number	Title	Reference
1st	Tax after coronavirus: the Government's response	HC 144
2nd	The appointment of Tanya Castell to the Prudential Regulation Committee	HC 308
3rd	The appointment of Carolyn Wilkins to the Financial Policy Committee	HC 307

### Session 2019–21

Number	Title	Reference
1st	Appointment of Andrew Bailey as Governor of the Bank of England	HC 122
2nd	Economic impact of coronavirus: Gaps in support	HC 454
3rd	Appointment of Richard Hughes as the Chair of the Office for Budget Responsibility	HC 618
4th	Appointment of Jonathan Hall to the Financial Policy Committee	HC 621
5th	Reappointment of Andy Haldane to the Monetary Policy Committee	HC 620
6th	Reappointment of Professor Silvana Tenreyro to the Monetary Policy Committee	HC 619
7th	Appointment of Nikhil Rathi as Chief Executive of the Financial Conduct Authority	HC 622
8th	Economic impact of coronavirus: the challenges of recovery	HC 271
9th	The appointment of John Taylor to the Prudential Regulation Committee	HC 1132
10th	The appointment of Antony Jenkins to the Prudential Regulation Committee	HC 1157
11th	Economic impact of coronavirus: gaps in support and economic analysis	HC 882
12th	Tax after coronavirus	HC 664
13th	Net zero and the Future of Green Finance	HC 147
1st Special	IT failures in the financial services sector: Government and Regulators Responses to the Committee's Second Report of Session 2019	HC 114

<b>Number</b>	<b>Title</b>	<b>Reference</b>
2nd Special	Economic Crime: Consumer View: Government and Regulators' Responses to Committee's Third Report of Session 2019	HC 91
3rd Special	Economic impact of coronavirus: Gaps in support: Government Response to the Committee's Second Report	HC 662
4th Special	Economic impact of coronavirus: Gaps in support: Further Government Response	HC 749
5th Special	Economic impact of coronavirus: the challenges of recovery: Government Response to the Committee's Eighth Report	HC 999
6th Special	Economic impact of coronavirus: gaps in support and economic analysis: Government Response to the Committee's Eleventh Report	HC 1383