The FCA's response to the Complaints Commissioner's Report into our oversight of LCF. Published on 15 March 2022.

1. The collapse of London Capital and Finance plc (LCF) had a profound effect on the many bondholders who invested money they could not afford to lose. Over 1,100 affected bondholders have complained to us, explaining the impact that LCF's collapse has had on them. We are very sorry for the errors we made in our handling of this case. We have previously set out in our response to Dame Elizabeth Gloster's Independent Report (the Gloster Report) that we accepted the nine recommendations Dame Elizabeth made for us. We are providing regular updates on our progress against these, as well as on our Transformation Programme in general. We published our latest update in December 2021. Together with the Serious Fraud Office (SFO), we are continuing to investigate the circumstances surrounding the sale of mini-bonds and ISA bonds by LCF.

2. This document sets out our response to the Complaints Commissioner's Final Report on the FCA's handling of LCF. The Commissioner published her Final Report on 15 February 2022. It sets out her conclusions on the three main topics she identified when reviewing complaints about the FCA's handling of LCF: the FCA's oversight of LCF, the FCA's approach to ex gratia compensation and the FCA's handling of complaints. We appreciate the opportunity to respond to the Commissioner's findings and recommendations.

Recommendations we accept:

3. In paragraph 166 of the Final Report, the Commissioner highlights that we have accepted a recommendation in her Preliminary Report that it would have been best practice to have directly informed complainants about the progress of the Gloster Report. Where there are similar circumstances in the future, we have committed to taking a proactive approach to communication.

4. In paragraph 168, the Commissioner recommends that we keep her informed of the progress of our Transformation Programme. We have accepted this recommendation and will continue to provide the Commissioner with regular updates on our progress in delivering the Transformation Programme, consistent with our broader public reporting.

5. In paragraph 171, the Commissioner recommends that we proactively make every effort to keep up to date with the maintenance of the Financial Services Register (the Register). We have invested significantly in the Register and will continue to do so, making it more user friendly, accessible and with prominent risk warnings. For example:

    a. The data on the Register is partly provided by authorised firms. To improve the accuracy of this data, we now require most FSMA solo regulated firms to annually check their information on the Register and attest that the information is correct, making corrections to any inaccuracies.

    b. In July 2020, we launched a re-designed Register. This specifically focused on helping consumers understand how they should use the Register and how important it is to check what activities the FCA has authorised the firm to carry out (permissions), rather than relying on its authorised status. In December 2020, we introduced a new directory of certified and assessed persons for dual and solo regulated firms.

    c. We have responded to feedback on the new design of the Register. As an example, in July 2021, we introduced changes to the Finanical Ombudsman Service / Financial Services Compensation Scheme (FSCS) protection wording for Exempt Professional Firms (EPF), European Economic Area (EEA) firms and firms on the Register under money-laundering regulations, based on feedback provided to us by the Ombudsman Service and the FSCS. We will make further improvements based on the feedback we get. As part of our future development of the Register, we will be carrying out further market research and user testing.

    d. The Commissioner suggests in her Final Report that the FCA should review the risk warnings on the Register. We will reconsider the language and prominence of the risk warnings by the end of May 2022 and see where we can further improve the current Register and associated webpages to help consumers. This work will be informed by consumer research and testing.

6. We have previously provided the Commissioner with updates on our changes to the Register. We will provide further updates to the Commissioner when major changes are made.

7. In paragraph 186, the Commissioner recommends that the FCA publish its internal guide when determining ex gratia payments for delays in its complaints handling. In response to this recommendation in the Preliminary Report we set out how we calculated ex gratia payments for these delays and gave examples in relation to LCF complaints. We accept this recommendation and will publish our guide for ex gratia payments for complaint handling delays on the FCA website by the end of April 2022. We want to underline that this document is only a guide – we will take the circumstances of each individual case into account as we set out in our Complaints Scheme.

Recommendations we do not accept:

The FCA's oversight of LCF

8. In addressing the first topic of the Final Report (the FCA's oversight of LCF), the Commissioner recommends that the FCA upholds allegation five that, in the case of LCF, the Register was misleading.

    a. We do not accept this recommendation. We do accept that in some ways the Register could have been clearer, but we do not accept that the Register was misleading. We have set out our reasoning below.

    b. We are legally obliged to keep the Register as a record of, among other things, every person who appears to the FCA to be an authorised person and the services that they say they are able to provide. In the case of LCF, and based on the information we have, we provided a Register entry which reflected LCF's permissions and authorised status at the time.

    c. Although the Register is an important source of information, it is not designed to be the sole source of information for investors to use before making investment decisions. We would expect investors to consider a wide range of information from different sources to help them understand any potential investment and the risks involved and to identify if they are protected if things go wrong. In order to further our objective of securing an appropriate degree of protection for consumers, the FCA made rules in 2014 to restrict the types of investor to which firms offering investments such as the LCF bonds could make direct offer promotions. The rules also required firms to check that their clients had the knowledge or experience to understand the risks involved where they had not received advice about their investment and that investors were warned, in the context of a certification process, that there was a significant risk of losing all of the money invested. LCF's Information Memoranda confirmed that FSCS protection did not apply.

    d. It appears that the Commissioner has concluded that the Register was misleading because investors assumed they were investing in a safe product solely, or largely, because LCF was on the Register. As required by legislation we give authorised persons permission to carry on certain financial services and we provide information about those permissions on the Register. Based on the information that we have, the Register's entry correctly reflected LCF's permissions at the time. Given this, we cannot agree with the Commissioner's conclusion that the Register was misleading.

    e. We know and accept that there is scope for improvement of the Register. In particular, as we explain above, we have since changed the Register so that its role is displayed more clearly and prominently. The Register shows what regulated activities a firm can carry out, but it cannot inform users about which particular products and services offered may be protected by the FSCS or included in the jurisdiction of the Financial Ombudsman Service. This is because protection applies, amongst other things, on the basis of regulated activities, and not on the provision of particular products. For example, a consumer may

invest independently in a product provided by a firm, even where the firm is an authorised firm, where the provision of that product is not a regulated activity. In this example, the provision of this product by the firm would not be covered by the FSCS because it is not a regulated activity. Complaints about the provision of the product may also not be something that is included in the jurisdiction of the Financial Ombudsman Service (which in certain cases can be wider than regulated activities). However, if a consumer had received regulated advice to invest in that same product, then they may be able to take a claim to the FSCS or a complaint to the Financial Ombudsman Service. This is because the provision of that advice is the regulated activity in this case, and the claim or complaint from the consumer would be about that advice (rather than about the product itself), and financial advice is likely to be protected activity from the point of view of the FSCS and within the jurisdiction of the Financial Ombudsman Service. It is relevant in this case that the issuing of LCF bonds was not a regulated activity.

f. Standing back, we still think there is an important distinction between the fact of LCF being authorised giving a false sense of security (the 'halo effect') and the Register being misleading. We do not believe that in presenting the legally required information, as in this case, the Register could be described as misleading. Many firms are FCA authorised but also undertake activities or offer products or services that are unregulated. For example, several large authorised financial services firms, including high-street banks, provide some type of unregulated services, and the risk that consumers may be influenced by the 'halo effect' also exists for these firms. Any 'halo effect' is an unavoidable consequence of the legislative framework.

g. We recognise that the Register uses technical legal language. We appreciate consumers may not be using it to check if a firm can carry out certain activities, but to understand whether the product they are considering is appropriate for them. The Register cannot answer this question. The current legislative framework means that what the Register is required to show relates to the activities which the firm is stating it is able to provide. However, firms are not required to let us know about the unregulated activities they carry out and these activities are not included on the Register. We understand this presents a challenge for consumers trying to navigate the Register.

9. At paragraph 171, the Commissioner recommends that the FCA take steps to mitigate the 'halo effect'. The Register is one way in which we can respond to the 'halo effect' by showing, as clearly as possible, all the firms and individuals authorised by the Prudential Regulation Authority (PRA)/FCA and what permissions they have. But the Register is not intended to be used as a tool by someone to decide if an investment is appropriate for them or not, or whether or not the particular investment or service has Financial Ombudsman Service or FSCS protection. We recognise that the fact that a firm is authorised by the FCA for its regulated activities can give consumers a false sense of security about its unregulated activities because of the 'halo effect'. However, the Register alone cannot solve the problem of the 'halo effect'.

10. In our response to the Gloster Report, we said it was particularly difficult for us to solve this on our own under the current legislative framework, which allows authorised firms to carry out both regulated and unregulated activities. Nevertheless, we have taken steps since the Gloster Report was published to respond to the 'halo effect'. In March 2021 we added a new banner on the Register to highlight to consumers that firms we regulate may carry out unregulated and regulated activities and that they should contact the Financial Ombudsman Service and the FSCS directly if they want details about the protection the Financial Ombudsman Service or the FSCS might offer them. We are also taking action to prevent firms which do not use their permissions from that information remaining on the Register. As of December 2021, we had removed permissions from 166 firms and individuals who have not used these in the past 12 months. Our work on our 'use it or lose it' programme is ongoing.

11. As set out above, the FCA has committed to providing updates to the Commissioner when we make major changes to the Register.

The FCA's approach to ex gratia payments/compensation

12. In dealing with the second topic of the Final Report (the FCA's approach to ex gratia payments/compensation), the Commissioner recommends that we remove what is described as the 'sole or primary cause test' in the Remedies Statement and refer only to the test as set out in the existing Complaints Scheme. The Commissioner recommends that once we have done this, we should withdraw our decisions on LCF complaints and re-decide them in accordance with paragraph 7.14 of the Complaints Scheme.

13. We want to make clear that we agree we should assess complaints in accordance with paragraph 7.14 of the Complaints Scheme. Where we are not the 'sole or primary cause' of the complainant's loss, this does not not act as a block to the award of compensation where we consider compensation would be appropriate. In the case of LCF bondholders, we have concluded that it is appropriate (in light of the paragraph 7.14 factors) to make ex gratia payments in cases where we gave investors incorrect information in direct communications which may have led them to believe that their investment would be safer than it was (incorrect information cases), even where the FCA was not the sole or primary cause of that loss.

14. We have already considered the LCF complaints against the factors in paragraph 7.14 of the Complaints Scheme. In considering our response to the Final Report we have also taken into account the Commissioner's further comments where relevant to these factors. Below, we explain why, given those factors, we do not consider it would be appropriate to pay compensation to LCF investors, apart from those involving complaints handling delays and the incorrect information cases. This reasoning reflects our previous analysis and the Commissioner's most recent comments. So we do not accept this recommendation. As we have already assessed all complaints in accordance with the paragraph 7.14 factors, no purpose would be served by considering these again by reference to the same factors.

The Complaints Scheme Factors (paragraph 7.14)

15. Factor (a): the gravity of the misconduct and its consequences for the complainant.

    a. Many LCF investors have suffered significant financial consequences from the collapse of LCF, with many losing money that they could not afford to lose. We have accepted that we made mistakes in our oversight of LCF. We could have made better judgements. But these are the types of judgements which Parliament has tasked the FCA with making in good faith, and for which it has specifically excluded liability. We also note that the complaints are not directly about any specific misconduct by the FCA towards an individual bondholder. The cases we proactively identified in light of the findings of our oversight of LCF where we gave incorrect information to investors in direct communication with us are clearly an exception to this.

        i. We have taken the Gloster Report into account when responding to the allegations from the investors who complained. At paragraph 12 in the Commissioner's Final Report, she says *'The FCA's own investigation was extensive and thorough and resulted in a further comprehensive analysis of the facts relating to its oversight of LCF.'* The Commissioner has also agreed with the outcome we reached on nine out of the ten standard allegations. As our responses to complainants published alongside the Final Report reflect, we have referred extensively to the Gloster Report. Based on that, we have demonstrated that we have taken into account the concerns Dame Elizabeth raised in her Report.

        ii. We have carefully considered the Commissioner's comments and the statements in the Gloster Report about causation. We still believe it is appropriate to take into account the fact that, apart from the incorrect information cases, the complaints are not about any specific misconduct by the FCA towards an individual investor.

        iii. We have also further considered the consequences for investors who complained in light of FSCS payments, recoveries in the insolvency proceedings and the Government compensation scheme. We expect that, in total, compensation and recoveries received by investors will amount to around two thirds of the total amount invested in LCF, and individual investors who invested less than £85,000 will receive a higher proportion. The payments made so far are:

            1. FSCS compensation of £58.3m
            2. Administrator payments of £5.4m
            3. Government LCF compensation of £109.4m as of 14 March 2022. The government expected to pay out around £120m in compensation in total under their scheme.

        iv. As such, it is appropriate to give weight to the fact that, while there were substantial total losses, many investors have also received significant compensation for losses in respect of a high risk unregulated investment.

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

    a. The Commissioner's Final Report states that we should not interpret 'direct dealings' as a binary question of whether or not we spoke directly with the consumer, but as a sliding scale which takes into account all the relevant factors which make up the relationship between the regulator and the consumer. The Commissioner suggests that the closeness of the relationship should be weighed in with the other factors in the Scheme and *'where the relationship is a close one, it may be that other factors need not be as 'weighty' in order to justify, for example, an ex gratia compensatory payment for regulatory and supervisory failings'*. She also says that 'direct dealings' should not be regarded as a 'test' or 'threshold' which needs to be met.

    b. In our view, factor (b) is clear in requiring us to consider the nature of our relationship with the complainant and the extent to which the complainant has been adversely affected in the course of their direct dealings with us. This is how we have considered this factor in this case, and why we reached the conclusion that it weighed differently for incorrect information cases. Our view is that incorrect information case investors had a different relationship with us through having direct contact. They had direct dealings with us, which had adverse consequences, compared to other complainants, where the relationship was not direct or the complainants did not suffer in the course of direct dealings.

    c. We have also considered the Commissioner's concerns about the distinction we have made between those investors who consulted the Register, or who otherwise relied on the 'halo effect', and the incorrect information cases. We do not consider that these statements raise points which change our original conclusion that it is reasonable to conclude that this factor weighs differently for the incorrect information cases.

    d. We agree with the Commissioner, however, that the reference to whether a complainant has had "direct dealings" with the regulator is not a "test" or "threshold" which excludes the need to consider other matters. In making our decision on LCF complaints we have considered the factors in paragraph 7.14 both individually and cumulatively.

17. Factor (c): whether what has gone wrong is at the operational or administrative level.

    a. Our view is that we must consider both whether there were operational or administrative failures, whether there were matters of policy involved, or whether we had to balance conflicting interests and complex issues. We clearly made operational errors in our regulation of LCF. However, it is also the case that we made decisions regarding policy and had to balance conflicting interests and complex issues. In particular:

        i. We had taken on responsibility for approximately an additional 50,000 consumer credit firms previously regulated by the Office of Fair Trading (of which LCF was one) in 2014. We had very limited information about

these firms, and so had to make difficult decisions on where to prioritise our resources.

ii. We chose to prioritise high-cost consumer credit, and this led to significant consumer benefit. For example, in January 2015 we introduced new rules including price caps in relation to the high-cost short term credit market and did the same in the rent-to-own market in March 2019. We have also provided greater clarity about our creditworthiness rules and taken action against firms that fail to meet our standards or fail to recognise their duty to pay redress to customers for historical poor lending practices.

iii. We made a policy decision to intervene in relation to the marketing of unlisted securities (such as mini bonds) by making rules in 2014 governing the marketing of non-readily realisable securities (NRRS). These rules cover most mini bonds including those issued by LCF. Although issuing mini bonds does not generally involve a regulated activity, the promotion of such investments is subject to the financial promotions regime. Our policy decision meant that authorised persons could only communicate or approve direct offer financial promotions relating to NRRS to retail clients who were certified as sophisticated investors, high net worth investors or 'restricted investors' (those who had confirmed that they would limit their investment in NRRS to 10% of their net investable assets). Having put these safeguards in place, we subsequently made the decision to prioritise other areas, for example, high-cost consumer credit.

iv. We also issued a number of warnings about investment risks. Links to these warnings have been published alongside the Commissioner's Final Report, on pages 230-232.

b. We still consider that it is appropriate to take these factors into account as one of the considerations in determining whether investors should receive ex gratia compensation under the Complaints Scheme.

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

a. We need to consider the precedent implications of any decision we take in a particular case. In this case, if we awarded compensation to investors, we would also need to consider making payments in similar circumstances. That is, where, in hindsight, we could have made different prioritisation decisions about our resources and thereby achieved better outcomes for a particular group of consumers. We currently regulate the conduct of approximately 50,000 firms and we focus on their regulated activities. If we were to award payments to all LCF investors and apply the same approach to every complaint about unregulated activities from now on, we risk our Complaints Scheme imposing a disproportionate burden on consumers as regulated firms' costs would increase significantly. This would also call into question the legislative scheme, which

requires us to prioritise the regulated activities of authorised firms and sets boundaries to the FSCS.

b. The total remaining losses for LCF are estimated to be around £50m. If we made significant payments for all the LCF complaints we receive this could become a significant financial burden on the firms we regulate and their consumers, who ultimately bear the financial burden.

19. Having re-considered these factors individually and cumulatively, we still consider that it is not appropriate to make ex gratia compensatory payments for the complaints we have received about LCF, other than for the incorrect information cases and for delays in complaint handling.

20. Based on our assessment of the four factors above, our view remains that an apology is the most appropriate remedy under the Complaints Scheme. We have sincerely apologised to all LCF bondholders whether or not they have complained. The FCA's Chair, Charles Randell, also apologised further to those who did complain, alongside the FCA Complaints Team's decision letter.

Remedies Statement

21. In relation to the Commissioner's comments about the Remedies Statement, we would like to set out clearly the purpose of the Remedies Statement. Following a series of public statements from the previous Commissioner criticising the lack of clarity in our approach to remedies under the Complaints Scheme, and particularly our approach to compensatory payments, we published the statement in June 2020. Our aim was to clarify for complainants the approach we have broadly followed historically, and which we think is appropriate given the purpose of and factors in the Complaints Scheme. The Remedies Statement does not introduce a new 'test' or reflect any change to our longstanding approach. We also disagree with the Commissioner's comments about the examples of past practice we provided in response to her Preliminary Report. Our view is that these examples illustrate both that the Remedies Statement reflects our longstanding general approach, and that we have paid compensation, including to consumers, where we were the sole or primary cause of their loss.

22. As the Commissioner notes, the Complaints Scheme is not designed to deal with complex questions of causation although how far we could be said to have caused a complainant's loss is clearly relevant in how we apply the factors in paragraph 7.14 of the Complaints Scheme. However, as we explained above, the question of whether the FCA is the 'sole or primary cause' of loss is not intended to be, and does not in fact operate as, a barrier to awarding compensation where we consider that it would be appropriate under the paragraph 7.14 factors.

23. While the Remedies Statement states that *'in deciding what remedy is appropriate we take into account the factors set out in paragraph 7.14 of the Scheme'*, we accept we could have explained more clearly that, while we have generally paid ex gratia compensatory payments for financial loss where we were the sole or primary cause of such loss, this does not alter the fact that we will always consider remedies in line with paragraph 7.14 of the Scheme, as we have done for LCF complaints.

24. We are currently considering our response to the consultation on a replacement to the current Complaints Scheme. In doing so, we will do our utmost to ensure that, whatever approach to remedies we decide on, it is explained clearly and comprehensibly.

25. We hope this response provides more clarity about the approach we have taken in this case and explains why we have come to the decisions we have under the Complaints Scheme.