

**INDEPENDENT REVIEW INTO THE FSA AND FCA'S HANDLING OF THE  
CONNAUGHT INCOME FUND SERIES 1 AND CONNECTED COMPANIES**

**REPORT OF THE INDEPENDENT REVIEWER**

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## GLOSSARY OF COMMON TERMS

<b>Accountants</b>	the firm of accountants engaged by Tiuta in 2011
<b>BGC</b>	Blue Gate Capital Limited, the operator of the Fund from 2009 - 2012
<b>CAG</b>	the Connaught Action Group, a group comprising investors in the Fund and other stakeholders and parties with an interest in the collapse of the Fund
<b>CAM</b>	Connaught Asset Management Limited, a company registered in England and Wales, which was the asset manager of the Fund
<b>CAM Guernsey</b>	Connaught Asset Management (Guernsey) Limited, a company registered in the Bailiwick of Guernsey, and which was the asset manager for the Connaught Income Fund Series 2
<b>Capita Final Notice</b>	the Final Notice dated 10 November 2017 issued against CFM by the FCA
<b>CET</b>	the Regulator's Complex Events Team (initially, the Crystallised Risk team). This was a new team set up in 2012 to deal with resource-intensive, complex cases in which risks had crystallised within Supervision, and which may involve multiple teams across different departments within the Regulator, such as the Fund
<b>CFM</b>	Capita Financial Managers Limited, the operator of the Fund from 2008 - 2009
<b>Complaints Commissioner</b>	the Office of the Financial Regulators Complaints Commissioner
<b>DS1</b>	Land Registry Form DS1 for the cancellation of entries relating to a registered charge over property, for submission to the Land Registry by lenders as proof that a mortgage has been discharged
<b>Enforcement</b>	the Regulator's Enforcement division, now the Enforcement & Market Oversight division
<b>ERD</b>	Enforcement Referral Document
<b>ERIC</b>	the Regulator's Executive Regulatory Issues Committee (an historical committee, from 2013 - 2017). An executive committee chaired by the CEO and responsible for making decisions on firm, sector or product specific regulatory issues escalated from divisions across the Regulator. Its functions

included reviewing and challenging the entity watchlists, ensuring staff across the organisation were informed about significant regulatory issues, making decisions on statutory notices (including warning notices, decision notices, waivers and supervisory notices), and referring issues to EXCO and the Regulator's Board

<b>ESRC</b>	the Regulator's Enforcement and Supervisory Risk Committee. An executive committee chaired by the CEO responsible for making decisions on escalated issues where there may have been a divergence of views, and where a particular decision may impact the regulatory strategy in a number of areas
<b>EXCO</b>	the Regulator's Executive Committee. Oversees the general strategy, direction and activities of the Regulator, including the delivery of the organisation's annual Business Plan. It is responsible for monitoring the direction and performance of the Regulator within the strategic framework set by the Regulator's Board, and has oversight over sub-committees to which it may delegate its functions
<b>FCA</b>	the Financial Conduct Authority
<b>FCC</b>	the Regulator's Firm Contact Centre
<b>FOS</b>	the Financial Ombudsman Service
<b>FSA</b>	the Financial Services Authority
<b>FSCS</b>	the Financial Services Compensation Scheme
<b>FSMA</b>	the Financial Services and Markets Act 2000
<b>The Fund</b>	the Connaught Income Fund Series 1
<b>GCD</b>	the Regulator's General Counsel's Division
<b>GFSC</b>	Guernsey Financial Services Commission
<b>IFAs</b>	Independent Financial Advisers
<b>Independent Reviewer's Team</b>	the Independent Reviewer and his team
<b>JFSC</b>	Jersey Financial Services Commission
<b>MGI</b>	the Mortgages and General Insurance Intermediaries department within the Retail Firms Division of Supervision
<b>PIDA</b>	Public Interest Disclosures Act 1998

<b>Regulator</b>	the FSA and/or FCA, as appropriate from the context
<b>regulatory perimeter or perimeter</b>	the extent of the Regulator's jurisdiction and powers
<b>Report</b>	this report relating to this Independent Review
<b>Review Period</b>	the period between 1 February 2007 and 10 March 2015
<b>Review</b>	this Independent Review
<b>Skilled Person</b>	a third party appointed by the Regulator under section 166 FSMA to report to the Regulator on a regulated firm on matters specified by the Regulator, at the firm's expense
<b>Supervision</b>	the Regulator's Supervision division
<b>TIL</b>	Tiuta International Limited
<b>Tiuta</b>	Tiuta plc
<b>TOR</b>	the Terms of Reference for this Independent Review
<b>UBD</b>	the Regulator's Unauthorised Business Division
<b>UCIS</b>	Unregulated Collective Investment Scheme
<b>WSF</b>	the Wholesale Small Firms department within the Regulator's Supervision division

## A. INTRODUCTION

1. The Connaught Income Series 1 Fund (the "**Fund**") was an unregulated collective investment scheme ("**UCIS**")<sup>1</sup> established in April 2008. Like many UCISs, the operation of the Fund involved a number of different entities, each of which performed a different role in connection with the Fund. Materially, Connaught Asset Management Limited ("**CAM**") was the asset manager of the Fund, Capita Financial Managers Limited ("**CFM**") was the operator of the Fund from its inception to September 2009, and Blue Gate Capital Limited ("**BGC**") was the operator from September 2009 until the Fund's liquidation in December 2012. UCISs are not restricted by regulatory requirements in the types of assets they can invest in, and therefore may include high volatility, speculative, illiquid asset bases with concentrated risks. As such, this feature of UCISs may be considered to pose an inherent risk for consumers.
2. At the time the Fund was established, an April 2008 Information Memorandum approved by CFM named the Fund "*The Guaranteed Low Risk Income Fund*" and "*guaranteed*" returns on investment of 8.15% - 8.5% per annum, distributed quarterly. The proposed investment model was to provide short term bridging finance to property investors, via the Fund's "*Specialist Partner*", Tiuta plc ("**Tiuta**"). At this time, the global financial crisis had begun to hit the markets and Tiuta's other lines of credit for example with banks, became more difficult to access. As a result, Tiuta came to rely exclusively upon the Fund as its only source of capital. That capital was supposed to be used solely for loans approved in accordance with criteria in the Information Memorandum and was to be repaid to the Fund on redemption of those loans by borrowers. In fact, management at Tiuta, apparently with the consent of CAM, from time to time used those monies for other purposes. Tiuta went into administration in September 2012 and was therefore incapable of meeting its contractual obligations to the Fund. The Fund went into liquidation in December 2012. Between July 2008 and March 2012 (when the Fund was suspended by BGC), approximately £108m had been invested by well over a thousand investors and the losses were widespread. Over one hundred Independent Financial Advisers ("**IFAs**") placed investors' monies in the Fund.
3. In January 2011 the CEO of Tiuta, George Patellis, informed the Financial Services Authority ("**FSA**") that he believed there were serious financial irregularities and solvency concerns at Tiuta<sup>2</sup>, which had led him to resign. Prior to Mr Patellis' resignation in January 2011, a total of (approximately) £95m of capital had been invested in the Fund, and a further (approximately) £13m of capital was invested thereafter, prior to the suspension of the Fund in March 2012. The handling by the FSA and then the Financial Conduct Authority ("**FCA**")<sup>3</sup> (in this Report, the "**Regulator**" refers to the FSA in respect of matters taking place prior to 1 April 2013, and to the FCA in respect of matters taking place from 1 April 2013 onwards, as appropriate) of the allegations raised by Mr Patellis regarding both Tiuta and the Fund have been subject to criticism by many, including those affected by the demise of the Fund,

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<sup>1</sup> Within the meaning of Part XVII of the Financial Services and Markets Act 2000 (FSMA) and a UCIS within the meaning of the FSA Handbook.

<sup>2</sup> Hansard House of Commons – Serious Fraud Office, 18 April 2017, Vol 624, paragraphs 19-20: <https://hansard.parliament.uk/Commons/2017-04-18/debates/6ECC7008-897E-4B6A-B8F3-B45CBAAEEEC32/SeriousFraudOffice>

<sup>3</sup> Which replaced the FSA on 1 April 2013.

Members of Parliament ("MPs"), and the media. There was litigation between the liquidators of the Fund on behalf of the investors, and the operators, which settled in January 2016 for £18.5m<sup>4</sup>. The Regulator took enforcement action against CFM which resulted in a Final Notice in November 2017 (the "**Capita Final Notice**") and a further payment to the investors in the Fund of up to £66m which the Regulator considered would be sufficient to ensure that the outstanding invested capital was returned, together with a rate of interest of 0.52% applied to the sum<sup>5</sup>. These events have given rise to a number of complaints to the Office of the Financial Regulators Complaints Commissioner<sup>6</sup> (the "**Complaints Commissioner**") and an investigation and action by the Insolvency Service against certain individuals. The events surrounding the collapse of the Fund and the Regulator's handling of it have led to directorship disqualifications: for example, in December 2014 Nigel Walter (a director of CAM) and Mike Davies (another director of CAM who was also a compliance officer at Tiuta) were banned for nine and seven years respectively<sup>7</sup>. Numerous cases were referred to and handled by the Financial Ombudsman Scheme ("**FOS**") and the Financial Services Compensation Scheme ("**FSCS**")<sup>8</sup>.

### Scope of Review

4. This Independent Review (the "**Review**") arose from a commitment by the Regulator's Board in 2016 to an Independent Review<sup>9</sup> in light of a recommendation made by the Complaints Commissioner<sup>10</sup> following a complaint made by Mr Patellis regarding how his disclosure of information to the Regulator had been handled<sup>11</sup>.

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<sup>4</sup> Capita Financial Managers Final Notice dated 10 November 2017, paragraph 2.5: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

<sup>5</sup> Capita Financial Managers Final Notice dated 10 November 2017, p. 2: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

<sup>6</sup> See, for example: Complaints Commissioner final report for complaint FCA00383 dated 7 December 2017: <https://frccommissioner.org.uk/wp-content/uploads/FCA00383-for-publication-FR-7-12-2017.pdf>; Complaints Commissioner's response to Mr. Patellis' "*Complaint against the Financial Conduct Authority*" – dated 12 October 2016: <http://frccommissioner.org.uk/wp-content/uploads/FCA00114-Patellis-George-Stage-2-Final-Decision-24-11-16.pdf>

<sup>7</sup> UK Government Press Release: "*Connaught Asset Management directors banned for 16 years*", dated 19 December 2014: <https://www.gov.uk/government/news/connaught-asset-management-directors-banned-for-16-years>; Companies House profiles: [https://find-and-update.company-information.service.gov.uk/disqualified-officers/natural/a1tILgDY9xITtf51\\_GukjwLHCBw](https://find-and-update.company-information.service.gov.uk/disqualified-officers/natural/a1tILgDY9xITtf51_GukjwLHCBw); <https://find-and-update.company-information.service.gov.uk/disqualified-officers/natural/NtPckJSXJVdG9B02IrmACzdkG5Q>.

<sup>8</sup> See, for example: Financial Ombudsman Service decisions <https://www.financial-ombudsman.org.uk/files/152167/DRN6024919.pdf> and <https://www.financial-ombudsman.org.uk/files/186686/DRN7691893.pdf>.

<sup>9</sup> FT Adviser, "*FCA commissions review into Connaught failings*", dated 5 December 2016: <https://www.ftadviser.com/regulation/2016/12/05/fca-commissions-review-into-connaught-failings/>; Independent review of the Connaught Income Fund Series 1 - <https://www.fca.org.uk/transparency/independent-review-connaught-income-fund-series-1>

<sup>10</sup> Letter from Antony Townsend (Complaints Commissioner) to George Patellis dated 24 November 2016, p. 12: <https://frccommissioner.org.uk/wp-content/uploads/FCA00114-Patellis-George-Stage-2-Final-Decision-24-11-16.pdf>

<sup>11</sup> Ibid.

5. I was appointed in June 2019<sup>12</sup> to carry out the Review in accordance with the Terms of Reference ("**TOR**") (see Appendix 1). The TOR, including in particular the time period and issues to be examined, were drafted following engagement and input from a number of stakeholders including Fund investors, IFAs, the Tiuta/Fund liquidators and MPs. The main areas to be examined in this Review are whether, between 1 February 2007 and 10 March 2015 (the "**Review Period**")<sup>13</sup>:
  - (a) The FSA's regulation of Tiuta Plc, Capita and Blue Gate, and the individuals associated with these entities, and its response to intelligence was appropriate and effective ("**TOR1**");
  - (b) The FSA's jurisdiction at the time impacted its ability to meet its statutory objective to protect consumers ("**TOR2**");
  - (c) The approach to communications with investors was appropriate, timely and transparent ("**TOR3**"); and
  - (d) The FCA's decisions to support negotiations in July 2014, and then subsequently withdraw that support in March 2015, were appropriate ("**TOR4**").
6. In addition, within these broad areas I have examined, as required by the TOR: the effectiveness of conflicts of interest management within the Regulator; the approach to whistleblowers; the coordination of departments in the use of intelligence; the responses to and the sharing of intelligence with other regulators and law enforcement entities; and the coordination with other organisations including the FOS and the FSCS.
7. It is important to be clear about what this Review concerns and what it does not concern. The collapse of the Fund has had a serious financial, personal and professional impact on a significant number of people. These have been primarily investors, but also IFAs through whom investments in the Fund were placed, those associated with Tiuta, and many others. A number of stakeholders who came to see me and who submitted material in the course of the Review expressed very firm views. They said they believed that there was serious misconduct and deficiencies in the operation of the Fund, and at Tiuta and CAM. They were highly critical of what they saw as the Regulator's failure to deal with those apparent deficiencies and the conduct of those entities and individuals involved. They expressed these opinions from years of investigating these matters for themselves.
8. They also had strong views about what should be done in the future, particularly with regard to compensation. Certain stakeholders have spent considerable time and effort since 2012 campaigning for compensation and a thorough and comprehensive investigation into the Fund, Tiuta, the operators, the relevant individuals involved, and the Regulator's handling of the problems<sup>14</sup>. I recognise that it has taken a long time for

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<sup>12</sup> FCA Press Release: "*Independent Reviews of Interest Rate Hedging Products and the Connaught Income Fund Series 1*", dated 20 June 2019: <https://www.fca.org.uk/news/press-releases/independent-reviews-interest-rate-hedging-products-and-connaught-income-fund-series-1>.

<sup>13</sup> Terms of Reference Lessons Learned Review for Connaught Income Fund Series One dated 20 June 2019: <https://www.fca.org.uk/publication/corporate/terms-of-reference-interest-rate-hedging-products.pdf>

<sup>14</sup> Connaught Action Group Website: [www.connaughtactiongroup.com](http://www.connaughtactiongroup.com); Reuters Article: "*UK regulators face mounting concerns over their handling of multi million pound fund collapse*", dated 4 April 2014:

this Review to be commissioned and then completed. It has been 8 years since the demise of Tiuta and the Fund, and regrettably there has been considerable personal cost to many individuals in terms of the time and resource expended.

9. The time taken to commission and complete this Review has also had other consequences. In particular, I am conscious that lessons that might be usefully learned today in relation to the regulation of a fund that collapsed 8 years ago are harder to identify than in the immediate aftermath. Much has changed at the Regulator and remedial action has been taken as time has moved on. There is no doubt that many of the deficiencies I have identified have been addressed in the intervening period and further work to continually improve is ongoing.
10. It is not within the scope of this Review to answer every question raised by stakeholders or satisfy every demand that has been made. Some have suggested that I should depart from my TOR and make additional findings. I would like to assure any such persons that I have given very careful thought to all suggestions and carefully examined the extensive material put before me. I have particularly considered whether to make findings outside my TOR, but have decided not to do so. To do so would have been inappropriate in principle, given that the TOR set out the scope of the Review that I was appointed to conduct.
11. The purpose of this Review and my appointed role is not to determine or recommend whether or how much further compensation should be paid and to whom or by whom, or to assist adversely impacted parties in obtaining financial redress. Rather, its purpose is to set out findings with regard to the specific questions set out in the TOR. These are limited to examining the way in which the Regulator dealt with matters relating to the Fund, and to make recommendations as to any lessons that should be learned. Those findings and recommendations have benefited from engagement with the many stakeholders (both within and outside the Regulator) who have come forward, and taken into account their views and suggestions. My team and I (the "**Independent Reviewer's Team**") have also conducted a detailed and thorough investigation and analysis of extensive documentary material, primarily comprising the Regulator's internal and other documents in the possession of the Regulator, but also material that may not have been available to the Regulator or other relevant entities and individuals at the time, which I have been sent from various sources. Every effort has been made to identify, collate, and examine relevant material. I have held meetings and interviews with numerous stakeholders and current and former employees at the Regulator. This report (the "**Report**") sets out the picture and lessons which emerge from the Review. Further details of the Review methodology are set out in Appendix 4.
12. Finally, the Review has been carried out with the necessary assistance of the Regulator, for which my team and I are grateful. This Report is, however, entirely independent of the Regulator and I would like to make it clear, for the avoidance of doubt, that my findings are objective and impartial and have not been improperly influenced in any way by the Regulator or anyone else.

## Hindsight

13. The events concerning the Fund, which I have reviewed, themselves covered a period of 8 years and in some cases took place more than a decade ago. A high-level chronology of some of the events and reference points relevant to the Review and a simplified overview of how the Fund was structured may be found in Appendix 2. I have been careful to ensure that my findings are firmly based on contemporaneous knowledge, law and regulatory approach and practice, and are set in their proper context. I am aware that it may be tempting to draw conclusions and to be critical based upon hindsight, given the time that has elapsed since the key events in question. However, I have made every effort to avoid hindsight analysis and to draw conclusions only in relation to what the Regulator did or did not do on the basis of the knowledge available to it at the relevant time and in the context of the prevailing circumstances.
14. I should emphasise that, as set out in the TOR, the primary focus of the Review is on the Regulator's conduct, based on the information reasonably available to it at the time, rather than the conduct of the individuals and entities involved in the matters under review. A number of the events surrounding and leading to the collapse of the Fund have been, and continue to be, vigorously disputed. For the purposes of this Review, it has been neither feasible, nor necessary, for me now to consider each and every disputed version of events and determine which is the most accurate. I have only done so to the extent necessary to address the matters set out in the TOR. Accordingly, the findings in this Report are based on the information considered as part of this Review, which in turn – given the matters under Review – has concerned primarily what the Regulator knew at the time.
15. I have set out a summary of my findings and recommendations in the next section. I have found identifiable failures and missed opportunities in the Regulator's regulation of, and in its response to information and intelligence raised regarding, various entities and individuals associated with the Fund. Where it has been necessary to criticise the Regulator's regulation in this regard, the Regulator has been given an opportunity to make representations in response which I have considered carefully before finalising my Report. I recognise, as one would expect and as I have said, that relevant aspects of the Regulator's approach and systems have changed considerably since the critical events which led to the demise of the Fund began to coalesce in 2011. I trust that the Regulator will examine my findings and recommendations with care and scrutinise its current procedures, systems, operations and regulatory approach in order to ensure that the regulatory response to issues similar to the collapse of the Fund have been sufficiently updated and, if not, are further improved.

## B. EXECUTIVE SUMMARY OF CONCLUSIONS

16. Fund investors recouped a considerable proportion of their investment through a combination of a payment of £18.5m<sup>15</sup> arising from the settlement of civil litigation with the Fund's operators in January 2016, and a payment of up to £66m following the Capita Final Notice<sup>16</sup>. This was a positive outcome for Fund investors which the Regulator's actions from around 2015 onwards were instrumental in achieving and for which it deserves credit. However, this does not answer the question of whether the Regulator's handling of the Fund was appropriate and could have been more effective before its collapse in 2012 and in the immediate aftermath. I have concluded that the Regulator's regulation of the relevant entities and individuals connected to the Fund was not appropriate or effective for the reasons I have described in this Report. I have reached this conclusion against the background of known risks to investors posed by UCISs in general as well as the specific information the Regulator was presented with as to the particular risks posed to investors in the Fund. I recognise that the Regulator's approach may not have been at material variance from the regulatory orthodoxy at the time in some respects, but overall it remains my view that it could have acted in a more effective way to protect investors in the Fund.
17. A summary of my findings is set out below.
- (a) In January 2011, George Patellis, the CEO of Tiuta, brought serious concerns about Tiuta to the Regulator's attention, and alleged various financial misconduct and solvency issues. The response to the matters raised by Mr Patellis was generally inadequate. Mr Patellis should have been considered at the time an unusually senior whistleblower and his allegations, which were disclosed to the Regulator with supporting documentary material, should have been taken seriously and acted upon. Unfortunately they were not, and he was not sufficiently protected or treated appropriately. Prior to 2011 regulatory supervision of a small firm such as Tiuta was light-touch and reactive, given the large number of small firms within the Regulator's supervisory jurisdiction. As such, supervision was in part dependent upon whistleblowers or stakeholders like Mr Patellis bringing issues to its attention. It was therefore particularly unfortunate that Mr Patellis' allegations were not followed up in the circumstances.
- (b) Measures to deal with the worsening problems at Tiuta were not properly coordinated or sufficiently robust for the rest of 2011. Decision-making was delayed and potential avenues of intervention not implemented, partly because the approach from individual departments<sup>17</sup> was not sufficiently coordinated. The Regulator operated at the time in a siloed way, with numerous departments and teams becoming involved from time to time<sup>18</sup>, but who did not always

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<sup>15</sup> Capita Financial Managers Final Notice dated 10 November 2017, paragraph 2.5: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

<sup>16</sup> Ibid., paragraph 1.2.

<sup>17</sup> Unauthorised Business, Supervision (including (i) the Mortgage and General Insurance department within the Small Firms Division and (ii) the Wholesale Firms Division), Enforcement and GCD.

<sup>18</sup> Including (without limitation) Authorisations, Supervision – Retail Small Firms, Supervision – Wholesale Small Firms, Supervision – Complex Events, Unauthorised Business Department, Financial Promotions, Enforcement - Retail, General Counsel's Division.

communicate effectively amongst themselves (or with others). It is evident that the supervisors within the Regulator's Supervision division ("**Supervision**") had difficulty in persuading individuals in Enforcement to take the case forward. From about May 2011 onwards in particular, whilst the situation at Tiuta continued to deteriorate, no one decision maker (or group) within the Regulator took sufficient responsibility for appropriate regulatory intervention to mitigate risks to investors or to coordinate an effective regulatory response to the complex issues which had emerged and were emerging. It was not before the end of 2011 that the operator of the Fund was engaged by the Regulator in relation to these issues. Subject matter experts in funds and/or financial crime were not engaged by a central decision maker or team. Had the Regulator chosen to investigate Mr Patellis' allegations, and had those experts been part of the team, the risk of harm for investors arising from the interdependency between Tiuta and CAM, and the apparent misconduct taking place at both entities, might have come to light earlier. There was a lack of a proper understanding of the overall picture, the business model and the risks to new and existing investors in the Fund, which were allowed to continue. Moreover, throughout 2011, senior management at Tiuta and CAM made commitments, provided information, and advanced arguments to the Regulator which were not sufficiently tested or challenged where appropriate, or adequately monitored or followed up. Such monitoring of Tiuta that was put in place was reactive and misplaced, depending as it did upon the management at Tiuta, supported by CAM, and a firm of accountants which was engaged by Tiuta (the "**Accountants**") on a limited basis.

- (c) There was throughout the Review Period insufficient information-sharing between Regulator divisions, departments, and teams. Part of the issue with information-sharing was a practical one, but there was a more fundamental problem highlighted by the lack of coordination between various teams when regulating a business model of the Fund's type and complexity.
- (d) There were also a number of red flags in Tiuta and CAM's regulatory history between 2006-2010 known to the Regulator that should have been referred to and considered in light of Mr Patellis' allegations. Unfortunately not all of them were, so his allegations were not given the weight and examined in the context that they merited at the time. These red flags included:
  - (i) The Regulator's concerns arising out of Tiuta's authorisation regarding certain individuals and entities connected to Tiuta;
  - (ii) The involvement of Nigel Walter, about whom the Regulator had had concerns in relation to his connection to a land banking scheme prior to establishing CAM;
  - (iii) Concerns that CAM may have been carrying out business without proper regulatory authorisation;
  - (iv) Concerns regarding financial promotions issued by CAM;
  - (v) The circumstances surrounding the change in the Fund's operator from CFM to BGC in October 2009 when, according to the FCA's own

records, at or by around the same time CFM had been subjected to section 166 reviews by the Regulator, concerning the adequacy of CFM's systems and controls in connection with its role as an Authorised Fund Manager, following CFM's involvement with another investment scheme known as the Arch Cru Funds<sup>19</sup>;

- (vi) Concerns expressed by whistleblowers in October and November 2010 relating to financial difficulties with the Fund and BGC's solvency; and
  - (vii) A conflict of interest in Mike Davies' functions in that he was acting as Chairman of CAM and compliance officer at Tiuta at the same time.
- (e) Once Tiuta and the Fund were put into administration and liquidation respectively at the end of 2012, the Regulator's reluctance to take enforcement action against the various entities and individuals involved continued, despite the clear evidence it had of potential breaches of Rules and Principles. This continued into 2013 and 2014 as the Fund's liquidators and the Connaught Action Group ("**CAG**") became active, litigation commenced, questions were raised in Parliament, and other public bodies became more involved; particularly the Insolvency Service<sup>20</sup>, the FOS<sup>21</sup> and the FSCS<sup>22</sup>.
- (f) The Regulator did take some immediate action to address the issues it was presented with. Tiuta agreed to a Voluntary Variation of Permission ("**VVOP**") on 13 May 2011, preventing it from undertaking regulated business from 12 June 2011 onwards. A consumer alert regarding the Fund was published on the Regulator's website on 26 May 2011<sup>23</sup>, the content of which was appropriate in the circumstances, and in August 2011 certain IFAs through whom investments in the Fund had been placed were directed to review the suitability of those investments. However, whilst well intentioned, these measures were not strong or effective enough to protect investors.
- (g) A potential conflict of interest issue concerning a particular employee within the Regulator did arise. The employee properly identified and escalated it and the Regulator ensured that it was managed and dealt with appropriately.
- (h) The Regulator's interactions with the FSCS, FOS, Office of Fair Trading ("**OFT**"), the Guernsey Financial Services Commission ("**GFSC**"), the Jersey

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<sup>19</sup> It should be noted that these Skilled Person reviews related to CFM's systems and controls as regards its role as the Authorised Fund Manager for a regulated investment scheme. According to the Regulator's records, these reviews did not assess CFM's systems and controls as regards its role as Operator for unregulated funds such as the Fund, and I have seen no suggestion that such a review was conducted.

<sup>20</sup> UK Government Press Release: "*Connaught Asset Management directors banned for 16 years*", dated 19 December 2014: <https://www.gov.uk/government/news/connaught-asset-management-directors-banned-for-16-years>

<sup>21</sup> FOS decision in relation to the Fund, dated 5 December 2013: <https://www.financial-ombudsman.org.uk/files/61955/DRN2113835.pdf>

<sup>22</sup> See: Financial Ombudsman Service decisions: <https://www.financial-ombudsman.org.uk/files/152167/DRN6024919.pdf> and <https://www.financial-ombudsman.org.uk/files/186686/DRN7691893.pdf>.

<sup>23</sup> FSA News Story: "*Investors warned over Connaught Income Funds*", published 26 May 2011: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>

Financial Services Commission ("JFSC"), the Insolvency Service, the Serious Fraud Office ("SFO") and City of London Police ("COLP") were generally appropriate, but not always timely or properly directed. The Regulator could have communicated concerns regarding Tiuta and the Fund to the Insolvency Service, COLP, and/or the SFO by mid-2011 but did not do so until August of the following year and when it did, this was not well coordinated or recorded internally. Communication with the GFSC was confused as a result of a lack of clarity within the Regulator as to the GFSC's regulatory responsibility (or lack thereof) for the (Series 1) Fund.

- (i) The Regulator's approach was impacted by its perception of the limits to its own jurisdiction. The Regulator did have regulatory tools available, most notably an ability to collect more information regarding the Fund and to take action through the authorised entity, the operator of the Fund (CFM until September 2009, and then BGC until 2012). However, the Regulator was cautious about using such powers, and reluctant to require the operators to look into the issues causing concern. In addition, as red flags and intelligence were revealed to the Regulator after Mr Patellis provided specific allegations and potential causes for concern, enforcement and other intervention powers were not used. This was, in part, due to the continuing internal uncertainty as to the regulatory perimeter. Only a small part of Tiuta's lending was regulated (about 5%) and most of the business it did was not. There were also perceived limits of regulation concerning UCISs and, in addition, CAM itself, the asset manager of the Fund, was unregulated. These factors affected the Regulator's appetite to investigate and address the misconduct issues which had been brought to its attention in respect of both CAM and Tiuta. Due to this, the perceived disproportionality of certain suggested measures was given too much weight. As a consequence, swift and effective measures to mitigate the significant potential consumer impact of the collapse of the Fund were delayed during 2011 and, ultimately, not taken.
  
- (j) The Regulator was focused on the risks of UCISs soon after the Fund was set up in April 2008. As a result of projects and thematic reviews in October 2009 and July 2010<sup>24</sup>, the risks posed by UCISs were well known to and actively and seriously considered by the Regulator. The Regulator chose to focus on the financial promotions and point of sales areas and as a result concentrated on the selling practices of IFAs and in January 2011, the Regulator published a Discussion Paper, titled "Product Intervention", which highlighted concerns about the promotion of UCISs<sup>25</sup>. More broadly, however, the Regulator also recognised in the Paper that experience had shown that earlier effective intervention in design, governance, and how products functioned, was important and would be the new regulatory approach<sup>26</sup>. However, the Regulator did not, when made aware of solvency and financial misconduct concerns at Tiuta, subject the relevant entities themselves (Tiuta, the operators and, through them,

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<sup>24</sup> FSA Report: "*Unregulated Collective Investment Schemes: Project Findings*", dated July 2010 (initial project started in October 2009). See: Paragraph 1.3: <https://www.fca.org.uk/publication/archive/fsa-ucis-findings.pdf>

<sup>25</sup> FSA Product Intervention Paper – dated January 2011: [https://www.fca.org.uk/publication/discussion/dp11\\_01.pdf](https://www.fca.org.uk/publication/discussion/dp11_01.pdf)

<sup>26</sup> *Ibid.*, paragraph 5.17.

CAM) to appropriate scrutiny, or analyse properly the risks to investors. Instead, the Regulator chose to take action mainly on the financial promotions side of the Fund's activities. Despite the content of the Discussion Paper it did not examine, for example, the operation of the business model, or the lack of proper governance at Tiuta and the Fund. Investors were at risk not just due to the advice they received, the misleading disclosures in the scheme documentation, and the poor selling practices of some IFAs (as repeatedly found by the FOS). The design and operation of the scheme itself, in which there were clear deficiencies and a lack of oversight and governance, contributed to the risks. Those features permitted the misconduct at both CAM and Tiuta to take place and continue to the detriment of investors.

- (k) The aftermath of the Fund's collapse in 2012 unsurprisingly involved a strong and continuous demand for information from those adversely affected. In dealing with this demand, the Regulator did communicate appropriately with those affected persons to the extent that it was able to. It was sufficiently transparent in all the circumstances bearing in mind that it had to balance confidentiality duties and concerns because of the various investigations, regulatory cases, and legal proceedings being conducted. It could not publicly disseminate the still emerging facts until it had reached a clear position internally. It was also reasonable for it not to report events that were being worked through in real time. As part of its communications strategy, the Regulator posted FAQs on the Regulator's website. The FAQs were, in general, informative and appropriate, but with respect to Mr Patellis they were not as clear and transparent as might have been expected.
  - (l) The Regulator's decision to support negotiations between the Fund liquidators, CFM, and BGC in July 2014, whilst unusual, was appropriate in the circumstances and indeed may have contributed to securing a better financial outcome for investors. The decision to withdraw from negotiations in March 2015 was also reasonable in all the circumstances given the apparently limited prospects of achieving a larger settlement at that stage. It also enabled the Regulator to pursue enforcement proceedings against CFM, the outcome of which resulted in a significant recovery of monies to investors.
18. Finally, prior to and during this Review, serious allegations have been made about employees at the Regulator at all levels who dealt with these complex problems as they unfolded. These individuals faced, and in some instances continue to face, demanding and difficult issues and their conduct has been criticised by a number of stakeholders. I should make clear that as part of this Review I have found no evidence of complicity, bad faith, wilful misconduct, or dishonesty on the part of any individual working at the Regulator. I have found no evidence of any conspiracy or cover up, or any deliberate misbriefings of interested parties or inappropriate collusion with other regulators. I have concluded that, at all levels, the various individuals at the Regulator dealing with the issues as they arose worked hard to address the problems in good faith and were well-intentioned. I have no reason to doubt that they each did their best to grapple with the complexity of the issues they faced, whilst at the same time doing their best to deal with deficiencies with internal systems, and uncertainty about jurisdiction. The Regulator's institutional failure to adequately protect investors in the Fund was a result of a

combination of these systemic internal issues and the overall regulatory approach which prevailed at the time.

### C. REGULATORY AND ENFORCEMENT POWERS OF THE REGULATOR AT THE RELEVANT TIME

19. The FCA was created under the Financial Services Act 2012 (with effect from 1 April 2013)<sup>27</sup>. Its predecessor the FSA was criticised for supervisory failings in the lead up to the global financial crisis of 2008<sup>28</sup>. From 2008 onwards, the overall approach to regulation was shaped to a considerable extent by the response of the government and international regulatory bodies to the issues which led to the financial crisis, and focussed on the regulation and supervision of large firms. This focus led to various significant conduct related scandals being identified, such as missold PPI, and manipulation of the LIBOR and FX trading. In 2013, financial regulation moved to a "twin peaks" model with the Prudential Regulation Authority (the "**PRA**") focused on mitigating prudential risks in large firms with the biggest impact on financial stability and a new regulator, the FCA, responsible for the prudential regulation of those financial services firms not supervised by the PRA and the conduct regulator of all firms.
20. Like the FSA before it, the FCA is responsible for overseeing what regulated firms do, their conduct and how they carry out their business<sup>29</sup>. It operates independently from government and is entirely funded by regulated firms. It regulates both the very largest and the smallest financial services firms. One of its statutory objectives is to secure an appropriate degree of protection for consumers<sup>30</sup>.
21. The Regulator assesses whether there are problems in the market, approves those who work in the industry – authorised firms and individuals – produces and implements rules, and investigates if the rules are broken and if so punishes offenders.
22. The scope of the Regulator's responsibilities has widened significantly since the FSA was introduced by the Financial Services and Markets Act 2000 ("**FSMA**").
23. The extent of the Regulator's jurisdiction (sometimes referred to as the "**regulatory perimeter**") has been a perennial issue. It is important to both users and providers of financial services, because if there is uncertainty, this can affect the regulatory culture of firms and individuals and the approach of the Regulator. It also affects the level of protection consumers can expect for the financial services and products they purchase. The jurisdictional limits of this regime are set by Government and ultimately by Parliament.
24. The regulatory regime the Regulator operates largely works by requiring firms carrying out certain activities, and certain approved individuals within those firms, to be authorised or certified. The Regulator has powers it can exercise against those firms

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<sup>27</sup> Financial Services Act 2012: <http://www.legislation.gov.uk/ukpga/2012/21/2013-04-01>

<sup>28</sup> Mansion House address by George Osborne, 16 June 2010: <https://www.gov.uk/government/speeches/speech-by-the-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-at-mansion-house>

<sup>29</sup> FCA website, "*About the FCA*", published 21 April 2016, updated 5 May 2020: <https://www.fca.org.uk/about/the-fca>

<sup>30</sup> Ibid.

and individuals, for example by fining them or revoking their authorisation or certification<sup>31</sup>.

25. However, investment funds are a special case. It can be difficult to regulate them in that way. Investment funds are collections of investors, who pool their assets so that they can invest together. Often there is no entity or individual within the fund itself that performs a material role in relation to its operation. Instead those functions may be contracted out to third parties. For example, some funds are structured as limited liability partnerships, and each investor is a "partner". The partners may delegate the fund's management, and other aspects of its operation, to professional third parties under a contract.
26. As a result, it may not always make sense to regulate funds by requiring the fund itself to be authorised. In some cases, that would mean requiring the investors themselves to be authorised – i.e. the people who are most likely to require regulatory protection.
27. The UK regulatory regime, like other similar regimes, has addressed this by requiring the operators to be authorised instead – regardless of whether they operate aspects of the fund from within the fund itself (e.g. as a partner) or are third parties engaged under a contract.
28. Different rules can apply to these operators, depending on the sorts of funds they operate. For example, some types of UK funds, especially certain funds targeted at retail investors, are referred to as "regulated" funds. Other types of funds are referred to as "unregulated" funds. The operators of regulated funds are subject to more detailed and prescriptive rules. Unregulated funds are subject to less detailed and prescriptive rules. However, in both cases the operator is subject to regulation (even where they are operating "unregulated" funds).
29. The Fund was unregulated and UK-based. That meant its operators were subject to less detailed and prescriptive rules<sup>32</sup>. However, the rules they were subject to were still material and important. This is illustrated by the Capita Final Notice<sup>33</sup>. The Regulator found that CFM breached two important rules, with which all FCA authorised firms must comply: Principle 2 and Principle 7<sup>34</sup>. Principle 2 requires that "*A firm must conduct its business with due skill, care and diligence*". Principle 7 requires that "*A firm*

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<sup>31</sup> FCA website, "*Enforcement*", published 22 April 2016, updated 24 April 2019: <https://www.fca.org.uk/about/enforcement>

<sup>32</sup> A 2014 Regulator Paper from the Enforcement and Market Oversight Division noted that the FCA Handbook section "Conduct of Business Rules" that discusses operator's responsibilities disengaged the vast majority of the FCA Handbook for any entity that acted as an operator of a UCIS, in its management of the scheme's assets. The specific rules in COBS 18.5 cover the provision of information to investors and acting as administrator of the money provided by investors to the fund. The key applicable COBS rules beyond COBS 18.5 are those governing financial promotions and communications with investors (COBS 4.2.1 – 3). The Paper went on to note that "*In summary, the FCA retains reservations about an overly limited role of an operator, but we have not tested them beyond correspondence with regulated and unregulated entities. Industry practice has underpinned the reduction of an operator's role to largely administrative duties concerning the interaction of the scheme and its investors*".

<sup>33</sup> Capita Financial Managers Final Notice dated 10 November 2017: <https://www.fca.org.uk/publication/final-notice/capita-financial-managers-limited-2017.pdf>

<sup>34</sup> *Ibid.*, paragraphs 2.7-2.8.

*must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading".*

30. The Regulator found that CFM breached Principle 2 for a number of reasons. There were failures in the initial due diligence checks CFM carried out on the Fund so that it failed to understand the nature of the Fund – and therefore its supervisory role – properly. When it resigned as operator and handed over to BGC in 2009 it did so without properly disclosing the full extent of the deficiencies which had led it to resign or taking action to address all the issues of which it had become aware. The Regulator found that CFM breached Principle 7 because CFM approved representations that the Fund was "*guaranteed*" and "*low risk*", which the Regulator found were potentially misleading<sup>35</sup>.
31. Although some aspects of the regulatory regime changed during and since the Review Period, the high level points above have remained broadly the same. In particular, the authorised operators of unregulated funds have remained subject to Principle 2 and Principle 7.
32. A short summary of some of the Regulator's statutory powers at the relevant time is included for reference at Appendix 3.

### Supervision

33. The Regulator's approach to supervision changed during the Review Period. However, it was always based on principles of proportionality, with different firms subject to different levels of supervision depending on an assessment of the risk they posed.
34. Prior to the FCA's creation in April 2013, the FSA's Supervision division separated firms into different categories based on their perceived risk. Supervision was split, broadly, between Retail and Wholesale firms. One category of firm on the Retail side was called the Major Retail Groups Division, and comprised the very largest firms, usually around 25 at any one time. These were seen as posing the highest risk to the financial system and markets as a whole, and were subject to the closest supervision. They had dedicated supervisory staff within the Regulator and were subject to relatively frequent Regulator visits and discussions.
35. Aside from this, the Retail Firms Division was responsible for perhaps 1,000 or so firms dealing with retail customers. They were subject to less supervision than firms supervised by the Major Retail Groups Division, but were still relatively closely supervised because of the risks to their customers. For example, the Regulator considered their management and governance structures and they were subject to market reviews.
36. The Wholesale Firms Division comprised firms with relatively sophisticated business or high net worth customers, such as investment firms and asset managers, and whose businesses did not involve their dealing directly with retail consumers. This part of the Regulator supervised approximately 3,000 firms as at June 2010. Approximately 600 of these firms were considered risky enough to be relationship-managed, with firm-

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<sup>35</sup> Capita Financial Managers Final Notice dated 10 November 2017, paragraphs 2.7 - 2.8: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

specific supervision at the Regulator. The remaining firms were subject to supervision through thematic work and other collective initiatives, as described below.

37. Within each of the Retail and Wholesale sides of Supervision there was a Small Firms Division. This comprised about 90% of the firms regulated by the Regulator, which were subject to the lowest level of regulation, mainly due to their small size, which was seen as involving lower risk. Small firms did not have named regulatory contacts within the Regulator and reported using a generic contact address. They were not subject to firm-specific supervision or regular regulatory visits. Instead, the Regulator mainly supervised small firms through sector-wide thematic reviews, reviewing regulatory returns, and by relying on proactive reporting, including under Principle 11, which required firms to be open and cooperative with their regulators and notify them in a pro-active way about certain matters, and through whistleblowing.
38. The supervisory regime received a great deal of attention following the financial crisis, and changed in various ways. For example, in October 2007, the Chief Executive of the Regulator asked the its Internal Audit department to carry out a lessons learned review of the supervision of Northern Rock<sup>36</sup>. Further reviews followed and major changes were made, including the creation of the FCA and PRA in April 2013<sup>37</sup>.
39. Despite these changes, the supervisory regime retained a number of important features. For example, it remained tiered according to how FCA assessed the risk of firms. Overall, the number of firms subject to generic (sector focussed), rather than relationship managed, supervision increased. The supervision of small firms (whether with a wholesale or retail customer base) continued to rely mainly on thematic reviews, regulatory returns, and proactive reporting. However, there was an attempt from around 2015 onwards to shift from a primarily reactive to a pre-emptive style of retail regulation, with a greater emphasis on intervening early to protect consumers if necessary.

#### The regulation and supervision of Tiuta, CFM, and BGC

40. CFM was a large firm, and operated several hundred funds. Almost all of these funds were regulated, but a very small number, like the Fund, were not. During the Review Period, CFM was subject to supervision by the Wholesale Firms Division. Because CFM was a relatively large firm, there were from around 2010 onwards named, designated individuals within the Regulator responsible for CFM's supervision and who had regular contact with CFM as a result. However, they were not responsible for the supervision of the individual funds that CFM operated. They were responsible for ensuring CFM as a whole was operating properly, for example by using proper systems and controls and processes, and otherwise complying with the regulatory rules. As explained above, different rules could apply to the way CFM managed different funds, depending on whether the funds were regulated or unregulated.
41. BGC was much smaller than CFM. During the Review Period, it was subject to supervision by the Wholesale Firms Division but, because it was considered a less risky

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<sup>36</sup> FSA Internal Audit Division: "*The supervision of Northern Rock, a lessons learned review*", p. 3, published March 2008: <https://www.fca.org.uk/publication/corporate/fsa-nr-report.pdf>

<sup>37</sup> Bank of England: "*What is the Prudential Regulation Authority (PRA)?*": <https://www.bankofengland.co.uk/knowledgebank/what-is-the-prudential-regulation-authority-pra>

"Small Firm", it was not relationship managed and instead was supervised in a more reactive way, as part of a portfolio of firms, relying largely on self-reporting and sector-wide initiatives, by the Wholesale Small Firms team within Supervision ("**WSF**"). Like CFM, different rules could apply to the way BGC managed different funds, depending on whether they were regulated or unregulated.

42. Tiuta was a company providing bridging loans. It carried out a mix of lending activities; most of these were not regulated. However, about 5% of Tiuta's business was believed by the Regulator to involve providing home mortgages to retail customers. This was a regulated activity and, as such, Tiuta (which was a limited liability company rather than a fund) was required to be authorised by the Regulator.
43. At the very beginning of the Review Period, Tiuta was relationship managed through dedicated supervisors within the Retail Firms Division. However, because it was relatively small and only a very small part of its business was regulated, it received relatively little supervisory attention. Partly as a result of that, and because it was perceived as posing a relatively low risk, in July 2008 Tiuta was transferred to the Small Firms part of the Retail Firms Division along with about 10 or 11 other small lenders in a similar position. A project was undertaken at that time to improve the Regulator's understanding and knowledge of the firms being transferred. This included familiarisation visits to the firms, including Tiuta, to understand how they operated, how they were treating customers, and to identify any particular risks. Tiuta then became subject to the normal supervisory approach for Retail Small Firms. Within Retail Small Firms, there was a Mortgages and General Insurance Intermediaries department ("**MGI**"), and it was this team that supervised Tiuta. As described above, that was mainly reactive supervision, combined with sector-wide initiatives including thematic reviews.

## D. FACTUAL BACKGROUND

### 2005 – 2010

44. Between April 2005, when Tiuta first applied to be authorised by the Regulator, and January 2011, when George Patellis provided allegations to the Regulator of financial irregularities and solvency problems at Tiuta, individuals from CAM and Tiuta were in contact with various departments at the Regulator on a number of occasions.

#### *The initial issues with authorisation of Tiuta*

45. In April 2005 Tiuta applied for permission to be authorised as a Mortgage Lender, Mortgage Administrator and Mortgage Intermediary in relation to regulated mortgage loans. It was granted authorisation in April 2006. The authorisation application was treated as "non-routine" because of concerns about the suitability of a corporate controller of Tiuta. The directors of the corporate controller had been subject to an Inland Revenue Investigation in 2002. This was settled and no criminal proceedings were brought but, in the course of the investigation, the directors had admitted to altering figures in invoices.
46. The application was approved. The above concerns appear to have been addressed and the issue dealt with by Tiuta agreeing that the corporate controller and its directors would cease to be an owner and instead each of the corporate controller's five directors would receive a non-voting 5% shareholding in Tiuta<sup>38</sup>. The application pack noted that this issue was discussed with the Head of Department of the Regulator's Unauthorised Business Division ("**UBD**") and the Regulator's General Counsel's Division ("**GCD**"), and that it was agreed that this restructuring mitigated the Regulator's concerns. Steven Nicholas was approved by the Regulator as director, compliance officer and money laundering reporting officer at Tiuta<sup>39</sup>.
47. It is unclear whether the transfer in ownership from the corporate controller to its directors actually took place in 2007, as was agreed as a condition of authorisation. In September 2009, the Regulator sent a letter to Tiuta summarising the outcome of a supervisory visit carried out as part of the project referred to in paragraph 43 above. The letter noted that the transfer had not been registered at Companies House and required this to be addressed.

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<sup>38</sup> Under s422 of FSMA (as in force in 2006), the definition of a controller included any person who:

*"hold[s] 10% or more of the shares in A" (s 422(2)(a));*

*is "able to exercise significant influence over the management of A by virtue of his shareholding in A" (s 422(2)(b)); or*

*"hold[s] 10% or more of the shares in a parent undertaking ("P") of A" (s 422(2)(c)).*

Note that there was no aggregation of shareholdings in 2006 to reach the threshold of control (but there is such provision in force now). Therefore when the corporate controller's 25% shareholding in Tiuta (qualifying as a controlling holding) was to be transferred to the corporate controller's five directors in 2006, who were each to have a 5% interest after the transfer (not at the time qualifying as a controlling holding), this would not meet the definition of control. The FSA seemed satisfied of this.

<sup>39</sup> Senior management functions CF1, CF10 and CF11, at the time.

*The issues concerning Nigel Walter*

48. Nigel Walter was a director and founder of CAM. According to the Regulator's records, he was previously connected to UKLI Limited, a land-banking scheme shut down by the Regulator in 2008<sup>40</sup>.
49. In 2006, there was protracted correspondence between the Regulator's authorisation department and Nigel Walter with regard to the authorisation arrangements for UKLI Limited, which had fallen into financial difficulties (and of which Mr Walter was believed by the Regulator to have been the managing director), and for other firms.
50. The Regulator was reluctant to grant authorisation to firms Mr Walter was involved with, because it had concerns that Mr Walter did not meet the requirements to be a "fit and proper" person associated with an authorised firm. This was for a variety of reasons, including because the Regulator believed that<sup>41</sup>:
  - (a) UKLI had carried out regulated activities without the appropriate authorisation;
  - (b) UKLI had failed to treat its customers fairly including by informing its customers of their potential rights in relation to its lack of authorisation;
  - (c) Mr Walter had failed to provide a satisfactory answer regarding the source of funding for a loan to be made available to an entity he wished to authorise, called The Berkeley Partnership Ltd ("**TBP**");
  - (d) Mr Walter had failed to provide a satisfactory explanation for the transfer of corporate value from UKLI to TBP;
  - (e) Mr Walter had failed to disclose information to the Regulator of which it would reasonably expect notice;
  - (f) Mr Walter had failed to discharge his duties as managing director of UKLI; and
  - (g) there was a connection between Mr Walter and a second individual, a co-director of UKLI, about whom the Regulator also had concerns.
51. Mr Walter ultimately withdrew his applications for TBP to be authorised in February 2007. As a result, the Regulator did not have to reach any formal conclusion regarding its concerns with Mr Walter, but it is clear from the authorisation materials relating to TBP that it had concerns at the time that he was not "fit and proper" to perform the intended role at TBP.

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<sup>40</sup> FSA Press Release: "*FSA seeks to close down UK's largest illegal 'landbanking' scheme*", 4 June 2008: <https://webarchive.nationalarchives.gov.uk/20090224123635/http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml>

<sup>41</sup> As set out in internal FSA documents relating to The Berkeley Partnership Ltd's application for regulatory permissions.

52. Mr Walter later changed the name of TBP to Connaught Asset Management<sup>42</sup>. In a letter to the Regulator dated 27 February 2007 withdrawing the application for TBP's authorisation, Mr Walter provided the following details:

*"Connaught Asset Management offers specialist asset advice on potential strategic land sites. It is proposed to enter into arrangements with FSA authorised firms, which will operate unregulated collective investment schemes. It is wholly owned and controlled by me.*

*I saw that an opportunity still existed for clients to invest in strategic land as an asset class as part of an unregulated collective investment scheme. Unfortunately, neither I, nor TBP or Connaught Asset Management could offer this product to investors without authorisation so I decided that I could still utilise my experience and combine investment proposals for strategic sites in order to offer asset services for FSA authorised operators of such schemes.*

*Capita Financial Managers Limited (FSA register 119197) will operate the first such scheme, which will be launched shortly".*

53. On 15 April 2008, the Regulator petitioned the High Court to wind up UKLI<sup>43</sup> and on 4 June 2008 released a press release, stating that:

*"UKLI advertised and sold plots of land to people by claiming that it could get planning permission for the land, which would increase in value and make investors a large profit once it was sold to a developer. As a result, about 4,500 investors paid UKLI £69 million to buy the land. None of the land sold was ever granted planning permission"<sup>44</sup>.*

#### 2007 - 2008

54. There were also several other interactions between the Regulator and Tiuta in 2007-8. According to the Regulator's records, in October 2007, the Regulator received a consumer complaint that Tiuta was acting fraudulently<sup>45</sup>. On 18 October 2007, Tiuta emailed the Regulator stating that, on the contrary, the firm itself was the victim of mortgage identity fraud or solicitor's negligence and Tiuta ultimately informed the Regulator that the fraud was the result of its solicitors acting negligently. Tiuta engaged another firm of solicitors to handle this claim and I have seen correspondence between these two sets of solicitors addressing the issues. Tiuta asked the Regulator for advice on any actions it should take from a regulatory perspective.
55. As mentioned above at paragraph 43, in September 2008 the supervision of Tiuta transferred from the FSA's Retail Firms Division to the Small Firms Division, along

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<sup>42</sup> Mr Walter subsequently changed the name back to TBP and established CAM as a separate entity in its own right.

<sup>43</sup> The London Gazette, Issue 58670, Thursday 17 April 2008, p. 60: <https://www.thegazette.co.uk/London/issue/58670>

<sup>44</sup> FSA Press Release: "FSA seeks to close down UK's largest illegal 'landbanking' scheme", 4 June 2008: <https://webarchive.nationalarchives.gov.uk/20090224123635/http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml>

<sup>45</sup> Per the Regulator's records. This document was requested during the Review, but the Regulator was unable to locate the original complaint.

with a number of other similar firms, all of which the FSA perceived as being relatively low risk. As part of that exercise, Tiuta and the other firms being transferred were analysed by a small team within MGI.

56. In November 2008 the Regulator received Tiuta's Mortgage Lending and Administration Return Alert Reports ("MLARs"), which highlighted high mortgage arrears at Tiuta<sup>46</sup>. No liquidity assessment was conducted. A case was opened and closed shortly afterwards following a note on the Regulator's file for Tiuta that:

*"The firm have responded to our query on control of arrears and adequacy of capital resources. Arrears are not out of line with other lenders in this sector, as planned exit strategies often take longer than expected to materialise. The firm appear to have a robust arrears handling policy, although we have not tested this in practice. The firm have now also responded to the 'Dear CEO' original arrears handling letter - response has been uploaded on Remedy. No further action recommended at present - may be a candidate for a visit on the next round following response to the small lenders 'Dear CEO' letter".*

#### *Jersey regulator's concerns and UBD enquiry*

57. In January 2009 the JFSC notified the UBD team of concerns regarding a director of CAM (Nigel Walter) carrying out regulated activities. In February 2009 UBD conducted a search on the Regulator's shared intelligence system for Mr Walter and CAM, but it is not clear whether the search revealed any concerns regarding Mr Walter<sup>47</sup>. Mr Walter resigned as a director of CAM on 1 February 2009<sup>48</sup>, although his involvement with CAM did not end there.
58. A separate enquiry was opened by UBD in April 2009 into whether CAM was carrying out regulated activities and making promotions without proper regulatory authorisation. CAM's position was that CFM was the authorised operator, and that CAM did not also require authorisation because it was merely carrying out unregulated activities on CFM's behalf. This was a complex matter relating to an area of the regulatory perimeter involving known issues which had been subject to considerable debate in relation to other firms in the past. The Regulator considered in some detail the need for CAM to be authorised and obtained additional information from CAM, but eventually decided that it would not pursue this further, as explained below.

#### *CFM hands over to BGC*

59. At around the same time, in April and August 2009, CFM was subject to section 166 reviews relating to the adequacy of its systems and controls as an Authorised Fund Manager<sup>49</sup>. This related to (regulated) UK open-ended investment schemes CF Arch

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<sup>46</sup> Also, in October 2008, CFM was concerned with the guarantee wording in the financial promotions issued by CAM in relation to the Fund and as to Tiuta's financial strength. I have seen no evidence that the Regulator was aware of this.

<sup>47</sup> The shared intelligence system (SIS) allowed UBD to search for particular individuals across information which could be submitted by various regulators and professional bodies involved in financial services.

<sup>48</sup> See Companies House appointments page for Nigel Walter: <https://beta.companieshouse.gov.uk/officers/Q2KYq-8aTPWerT1tqGVIAcoskQ4/appointments>

<sup>49</sup> Regulator's internal records.

Cru Investment and CF Arch Cru Diversified funds for which CFM acted as Authorised Corporate Director, which had been suspended in March 2009 due to insufficient liquidity in the sub funds. The funds were subsequently wound up.

60. BGC took over from CFM as the FSA authorised operator of the Fund in September 2009. On 23 October 2009 Mike Davies (in his capacity as Chairman of CAM) wrote to inform UBD (as part of the on-going correspondence between UBD and CAM regarding whether CAM was acting without the necessary authorisation) that CFM were no longer acting as operator, and that on advice the terms "*low risk*" and "*guaranteed*" had been removed from the Fund's name. There does not appear to have been a response from UBD to this letter, or querying the change of operator.
61. In December 2009 CFM notified WSF at the Regulator that CFM had taken a strategic decision to cease being the operator of the Fund, and to exit the unregulated funds market. The reason given by CFM in an email sent on 23 December 2009 was that "*we have decided that we wish to exit this area in order to focus our effort on our core business*". The email also stated that BGC had agreed to take over as the operator of the Fund.
62. As was revealed in 2017 in the Capita Final Notice, at around the time that CFM was seeking to secure a replacement Operator, CFM had concerns about the way the Fund operated<sup>50</sup>. CFM had suspended the Fund to new subscriptions in July 2009. As stated in the Capita Final Notice, CFM's handover of its role as operator of the Fund to BGC had fallen short of the standards expected of it: in short, the information CFM disclosed to BGC about concerns CFM had identified regarding the Fund was inadequate<sup>51</sup>. Prior to BGC agreeing to act as operator of the Fund, two other firms had declined the position. Indeed, one of them had written to CAM on 2 September 2009 explaining why it believed investors had not been given an accurate picture, namely that:
  - (a) Certain information in the Fund's documents was "*inaccurate and misleading and that the operational procedures currently in place do not reflect those set out in the limited partnership agreement and the information memorandum relating to the Fund*";
  - (b) Current investors may have "*been misinformed as to the nature of the Fund and its investments, due to a number of inaccuracies contained in the offer documentation*";
  - (c) It was not satisfied that the Fund currently, and in the short term, would be "*at a satisfactory level of compliance with its stated objectives or, indeed, that these are achievable*"; and

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<sup>50</sup> Capita Financial Managers Final Notice dated 10 November 2017. pp. 23 - 40: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

<sup>51</sup> Capita Financial Managers Final Notice dated 10 November 2017. pp. 52 - 53: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

- (d) It did not have a level of satisfaction with the operation of the Fund that it would both desire and that is incumbent upon an authorised operator to ensure<sup>52</sup>.

#### *Resolution of UBD enquiry*

63. On 24 December 2009 WSF, which was responsible for supervising CFM and BGC, requested confirmation from UBD by email about the position reached in relation to CAM's authorisation:

*"I just wondered if you could let me know if you were able to resolve your concerns about Connaught Asset Management possibly operating a CIS without authorisation and whether, off the back of that, we would have any issue with the other operator, Capita Financial Managers, transferring their interest to Bluegate?"*

64. The response from UBD was as follows:

*"I think our approach here will be to accept that Connaught is not operating a CIS if there is an authorised firm carrying on the actual management. **The fact that Capita is no longer involved makes this easier.** Happy to discuss" (emphasis added).*

65. In January 2010 UBD had made a decision to close the enquiry referred to in paragraph 58 above. On 22 January 2010 UBD wrote to Mike Davies as follows:

*"For the reasons given in previous correspondence, we do not agree that the functions performed by your firm are not part of operating the arrangements for the purposes of s235 of the Financial Services Act 2000. However, we are aware that this is an area where there has been no specific judicial ruling and where there are other interpretations that potentially have merit and on the basis of which schemes have been established in the past. In view of this, we do not intend to pursue this issue with you any further at this stage".*

The UBD Scorecard (which recorded the assessment of the case and reasons for closing it) dated 21 January 2010 set out the rationale for closing the case, including the fact that the Regulator had not taken action in a previous similar case. Accordingly, UBD did not *"...see why we should treat Connaught any differently. Other factors pointing to closure are that there are **no consumer complaints, Capita (with which we had quality concerns) are no longer the operator and the fund only targets high net worth individuals via IFAs**"* (emphasis added).

66. In March 2010 the issue came up again in response to a query from the Financial Promotions team at the Regulator ("**Financial Promotions**"). Financial Promotions contacted UBD on the grounds that the promotional material raised concerns that CAM was carrying out regulated business and had misleadingly compared investments in the Fund to cash. On 26 March 2010 UBD replied stating that UBD had looked into Connaught in the past and decided not to take forward inquiries as the investment management in relation to the unregulated CIS was being carried on by an authorised firm. I have not seen any evidence that the concern regarding the financial promotions

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<sup>52</sup> Capita Financial Managers Final Notice dated 10 November 2017. p. 32: <https://www.fca.org.uk/publication/final-notices/capita-financial-managers-limited-2017.pdf>

comparing investments in the Fund to cash deposits was raised with the operator (BGC) at this time.

*Tiuta visits: August 2009 and February 2010*

67. A visit to Tiuta by members of the MGI department within Supervision took place in August 2009 as part of the on-going transition of supervision arrangements referred to in paragraph 43 above, and another visit took place in February 2010. Supervision were satisfied by what they observed and made some recommendations on the first visit that were implemented by the time of the second visit. The supervisory visits were focused on Tiuta's treatment of customers of regulated loans i.e. Tiuta's borrowers. Supervision did not look in detail at the funding arrangements of Tiuta.
68. As far as I am aware, the supervisors who conducted these visits did not know about any link to Nigel Walter (about whom the Regulator had previously had concerns as outlined above at paragraph 50), notwithstanding the Regulator's reluctance the previous year to authorise entities associated with him. Supervision was aware that Mike Davies was acting as Compliance Officer for Tiuta in August 2009, as well as acting as a Director of CAM. However, Supervision were satisfied by a verbal explanation that it was a temporary situation and Mike Davies was providing services to Tiuta on a consultancy basis and there was no conflict of interest. The basis for that assessment is not clear. Supervision did not identify any particularly serious issues with Tiuta and noted that it contrasted with some of the other firms visited as part of the transition process referred to above, which had had their activities suspended due to concerns raised during their visits.

*BGC whistleblowers: October 2010*

69. In the autumn of 2010, the Regulator was alerted to concerns from three individuals relating to BGC. On 20 October 2010, the whistleblowing department sent an email to WSF regarding concerns about the promotion of UCISs by BGC. On 1 November 2010, the whistleblowing department sent an email to WSF informing them that "*We have received two separate reports regarding this firm ... raising concerns. The reports refer to an article in ifaonline: <http://www.ifaonline.co.uk/ifaonline/news/1730077/blue-gate-unveils-secured-income> and alleged that the firm needs to be visited by the FSA in order to protect investors' money. Both whistleblowers also referred to the £100 million Connaught Income fund which is allegedly in difficulties*". An internal note from 21 December 2010 recorded that BGC had provided detailed information about its loan structure and distribution and that a meeting had been arranged for January 2011 to discuss some further questions. The correspondence between BGC and the Regulator throughout December and January 2010 indicates that questions were asked about the distribution and marketing of the Fund, but the concerns regarding the Fund being in difficulties as referred to in the 1 November 2010 whistleblowing report do not appear to have been followed up (except in the context of BGC's financial systems and controls).
70. There was a meeting between the BGC and the Regulator on 20 January 2011. Again, however, it is not clear from the regulatory records that the Regulator followed up on the allegation regarding the Fund being in difficulties. There is a reference to it from the Regulator's meeting note, but the focus of the discussions appears to have been on

the capital adequacy of BGC and its systems and controls. The main regulatory concerns were summarised in the Regulator's meeting note as follows:

*"[T]he firm may be trading whilst insolvent due to the structure of loans provided by the business to [Compliance Officer at BGC] and an additional breach related to an illiquid debt on Blue Gate's balance sheet. The firm was asked to provide evidence to show that it was meeting its solvency requirement.*

*[...]*

*In view of the concerns surrounding the capital position of the company, double counting of director's loans and hardcore borrowing on the balance sheet, [Compliance Officer at BGC] agreed to review as a matter of urgency the systems and controls around the firm's accounts and reporting methods to the FSA".*

71. The whistleblowing file on BGC was closed on 8 April 2011. The closure note in the regulatory record referred to improvements made by BGC including the appointment of auditors; the fact that BGC was working closely with the custodian of the funds (which funds were being referred to is unclear); and regulatory reporting training for BGC's accountant. The note concluded that *"In view of actions taken, no further supervisory action is required at present, although SB has suggested to the firm that the FSA may undertake a visit later in the year to review SYSC and Conflicts management"*. It is unclear from the closure note what the Regulator's final view of the whistleblowing allegations of 1 November 2010 regarding the Fund was.

#### January 2011 – March 2012

72. On 18 January 2011 George Patellis telephoned the Regulator's Firm Contact Centre ("FCC") to report that he had been advised of serious issues regarding Tiuta and the effect on its solvency that had led him to tender his resignation. He then passed the FCC to the Tiuta compliance officer at that time, and she was advised by the Regulator to make a SUP15 notification<sup>53</sup>. Later the same day, Mr Patellis emailed the FCC to confirm a notifiable event under FSA Principle 11<sup>54</sup>, namely that:

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<sup>53</sup> SUP 15.3 of the FSA/FCA Handbook requires a firm to notify the regulatory authority if it becomes, or has information which reasonably suggests, that any of the following has occurred, may have occurred or may occur in the foreseeable future:

1. the firm failing to satisfy one or more of the threshold conditions; or
2. any matter which could have a significant adverse impact on the firm's reputation; or
3. any matter which could affect the firm's ability to continue to provide adequate services to its customers and which could result in serious detriment to a customer of the firm; or
4. any matter in respect of the firm which could result in serious financial consequences to the UK financial system or to other firms.

<sup>54</sup> Principle 11 of the FCA Handbook requires that a firm must *"deal with its regulators in an open and cooperative way"*, and must *"disclose to the [appropriate regulator] appropriately anything relating to the firm of which that [regulator] would reasonably expect notice"*. With regard to compliance with Principle 11, SUP 15.3.8 requires that the FCA be informed of *"1. any proposed restructuring, reorganisation or business expansion which could have a significant impact on the firm's risk profile or resources [such as setting up a new firm/branch, providing services into a new territory, starting a new regulated activity, and/or materially changing outsourcing arrangements]"; "2. any significant failure in the firm's systems or controls, including*

*"As a result of information very recently received by me and previously unknown to me, it appears Tiuta Plc's finances may be at risk. After raising these issues with the Board and not obtaining their agreement on the issues or on my proposal for the best way forward I resigned my Company Directorship with immediate effect".*

73. On 21 January 2011, Tiuta informed the Regulator that Mr Patellis had resigned. On 2 February 2011, Tiuta informed the Regulator that Mr Patellis had been reinstated. On 16 February 2011, MGI contacted Mr Patellis, referring to a conversation earlier that day during which Mr Patellis had informed the Regulator of the circumstances of his resignation and subsequent re-appointment, including providing the Regulator with further background and an update that a firm of accountants (the "**Accountants**") had been instructed to carry out a financial review of the firm. The Regulator stated that it wished to explore the reasons behind his resignation in more detail and proposed a meeting in mid-March. On around 23 February 2011, Mr Patellis again departed from Tiuta. Tiuta management, via a phone call on 28 February 2011, informed the Regulator that Mr Patellis had resigned for personal reasons. On the same day, the Regulator requested a number of documents from Tiuta, including a copy of the letter of instruction to the Accountants, company structure charts, the firm's underwriting procedures, arrears handling procedures, tariff of charges and complaints register.
74. By letter dated 11 March 2011, the Regulator wrote to Mr Patellis, expressly exercising its formal powers under section 165(11) of FSMA to require Mr Patellis to attend a meeting on 16 March 2011 at the Regulator's offices in London:

*"to provide us with the information and supporting documents as follows:*

- Any information that you believe to be important of which the FSA should be made aware; and*
- any documentation in support of the information that you are going to provide".*

75. On 15 March 2011, the Regulator received from Tiuta a report prepared by the Accountants to the directors of Tiuta outlining the financial position at Tiuta. Supervision noted, *"Report failed to provide full explanation regarding the firm's financial position. The scope given to [the Accountants] at the outset has changed three times, substantially reducing the content of the report"*<sup>55</sup>. Despite the Regulator's

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*those reported to the firm by the firm's auditor]"; and "3 any action which a firm proposes to take which would result in a material change in its capital adequacy or solvency".*

<sup>55</sup> On 9 May 2011 Supervision wrote to the Accountants requesting an explanation of the reduction in scope and a summary of any difficulties in conducting the review. A follow up letter was sent on 13 May 2011, referring to the power to request documents under s165 FSMA and s175 (2B) and requesting any documentation regarding the change in scope to be produced at a meeting between the Accountants and the Regulator on 16 May 2011. Following the meeting the Accountants provided a copy of the presentation given to Tiuta on 14 February 2011, but do not appear to have provided further information as to why the scope was changed.

In an internal update on the meeting with the Accountants, the Regulator noted that the Accountants had provided a financial forecast model to Tiuta, but *"had no control over the assumptions made in terms of information being fed into the model"*. On 19 May 2011 the Regulator requested documents from the Accountants pursuant to s165(1) FSMA as to whether the Accountants had found any misappropriation of funds by Tiuta plc. On 20 May 2011, the Regulator received a response from the Accountants stating that s165 was the incorrect power to use and requiring a request under s175. On 23 May 2011, GCD advised

awareness of the narrowing of the scope of the retainer given to the Accountants, the Regulator continued to rely on reporting from the Accountants as to the state of Tiuta's finances until the suspension of the Fund in March 2012. This is also despite the clear indication on page 1 of the Accountants' report that:

*"[o]ur engagement is with Tiuta Plc and its subsidiary undertakings only and we do not therefore assume responsibility to any other person to who[m] it is shown or into whose hands it may come. If others choose to rely on the contents of this letter they do so entirely at their own risk. This letter is based upon the latest information that is available to us and we accept no responsibility for events after the date of issue. We have carried out nothing in the nature of an audit".*

76. The Accountants' report stated that a review of the individual group entity balance sheets and profit and loss accounts at 31 December 2010 established that the business could not continue to trade on without some action being taken, that there was no agreed strategy for funding the interest payments due to the Fund in the first week of April, and that there were fundamental uncertainties in relation to the profitability and cash generation of the underlying business. The initial findings of the Accountants, which they had presented to the Tiuta Board on 7 and 17 February 2011, included the following:
- (a) as a result of a slowdown in lending in the last quarter of 2010, the Tiuta Group was not generating enough income/cash flow to cover operating costs;
  - (b) it was proving difficult to understand how the Fund was intended to operate as key documents were either missing or appeared to never have existed;
  - (c) a high level review of the Fund indicated that costs of funds appeared to exceed income as the Fund was not fully lent and non-performing loans were resulting in reduced churn;
  - (d) it was likely that the Group was currently trading at a loss and could potentially be balance sheet insolvent; and
  - (e) there appeared to be loans redeemed by borrowers where the monies had not been passed on to the Fund, and loans drawn down from the Fund where monies had not been passed onto an ultimate borrower.
77. In terms of future plans, the Accountants had been informed by Tiuta that if the Tiuta Group traded as expected they would be able to make the April 2011 interest payment due to the Fund, and that the Group was implementing additional controls to improve the profitability of the underlying business including daily meetings, monitoring of the cash position, and identifying ways to mitigate the risk in the loan book of the Group. The Regulator did not contact BGC about these issues and did not appear to have been particularly focused on concerns relating to the Fund itself, such as those at (b) and (c) above.

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Supervision that s165 was the correct power to use. It is not apparent from the documents that the Regulator took this any further with the Accountants.

78. Meanwhile, pursuant to the letter he had received from the Regulator dated 11 March 2011 (see paragraph 74 above), Mr Patellis then attended a meeting with the Regulator on 16 March 2011, for which he flew to London from the United States. According to the Regulator's note of the meeting, at the meeting Mr Patellis stated that there was a lack of professionalism in Tiuta's management, that there were no adequate written policies or procedures in place, no staff handbooks, that there was only one part time compliance officer, that Tiuta's sales department would make loan offers before the underwriting department had fully considered the transaction, that there were no business plans or budgets in place, that funding was restrictive or expensive, and that it needed to become a more professional operation in order to gain better funding terms and the confidence of funders.
79. Even more significantly, Mr Patellis alleged at the meeting that there was a "*£20m hole in the cash*"<sup>56</sup> at Tiuta that had been discovered after Mr Patellis appointed a new CFO in December 2010 to replace the Financial Director who had resigned in September 2010. The new CFO was unable to reconcile the accounts. Mr Patellis gave details of a Tiuta Board meeting held on 18 January 2011 where Mr Patellis informed the Board of the financial issues, and alleged that during the Board meeting Steven Nicholas (a Tiuta director) confirmed that Tiuta had been using redemption money for other purposes, under the terms of the agreement of CAM. Tiuta was thus effectively using the Fund as a revolving credit facility, and Mr Patellis had informed the Board that Tiuta was insolvent. Mr Patellis also indicated that the Regulator had not been informed by Tiuta of the true reasons for his leaving the firm on 23 February 2011, and that he had effectively been dismissed. He stated that his second departure had been due to his concerns that Tiuta was not taking the advice of the Accountants or its legal advisers to deal with the issues properly.
80. Importantly, Mr Patellis brought with him to the meeting a suitcase full of documents he had considered to be relevant, and which he had understood were responsive to the Regulator's section 165(11) FSMA request as set out in their letter dated 11 March 2011. However, the Regulator did not accept these documents and asked Mr Patellis to provide information that he thought they should be aware of, and suggested that he should consult with his lawyer and his wife. On the basis of the information and documents available to me during this Review, it is unclear why the Regulator did not take delivery of the documents Mr Patellis had sought to provide.
81. Following the 16 March 2011 meeting, Mr Patellis sent a lengthy letter to the Regulator on 24 March 2011 accompanied by 26 attachments via post. The letter set out Mr Patellis' allegations regarding Tiuta, and those allegations are summarised below.
- (a) There was a £20m cash shortfall, the majority of which was money owed to CAM.
  - (b) Steven Nicholas had been aware of the shortfall prior to Mr Patellis discovering it in January 2011 and admitted that he had been using loan redemption money for purposes other than immediately returning it to the lender (CAM).
  - (c) Mr Nicholas had apologised to Mr Patellis and accepted that he had been misled.

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<sup>56</sup> Regulator's internal note of the meeting with Mr Patellis on 16 March 2011.

- (d) Tiuta had agreed to instruct the Accountants to advise on managing the situation following the discovery of the shortfall and lawyers to advise on failures by Tiuta to issue forms releasing charges over property provided as security for loans (known as "DS1" forms) even after the loans had been fully redeemed by the borrowers. The forms were not being released because the loans were not always being paid back to the CAM, but instead were being used to pay Tiuta's ongoing running costs.
  - (e) However, the Board failed to follow the Accountants or lawyers' advice, particularly with regard to the "recycling" of loans or otherwise using the redemptions for purposes other than paying back the Fund. Board meetings were cancelled at the last minute and senior staff, including Steven Nicholas, went on a golf trip to Cyprus in January 2011 and to Milan to see Tottenham Hotspur despite the company being in severe financial difficulties at the time. Files had gone missing and Board minutes and other meeting notes were not provided in a timely manner. What was provided was often inaccurate.
  - (f) There was a long list of outstanding DS1 mortgage release forms.
  - (g) Steven Nicholas was reluctant to inform CAM of the financial position of Tiuta.
  - (h) Tiuta had misinformed the Regulator as to the reasons for Mr Patellis' departure, having reported that he had left for personal reasons when that was not true.
  - (i) Tiuta only operated one bank account for the entire Group, without clear accounting entries and practices which would assist in making sense of the transactions in and out of the account for all Group entities.
82. The exhibits accompanying the letter included a summary of Mr Patellis' notes that led him to believe that Tiuta was insolvent, a letter from Mr Nicholas apparently confirming that Mr Patellis had been misled over the company's financial position, a list of outstanding DS1 mortgage release forms, emails purportedly showing the cancellation of Board meetings, email exchanges between Mr Nicholas and Mr Patellis apparently regarding Mr Patellis' concerns as to whether the Accountants' and lawyers' advice was being followed and what information had been provided to the Fund.
83. Notwithstanding the very serious state of affairs in relation to the alleged misuse of funds and the cash shortfall owing to CAM in particular, no steps were taken by the Regulator to follow up on the allegations directly with the approved persons at Tiuta or indeed with the operator BGC. In fact, I have seen nothing to indicate that the Regulator reviewed or considered in detail Mr Patellis' letter dated 24 March 2011 or the documents enclosed, despite the fact that he had provided those documents directly in response to their formal request under section 165(11) FSMA. Instead, the Regulator relied on the Accountants to make enquiries into the alleged deficiencies at Tiuta and its solvency position. As a result, no investigation was conducted into the allegations of financial wrongdoing to reveal the true nature of the relationship between Tiuta and CAM, the particulars of misconduct by the individuals involved, and the risks to investors.
84. On 24 March 2011 the Regulator, due to solvency concerns, requested that Tiuta should:

- (a) cease accepting regulated mortgage applications until advised to do so by the Regulator;
  - (b) prepare and submit financial forecasts at firm and group level;
  - (c) address the deficit issues; and
  - (d) ensure the firm is solvent going forward.
85. On 11 April 2011, the Accountants sent a further letter to Tiuta regarding its solvency position. Tiuta did not share that letter with the Regulator, who would only become aware of it following a meeting with the Accountants on 16 May 2011. Also on 11 April 2011, the Supervision team members prepared an internal memorandum of the information provided by Tiuta which noted that *"the group is technically insolvent and does not appear to be in a position to meet either its short term or long term commitments. However, it is not clear what impact the recent changes implemented and to be implemented by management will have on profitability"*.
86. Discussions took place within the Regulator as to the appropriate course of action with regard to Tiuta. The team with primary responsibility for Tiuta was the MGI department within Supervision. An analysis of financial data received from Tiuta by a forensic accountant within the Regulator raised concerns that points had not been addressed and the firm appeared to be in deficit. On 12 April 2011, a decision was made to monitor Tiuta, pending discussions with Enforcement. A paper to the Executive Supervisory Committee<sup>57</sup> on 14 April 2011 summarised the information provided by Mr Patellis and noted as follows:
- "the accountancy firm carrying out the financial review, has indicated serious potential failings in the firm's financial controls, including lack of transparency and accounting to the investors for redemption funds received, which the firm has disputed. The firm also appears to have poor controls over the operation of the different loan facilities.*
- The quality of management information is poor. Copies of loan agreements have not been made available to the FSA and there are conflicting opinions on the reasons for the exit of the firm's CEO, which has highlighted concerns over the integrity of the firm's Chairman and the firm's openness with the FSA. The firm is attending FSA offices on 20 April for further discussion, however; in the meantime the firm has undertaken to cease any new regulated lending until the FSA is satisfied that the firm is financially viable.*
- The FSA is monitoring the firm's pipeline business to ensure no further lending takes place and is requiring the firm to report on a weekly basis"*.
87. The Regulator met with Tiuta on 20 April 2011 (the meeting had been postponed from 15 March 2011). A Tiuta presentation, authored by various individuals from Tiuta including Steven Nicholas and Mike Davies (whom the Regulator knew was also

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<sup>57</sup> The Executive Supervisory Committee was a sub-committee of the EXCO, responsible for the supervisory decisions in relation to matters that were escalated to it by the relevant departments.

Chairman of CAM<sup>58</sup>) attributed the difficulties being experienced by the Group to the credit crunch, the loss of the Finance Controller, and the resignation of the Chief Executive Mr Patellis (which was again said to be for personal reasons). The presentation confirmed that the Group had appointed a new compliance officer, had disclosed the position to the Fund, and was working with the Accountants and the Fund to stabilise the position. The implication of the presentation was that issues had been caused by *"very poor overall understanding of business model causing major liquidity issues"* on the part of Mr Patellis and the Board had only become aware of the issues in January 2011, whereupon it had taken *"robust corrective action"*. Mr Patellis had directly contradicted this account in his meeting with the Regulator, during which he had alleged that Mr Nicholas had been aware of the liquidity issues. The presentation emphasised that there would be no impact on regulated business which consisted of 26 loans with a value of £4.7m, scheduled to redeem within 12 months.

88. On 21 April 2011, an individual in the MGI department assessed the solvency of Tiuta based on the information provided so far and the information provided in the meeting on 20 April 2011. The analysis concluded that the projections provided by Tiuta were optimistic, that Tiuta had significant losses in the past two years, and that if these continued it was likely the firm would be insolvent in the coming year. It was also noted that the firm was using redeemed loans to support cash flow rather than repay facilities. An internal Regulator meeting on 21 April 2011 confirmed that, following the meeting with Tiuta, the intention was to obtain details relating to the recycled loans, *"keep [Mike] Davies out of control"*<sup>59</sup>, and consider whether the Regulator needed to get a Skilled Person to assist pursuant to section 166 FSMA.
89. Also, on 20 April 2011, an individual in Supervision (a Technical Specialist who was not in MGI) had raised concerns that whoever at the Regulator was looking at Tiuta also needed to look at CAM on the basis that if Tiuta was insolvent, then the Fund might have to notify investors of a material change. There was a concern that Tiuta was the firm *"guaranteeing"* investors' money, and Tiuta was about to be declared insolvent. The suggestion that the risk to investors meant that CAM needed to be examined as well was followed up in an email on 5 May 2011, and in a report to the Director of Supervision on 6 May 2011.

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<sup>58</sup> In a paper discussing the financial position of Tiuta, the Regulator noted that at the meeting on 20 April 2011, Steven Nicholas informed the Regulator that Mike Davies had only been the compliance officer at Tiuta for a *"few days in January/February 2011"*. However, the Regulator noted that Mike Davies had represented Tiuta at a meeting with members of the mortgage policy team on 14 October 2011. The paper went on to note that *"further narrative about the involvement of Mike Davies was included by Tiuta but has not been addressed further in this paper"*. In a letter dated 21 April 2011, the Regulator requested the dates as to when Mike Davies had provided compliance services to Tiuta. On 6 May 2011, Tiuta provided the following information: *"Confirmation of date where Mike Davies has provided a compliance service - Mike Davies was appointed as Compliance Officer for Tiuta in May 2008. George Patellis appointed Sue Colquhoun Compliance Officer in July 2010 and since that date Mike Davies has advised on the Mortgage Market Review and dealt with Consumer Credit Licencing issues only. Mike Davies provided temporary cover from late January 2011 until Bill Warren was appointed in early March 2011. Mike Davies was the lead manager for two successful visits by ... the FSA. The subject of conflicts of interest between his role at Tiuta and Connaught was discussed, together with the controls in place, and at that time the FSA team advised there was no issue, had this been an issue Mike Davies would have resigned from Tiuta immediately. Electronic forecasting model enclosed"*. An email from Supervision on 15 May 2011 noted that Mike Davies was still collecting emails from a Tiuta address.

<sup>59</sup> Per internal Regulator note of the meeting.

90. The same individual from Supervision reiterated the view in an internal email on 12 May 2011 that CAM and the Fund needed to be looked at as well: "*we should be informing the operators/ACDs of these funds (Bluegate Capital in the case of Series 1, FSA Registration Number No: 478314...) of our concerns over the Fin. Proms. Of those funds, the possible risk of future customer detriment, risk of regulatory action, future litigation risk and the risk of mass redemption requests*". WSF decided to inform BGC of any actions against Tiuta only when it was made public, apparently due to concerns about providing BGC with confidential information. I have not seen any evidence that the Regulator sought Tiuta's permission to inform BGC.

91. An email from WSF on 13 May 2011 said "*WSF can inform Bluegate and [the asset manager for the Series 3 fund] of action taken against Tiuta **when it is made public**. We can then request the firms to advise us of the likely impact on the funds/investors, and what their intended course of action will be*" (emphasis added). No proactive steps were taken to look more closely at the Fund or to ask BGC for its understanding of the risks to the Fund and the relationship with Tiuta, other than a contact on 25 May 2011. On that date a member of WSF contacted BGC and appears to have accepted at face value BGC's assurances that the Fund was working as it should:

*"As I mentioned above, Blue Gate are keeping a close eye on Tiuta as their main concern is that interest payments are made to the fund. They do have some concerns about the firms' profitability **but overall they believe the fund itself has been working as expected and they are not aware of any significant issues. Conversations with Tiuta also lead them to believe that the situation is improving. The firm has no information, which would lead them to suspend or close the fund.** We now have general information around the firm and their involvement with Connaught/Tiuta but I did not probe in any detail around which IFAs/retail investors are involved (which we believe they may have information on) or around the financial promotions they have approved. I out of the office tomorrow but [individual supervisor] will be able to assist from WSF"* (emphasis added)<sup>60</sup>.

92. One route identified to try to examine the Fund was to go via the Guernsey regulator, the GFSC, which Supervision appears to have believed was regulating CAM. This was focused on the Financial Promotions angle rather than looking at the actual operation of the Fund:

*"The firm's main funder is one large investment fund provided by Connaught Asset Management which is based and regulated in Guernsey. We have met with Financial Promotions and Conduct Risk to discuss the marketing of the fund, which is aimed at retail investors in the UK and is being marketed as a low risk product. The Financial Promotions Team is investigating this further and will be contacting the Guernsey Regulators within the next few days to discuss the marketing of this product. They will also look to establish the level of potential consumer detriment that may occur if Connaught faces liquidity issues should Tiuta fail to repay Connaught Asset Management"*<sup>61</sup>.

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<sup>60</sup> Internal Regulator email dated 25 May 2011.

<sup>61</sup> Internal Regulator email dated 22 May 2011.

93. However, CAM was not in fact regulated by the GFSC. CAM was a company registered in England and Wales, based in England, not Guernsey, and was not supervised or authorised by any regulator. It was a different firm, Connaught Asset Management (Guernsey) Limited ("**CAM Guernsey**"), the asset manager for the Connaught Series 2 fund, that was based (i.e. registered) in Guernsey and regulated by the GFSC. In addition to being unregulated, UCISs can sometimes have certain funds based "off shore", which can increase uncertainty about the perimeter of the Regulator's jurisdiction in certain cases and about which national regulator has primary responsibility.
94. Yet at around the same time (i.e. May 2011), some individuals within the Regulator did appear to set out the correct position in email correspondence, i.e. that the Fund was administered by CAM and the Series 2 fund by CAM Guernsey. However, a letter also sent in May 2011 to the Director of the GFSC incorrectly stated that both the Series 1 and Series 2 Fund were managed by CAM Guernsey. Other documents, from around this time and at other times – for example, emails to Enforcement, and briefings to the Director of Supervision and Head of MGI – referred to CAM and the Fund as being regulated by the GFSC. A letter from MGI to the GFSC in September 2011 titled "*Tiuta Plc / Connaught Asset Management (Guernsey) Ltd (CAMG)*" referred to the "*CAMG*" fund, in which "*£120 Million [was] invested*". In fact, the information referred to related to the (Series 1) Fund, which was being run by CAM and not CAM Guernsey.
95. On 14 May 2011, Tiuta agreed to a VVOP to stop conducting regulated activity. As noted above, this was believed to represent only approximately 5% of its lending.
96. On 16 May 2011, MGI had a meeting with the Accountants, during which the MGI department became aware of the letter from the Accountants to Tiuta dated 11 April 2011 regarding its solvency position. At the meeting, the Accountants also reported to the MGI department that:
- ***"As at 31.12.2010 the Group was technically insolvent on a consolidated balance sheet basis with net liabilities of £3m. Both Tiuta International and Tiuta Plc were insolvent as standalone corporate entities.***
  - ***[the Accountants] stated that after taking into consideration potential additional bad debt provision (estimated at between £5m and £10m) the net liability position would be significantly worse.***
  - ***The Group was also insolvent on a cash flow basis.***
  - It was also concluded that the Group was making a loss and that without some form of fundamental restructuring, the financial position would continue to deteriorate.

[...]

***They also stated that in the absence of additional equity or a consensual solution with Connaught, the firm should file for administration. We know that the firm has been working closely with Connaught regarding the fund. We have not yet been informed by Tiuta as to whether they have converted the loans to shares, which was discussed by [the Accountants] and by ourselves in April.***

[...]

*They [the Accountants] stated that the model should assume that the Group will consistently lend in the region of £20m per month and fully utilise funds at its disposal. They noted that this significantly exceeded recent trends. We can confirm that lending has been below this figure.*

[...]

*The model also assumed that the Group would develop and sell their investment property portfolio (currently 30 properties) to generate cash and profit. At this point we are concerned that the valuations of the properties have been carried out in house and no independent valuations have been completed.*

*Finally [the Accountants] confirmed in the above letter that the Group was expecting to be in breach of the FSA capital adequacy test through to March 2012 - this comment was not advised to us during our meeting with the firm on 20 April 2011" (emphasis added)<sup>62</sup>.*

97. Following the meeting with the Accountants, there was a meeting between Enforcement, WSF, MGI, and Financial Promotions, also on 16 May 2011. The meeting noted that an impact statement was being prepared "*to provide a more detailed analysis in respect of any consumers that may be affected should the Connaught Fund face financial difficulties as a knock on effect of any action taken against Tiuta*", and that WSF were not going to contact the operators of both the (Series 1) Fund and the Series 2 fund because "*it was felt that it was not appropriate to contact these firms as it may trigger a run on the fund given the recent press coverage on the firm. This could be dealt with at a later stage if necessary*".
98. Enforcement were asked to consider if an administrator was appropriate, as Tiuta appeared to be in breach of its regulatory capital requirements. Enforcement's view, as summarised by Supervision on 16 May 2011, was: "*At the current time, we are not confident that the firm's leadership team has a sufficient grasp on their financial responsibilities to the firm and the firm's business model to be able to do so. Enforcement will also be considering action against individuals within the firm for allowing the firm's financial position to deteriorate to the point where it became insolvent. Supervision is concerned that Tiuta could have the potential to become a 'Key Data' should decisive action not be taken against the firm*"<sup>63</sup>.
99. The reference to "*Key Data*" is a reference to Keydata Investment Services Limited, a firm which had produced and distributed structured products to retail consumers via IFAs. In May 2015, the Regulator published Decision Notices in respect of three former members of the firm's senior management, in which it was found (amongst other things) that the firm had not conducted adequate due diligence, that it had issued misleading financial promotion materials, that its senior management had received sales commissions improperly, and that they had made false statements to the Regulator. It went into administration on 8 June 2009 and was eventually dissolved on 2 July 2014.

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<sup>62</sup> Regulator's note of meeting with the Accountants on 16 May 2011.

<sup>63</sup> Internal Regulator email.

Prior to its administration, Keydata had £2.8 billion of its own and other institutions' investment products under administration<sup>64</sup>.

100. Following the meeting, MGI was of the view that the appointment of administrators would be the best option for Tiuta:

*"Many thanks for the update following your meetings today. The situation is more serious than we were led to believe.*

*What is a concern is that the firm have been insolvent for such a period but have not told us. It looks like administrators are the best option. It would be useful to gauge Enforcements thoughts on this ASAP.*

*We cannot afford another key data so time and consumer protection is critical"*<sup>65</sup>.

101. However, Enforcement were more cautious, given concerns that insolvency and/or cancellation of Tiuta's regulatory permissions might cause a run on funds managed by CAM:

*"Based on material provided to you by [the Accountants] yesterday we have good reason for believing that Tiuta is unable to meet its liabilities as they fall due and as such is in breach of Threshold Condition 4. On this basis we could refer the firm to TCT for cancellation however we are concerned that to do so might put a significant but currently unknown number of retail consumers at risk of losing monies invested in a property fund with CAM, the Income Fund Series 2. This is because there is an undertaking in the form of a guarantee on this fund provided by Tiuta. Our concern is that if Tiuta is insolvent and/or we seek to cancel Tiuta then the value of that guarantee is likely to be worthless. This in turn may cause a run on all CAM funds, not just the Income Fund Series 2. We have reason to believe that the CAM Income Fund Series 2 has approximately £8 million under management, with a minimum investment of £20,000, it also remains open" (emphasis added)*<sup>66</sup>.

102. It is unclear why there was no reference to the (Series 1) Fund as well as the Series 2 fund in the above email. In addition, I have not seen any evidence indicating the Regulator thought to approach the operator in order to ascertain the amount invested in the Fund at this point in time.

103. On 20 May 2011 MGI wrote to Tiuta indicating that it would prefer Tiuta to voluntarily appoint an administrator. On 23 May 2011 Tiuta refused, arguing that "CAM are satisfied that investor interests in the Series 1 and Series 2 funds have been protected and it is overwhelmingly in their interests to allow Tiuta to continue its improving trading progress to satisfy all of its financial and legal obligations and review Tiuta's performance on an on-going basis with the assistance of [the Accountants]". MGI were not satisfied with the response and in an email on 23 May 2011 asked Tiuta to clarify what such protection involved. On 24 May 2011, Steven Nicholas replied and referred

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<sup>64</sup> See Final Notices in relation to authorised individuals at Keydata: <https://www.fca.org.uk/publication/final-notices/peter-francis-johnson.pdf>; <https://www.fca.org.uk/publication/decision-notices/stewart-owen-ford.pdf>; <https://www.fca.org.uk/publication/decision-notices/mark-john-owen.pdf>

<sup>65</sup> Internal Regulator email on 16 May 2011.

<sup>66</sup> Internal Regulator email on 17 May 2011.

the Regulator back to the responses supplied by Tiuta on 23 May 2011. No steps were taken by the Regulator to verify how the investors were protected.

104. On 24 May 2011, a strategy was formulated by the Regulator whereby:

*"Following discussion with Enforcement and Conduct Risk, it is our intention to allow [the Accountants] to carry out a further financial review of Tiuta Plc. FSA would require sight of the letter of engagement and detailed scope together a detailed timeline for completion of the work. The firm's letter indicates this work could be completed in two weeks. Enforcement consider that the proposed work by [the Accountants] **would provide a definitive answer to the solvency of the regulated firm, as opposed to the Group and until this is fully established makes it difficult for the FSA to use its own powers to appoint an Administrator.***

*FSA is proposing to contact the Guernsey Regulator to advise them of our concerns regarding investment into the CAM fund and seeking clarification on their powers which includes the marketing of the fund and the possibility of taking down the website. The Guernsey Regulator might consider that they also have the powers to take more direct action by deciding to suspend the fund and prevent further investments. FSA intends to advise the firm of our intentions to allow [the Accountants] to carry out the financial review. In addition, we will require sight of the subordinated loan agreements. Failure to provide this information will put the firm in breach of Threshold Condition 4 – Adequate Resources and would result in us seeking an immediate OIVOP. FSA to obtain detailed proposals from the firm regarding the winding down of the regulated loan book. **Consumer Alert to be issued in respect of the CAM fund to advise that whilst the fund is being marketed as low risk, the FSA believes that it is a high-risk investment and is therefore, being misrepresented. This action may result in a run on the fund"** (emphasis added)<sup>67</sup>.*

105. The Regulator issued a consumer warning on 26 May 2011<sup>68</sup>. In July 2011, the Regulator notified certain IFAs who had sold the Fund to review the suitability of

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<sup>67</sup> Internal Regulator memorandum dated 24 May 2011.

<sup>68</sup> FSA News Story: "Investors warned over Connaught Income Funds", published 26 May 2011: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>:

*"Investors warned over Connaught Income Funds.*

*What are our concerns?*

*In the literature we have seen, the Connaught funds are described as 'very low risk' and 'low risk'. It makes comparisons between investing in them and putting your money in high street bank and building society accounts. We believe this is misleading.*

*Connaught's marketing material compares the returns on its funds with fixed-rate notice bank and building society accounts. However, customers need to be aware that these bank accounts have stronger investor protections should anything go wrong and offer lower risks to your money than there is investing in the Connaught funds.*

*Furthermore, these funds offer a quarterly 'fixed income payment'. Although, the probability of you receiving this payment depends significantly on the performance of the investments within the funds. We believe this is not explained well enough to investors.*

*Connaught also offers an 'additional guarantee on the income' within the funds, but it is unclear if investors would be able to understand what this guarantee is.*

*Who does this affect?*

advice given to investors. The implementation of the VVOP (imposed in May 2011, as per paragraph 95 above) was not mentioned in the update to IFAs, although it should have been noted on the Regulator's register, on the page relating to Tiuta.

106. In August 2011, the Regulator analysed the Accountants' reports received by Tiuta and formed the opinion that Tiuta had taken insufficient steps to address risk and would need to increase lending significantly in order for the business to be sustainable. The Regulator requested that Tiuta demonstrate how it intended to turn things around. Tiuta continued to assert that it would trade out of difficulties and that it had the support of the Fund. On 22 September 2011, Supervision advised Enforcement that the financial controller at Tiuta had provided information indicating that Principle 6 of the Regulator's rules (which requires firms to treat customers fairly) had been breached as he had been using funds repaid by borrowers to pay back the oldest loans first, rather than repaying them to the sub funder via the Fund<sup>69</sup>.
107. Supervision spoke to GCD who also advised that this could constitute a breach of Threshold Condition 5 (the regulatory requirement that authorised firms are fit and proper persons having regard to all the circumstances, including the nature of any regulated activity that it seeks to carry on) and could give rise to an "OIVOP" (a Regulator's Own Initiative Variation of Permissions, which forces a firm to vary its regulatory permissions, in comparison to a VVOP, which a firm agrees to voluntarily). Enforcement advised that a "*strongly worded letter to the firm giving 10 business days to put matters right*" would be appropriate. A letter was sent on 23 September 2011. Tiuta responded on 27 September 2011 stating that the Regulator had misunderstood the position regarding DS1 mortgage release forms. A response from the Regulator on 28 September 2011 required Tiuta to release its charge over all properties where the loan had been redeemed, and to do so by 5 October 2011<sup>70</sup>. In a letter dated 5 October

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*Consumers who are considering investing, or have invested in the Connaught funds, whether directly, though a Self-Invested Personal Pension (SIPP), Small Self-Administered Scheme (SSAS), an investment bond or an offshore investment bond.*

*What should you do next?*

*Make sure you and your financial adviser or stockbroker understand how the funds work and what investing in them means for your money.*

*Always make sure your financial adviser is qualified and regulated by the FSA (please check the FSA Register).*

*Discuss with your adviser whether there are any other products that would meet your needs and give you the protection of the Financial Services Compensation Scheme and Financial Ombudsman Service.*

*Investing in these funds is only appropriate if you are comfortable with the particular risks involved".*

<sup>69</sup> Internal Regulator email re Tiuta plc: "*When [the financial controller] joined the firm in January this year he discovered that due to the firm's liquidity issues there was a mass of funds that had been repaid by the borrower but had not been repaid to the sub funder. As the firm operates on a revolving credit basis he took the view that he would use funds received from recent redemptions to pay back the oldest loans first where possible to the sub funder. I asked [him] to inform me what consideration had been given to the borrower as we viewed this as a potential breach of Principle 6. [He] advised that if the client's solicitor was coming under pressure if the client wanted to sell the underlying property then it is moved up the register and redeemed earlier. He did not believe that any clients had been adversely affected by this process and had taken legal advice on this point. When asked if the firm had informed the client of the practice he stated that it had not. I advised [him] that we had a different view and reiterated Principle 6". Principle 6 states that "A firm must pay due regard to the interests of its customers and treat them fairly".*

<sup>70</sup> The Regulator considered an OIVOP if Tiuta did not release the charges: "*The OIVOP would be force the firm to release the charges over the redeemed regulated loans*".

2011, Tiuta confirmed that it would ensure all charges were released by 14 October 2011.

108. From July 2011 onwards, MGI and Enforcement worked together to produce an Enforcement Referral Document ("**ERD**") to assist with deciding whether Tiuta should be referred to Enforcement for investigation. However, the document was only considered by Enforcement in November 2011, at which point Enforcement advised (in response to an email from Supervision indicating that GCD had advised that administration was not the best option and that a better route would be to cancel authorisation, thus requiring Tiuta to sell the mortgage book immediately or use OIVOP powers to remove part IV permission):

*"if the firm cancels then we lose the ability to seek withdrawal of the individual approved persons approval. The only sanctions left would be financial penalty or prohibition, we can seek these so long as any misconduct took place whilst the individuals were approved persons, see s66(2) FSMA. I don't think that we are in prohibition territory although we do have concerns about the approved persons' competence! If the firm cancels then we also lose the ability to take action against the firm. We might want to hang onto the firm and issue a notice in relation to them as this might attract more publicity than just taking action against individuals"<sup>71</sup>.*

109. Following completion of the ERD in November 2011 there was an email exchange within Enforcement in early December. The view appears to have been that Tiuta was not "*a big FSA problem*" because only 1.5% - 5% was believed to be regulated loan business. In addition, "*whilst we may not like how Tiuta ran its business and whilst we think it had rather unusual arrangements with its main funder*", it was preferable for Tiuta to offload its regulated business as soon as possible and then to cancel its permissions. The Enforcement view was also that if Tiuta went into insolvency, any impropriety could be examined and the CAM side might be more worthy of enforcement action. In an email dated 15 December 2011, Enforcement confirmed to MGI that they would not be taking on the case on the following grounds:

*"Given that much of the Firm and the individuals' alleged misconduct is **minor in nature or degree**, given that the underlying problems have been resolved, or are being resolved, and given that the firm does not present an on-going risk to consumers (the firm **VVOP'd** earlier this year and its regulated business should be wound down by the end of Q2 next year) we consider that the alleged misconduct can be dealt with by way of private warnings, rather than referral to Enforcement. I attach a copy of the process for giving private warnings.*

*During our meeting you confirmed that Bluegate were visited by [the WSF] team of Wholesale Small Firms a couple of weeks ago. [The WSF] team have some concerns about how Bluegate had been operating **the fund I had not previously been aware that Bluegate were also the funds' operator.***

*Next steps*

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<sup>71</sup> Internal Regulator email on 29 November 2011.

***Given that [the WSF] team have concerns about how Bluegate have been operating the CAM funds Bluegate may be a more likely candidate for referral, we might also wish to revisit the Fin Proms as well"*** (emphasis added).

110. It does not appear that any such private warnings were issued to the relevant individuals.
111. In December 2011, Tiuta was still being monitored. It was however at this point that WSF began a more active examination of BGC's involvement in the Fund. WSF had contacted BGC in May 2011 (see paragraph 91 above), but the contact did not go beyond ascertaining that BGC were happy with how the Fund was operating, and this had been accepted at face value by the Regulator. On 2 December 2011, following a visit to BGC, WSF provided the following overview of BGC to MGI<sup>72</sup>:
- (a) WSF did not feel that BGC had sufficient oversight of the loans at Tiuta;
  - (b) WSF had concerns that "***Although it looks okay when the loan is initially given, in terms of approval, security obtained, etc. for some loans they have not monitored the repayment and hence Tiuta may have kept this money, re-lent it, or used it for something else! Although Bluegate are concerned, as the original loan has been repaid and so the security on it is now worthless, they are trying to resolve this but are taking "comfort" in an overall debenture security over Tiuta and that the sum of the security that they have on individual live loans is greater than the overall amount owed to Connaught (although whether that could be used for that purpose is I believe something you have raised from your end)***"<sup>73</sup> (emphasis added);
  - (c) The Fund had not been audited since the August 2009 accounts were signed off in June 2011;
  - (d) Mike Davies of CAM had been in the BGC offices during the visit and had provided the following information: "*Connaught may be looking to diversify and he said he was talking to another bridging provider in the North that Connaught could provide funding to. He also offered to discuss any concerns with us when he is back in Wimbledon. He said that Connaught was thinking about becoming authorised, as they may want to launch a FAIF*"<sup>74</sup>.
112. Following the visit to BGC, WSF requested the following from BGC:

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<sup>72</sup> Internal Regulator email.

<sup>73</sup> Tiuta calculated that they could identify £1.7m of assets over which a debenture could be taken at this stage (i.e. in 2011). On 10 September 2009 TIL granted CAM a debenture over their assets, although the original debenture was not registered in time. The Accountants' report from 28 June 2011 notes that this meant that was in fact no debenture in places for the Fund at that time. There was a further debenture made on 12 June 2012 by Tiuta Plc to CAM, according to a presentation given by D&P to investors on 13 August 2012, in relation to their initial findings as (at that time) independent advisers / investigative accountants for the Fund. The presentation noted that, as at the date of the presentation, "*CAM has floating charge but understood to be owed nothing*".

<sup>74</sup> A FAIF is a Fund of Alternative Investment Funds (i.e. a form of fund of funds). These funds allow the establishment and operation of a fund of funds which may invest all of its assets in unregulated offshore funds. They were introduced in March 2010.

- (a) A reconciliation of how much Tiuta owed the Fund, broken down into a schedule of "live" loans (with repayment dates) and the balance of matured loans not returned to the fund;
  - (b) A schedule showing how, although some of the money lent is not backed by specific loans, the fund still had sufficient overall security from the surplus on the known loans;
  - (c) A review of the financial condition of Tiuta to be able to value the worth of the debenture;
  - (d) Audited accounts for the Fund and any concerns raised by the auditors over the valuation;
  - (e) A liquidity profile of the Fund with the interest payments and CAM costs due by 14 January 2012 plus any expected redemptions;
  - (f) Details of any conflicts of interest and how these were managed;
  - (g) BGC's contingency plan for the Fund:
    - (i) Being unable to meet its interest payment to investors;
    - (ii) Having to write down its NAV to be fair (to the remaining investors) to meet redemptions;
    - (iii) Having to be suspended;
  - (h) The respective responsibilities of Tiuta, CAM, BGC, and the trustees of the Fund.
113. An urgent request for legal advice from GCD was made by MGI following WSF's visit to BGC, in respect of the Regulator's ability to force BGC to suspend the Fund. The advice was that the Regulator could only require BGC to suspend the Fund if there was sufficient evidence to show that its activities were harmful to consumers, and at this stage GCD was not aware of "*cogent evidence*" to establish Tiuta's breach of Threshold Condition 4 (its capital adequacy requirements) or BGC's activities being harmful to consumers.
114. BGC responded to the WSF request on 16 December 2011<sup>75</sup>. An email on 21 December 2011 clarified that BGC was now working on contingency planning for the Fund but

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<sup>75</sup> Internal Regulator email re Tiuta plc dated 19 December 2011: "[BGC] have obviously been liaising with Connaught/Tiuta as they state that there is a £3.4m surplus for Series 1, which is the same figure you were being provided with. I do not know if Blue Gate are aware of the [the Accountants'] report (£1.3m shortfall) but they have not commented on it. They have supplied a lot of detail, including loans, assets as security, investors (just over 1,000), IFAs, liquidity and a contingency plan that they (and Connaught) appear to be seriously thinking about (e.g. employing some Tiuta staff, alternative providers, etc.). On the plus side there appears to be liquidity to meet the January interest payment and redemption requests are currently only a few million. However, they could be hit with a lot of redemptions at 31 December as at that date investors would not then lose their entitlement to the January interest payment".

that there was sufficient liquidity to meet redemption requests and the January 2012 interest payment<sup>76</sup>.

115. An internal strategy paper on 28 December 2011 confirmed that the Regulator's approach was as follows:

*"Our overriding aim is to minimise UK investor detriment should Tiuta become insolvent. We believe that this is mitigated as long as CAM series 1 and 2 fund are fully secured against property assets secured by first charge to Tiuta (as the lender) against which CAM has taken a sub charge and that there are appropriate contingency plans in place should a shortfall occur. We intend to monitor this through [the Accountants'] monthly financial reports and through regular dialogue with the operator of the UK UCIS and GFSC for the Guernsey regulated fund".*

116. The strategy thus appeared to have moved on little since the position in May 2011, despite the deterioration in financial performance at Tiuta and the difficulties highlighted following the visit to BGC. On 20 January 2012, BGC reported to WSF that the auditors of the Fund had completed their site visit for the 2011 audit, that BGC had requested Land Registry checks on a sample of 53 loans, and that there was still a liquidity buffer of £2m but there had been an above average number of loan redemptions in the previous week.

117. On 27 January 2012, the MGI department noted that the January update from the Accountants indicated that there was no improvement in the firm's financial position. The property disposal programme continued to be significantly behind forecast, and this had an adverse impact on the firm's ability to fund new loans. This limited access to funds had suppressed the level of new loans and had been partly caused by an increase in liquidity required in the Fund by BGC, who had been notified of redemptions by investors in the Fund. Consequently, it was thought that BGC *"may need to consider possible suspension of the fund until they are able to satisfy themselves on the above points. If they were to take this action then it is likely to consolidate Tiuta's*

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<sup>76</sup> Internal Regulator email re Tiuta plc status report dated 21 December 2011: *"Answers [provided by Bluegate] to the questions mentioned below are:*

- 1) *Blue Gate have prepared the information but have shared it with Connaught (still no mention of the [the Accountant's] report)*
- 2) *Blue Gate have the final say on valuation of the fund. Based on the £3.4m surplus they believe that it is correct to allow redemptions at par (but see responses to questions below)*
- 3) *Yes the fund has security over the property assets.*
- 4) *They are doing a lot of work on contingency planning, he mentioned 10 scenarios with trigger points that he will send me, including what happens if Tiuta fails to make the 14th Jan payment and even replacing Connaught. I requested that he consider the increased costs on the fund in these scenarios, which he agreed to do, and hence whether it would still be equitable to allow redemptions at par.*
- 5) *The cash from maturing loans now comes back to the fund, rather than to Tiuta, and hence Tiuta has to submit a new loan request for the money. He said they manage liquidity on a daily basis (as evidenced by the spreadsheet in the earlier email) and try to keep this within a range of £2m to £5m. There is sufficient liquidity to meet the 14th Jan interest payment and current redemption requests.*
- 6) *It is hoped the 2010 accounts will be out in a few weeks and the 2011 audit will start in early January. 2009 delay was blamed on poor Capita records (Blue Gate's predecessor). Not many investors have asked for audited accounts, seemingly content that they still getting their 8% return".*

worsening financial position and possibly tip them over the edge. Should Blue Gate decide to suspend the fund we will inform the GFSC"<sup>77</sup>.

118. On 16 February 2012 BGC provided a response to further questions from WSF, noting that CAM was monitoring the loan book, and weekly meetings took place between the asset manager and Specialist Partner, and that BGC did "*not have independent oversight of these weekly meetings but [did] receive a verbal report from [CAM]*". In particular, BGC noted that:

*"We have some concerns regarding the conduct of the asset manager due to the asset manager failing in our view to monitor loan redemptions leading to the requirement to obtain replacement securities in the form of the 'recycled loans'.*

*We are also concerned that although the asset manager has reported to us the position regarding loans and defaults as being to their satisfaction we have not been provided with recent independent valuation evidence of properties in respect of which there has been an unusually long delay in repayment".*

119. WSF commented that BGC appeared to have "*woken up*" and were criticising CAM. An Enforcement and Supervisory Risk Committee ("**ESRC**") report from the end of February 2012 noted that the priorities were:

*"To minimise the risk of detriment to the UK investors who have invested £127.8m in two UCIS funds that have provided funding to Tiuta (a specialist bridging finance lender). The aim of our strategy is to: (i) preserve if possible the stability of the fund through supervision of Tiuta plc (ii) in any event, alert consumers to the risks that they face, and (iii) if/when appropriate, facilitate the payment of redress as appropriate through contact with the IFAs that sold the products in the UK; the UK operator Blue Gate Capital Ltd (BGCL) that approved promotions and if necessary, the FSCS".*

120. On 27 February 2012, the Accountants' report for January 2012 was received by the Regulator and a copy also sent to BGC (who had not previously been aware of the Accountants' monitoring of Tiuta). The report made clear that the financial position of the Fund was not improving.

121. On 29 February 2012, a paper was submitted by Supervision to the ESRC to agree the following strategy:

- (a) Tiuta to cease regulated lending and cancel permission in May 2012 when all regulatory loans were to be repaid;
- (b) Monitor the firm's financial performance through the review of the Accountants' monthly reports;
- (c) GCD had advised against exercising any powers against Tiuta including insolvency and OIVOP as that would be disproportionate considering the size of Tiuta's regulatory business;

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<sup>77</sup> Internal Regulator email dated 27 January 2012.

- (d) The firm would stay authorised as long as they were able to meet TC4;
  - (e) The Regulator should exert pressure on BGC to strengthen controls.
122. One of the strategy's stated aims was to alert consumers to the risks that they faced, but there was no action listed to implement this aim, other than to contact investors if the Fund did in fact collapse.
123. On 5 March 2012, WSF received notification from BGC that, having seen the Accountants' report, "*They [BGC] are not taking new money into the fund (e.g. top ups, dividend reinvestments) and are giving Connaught/Tiuta two weeks to sort it out or else they are likely to suspend the fund. Bluegate are also taking their own legal advice*".

#### March 2012 – March 2015

124. On 9 March 2012, BGC informed WSF that they were suspending new applications and redemptions on the Fund. On 13 April Tiuta defaulted on the quarterly interest payment and on the 26 April the CAM series 2 Fund was also suspended. On 25 May 2012, the Group was underperforming and the Accountants recommended that the Fund be wound down by redemption of the loan book and disposal of the property portfolio with proceeds to be paid back to the Fund. On 6 June 2012 it was agreed that the Fund was to be wound down by Connaught with the oversight of BGC. On 12 June 2012 Tiuta agreed another VVOP that would ensure that the proceeds of redeemed loans were returned to CAM<sup>78</sup>. TIL was placed into administration on 5 July 2012 with the Accountants appointed as the administrators. The Series 3 fund was also suspended.
125. In August 2012 the Regulator received a Principle 11 report of suspicion of major fraud suggesting that Tiuta management had been engaged in serious financial mismanagement and Fraud. Following a vote of Fund investors on 12 September 2012, on 10 October 2012, Duff & Phelps ("**D&P**") were appointed as the administrators of TIL in place of the Accountants, and on 19 December 2013 TIL entered into liquidation, with D&P appointed as liquidators. On 18 September 2012, CAM was placed into administration. On 28 September 2012, Tiuta went into administration, with David Rubin & Partners acting as administrators, and with D&P later appointed as joint administrators on 27 November 2012. Tiuta entered into liquidation on 27 September 2013, with D&P appointed as liquidators. On 12 December 2012, D&P were appointed as liquidators of the Fund.
126. From March 2012 (when the Fund was suspended) the focus of the Regulator shifted from monitoring the position at Tiuta to attempting to ensure redress for investors and

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<sup>78</sup> The text of the VVOP read: "*Tiuta plc ("Tiuta"), as the authorised person, hereby applies for a variation of the current permission granted to Tiuta pursuant to Part IV of the Financial Services and Markets Act 2000 ("its permission"), such that Tiuta is subject to a requirement as set out in the schedule below: SCHEDULE General 1. This schedule sets out the terms of a requirement to be imposed on Tiuta with effect from 12 June 2011. Variation of permission Tiuta plc (the "Firm") shall ensure in order to contribute to protection of the investors of any fund which provides capital to the Firm, or any company under its control (the "Companies") for lending: 1. that the Firm shall have received the specific written approval of [the managers of] each such fund in respect of each loan before entering into any loan agreement whether or not regulated; 2. that the relevant Company shall remit to the relevant fund immediately all loan book collections, investment property proceeds, and redemption moneys, once received by that Company. Signed ..... Chairman, On behalf of Tiuta plc*".

considering whether Enforcement action was appropriate. On 24 April 2012 an email from Supervision noted:

*"Had a discussion with Enforcement today about Tiuta. They are not convinced there is enough evidence to take a case against Tiuta's directors (seems tenuous and difficult case in a firm where most of the business is unregulated).*

*I explained the wider context and the fact that our supervisory strategy had been to use whatever regulated levers we could to mitigate risk to consumers - IFAs, Bluegate, Tiuta.*

***They want to look at Bluegate and also the IFAs. They think those cases would be much stronger"*** (emphasis added).

127. On 27 April 2012, MGI drafted a paper recommending that enforcement action should be taken against the directors of Tiuta: *"enforcement action would demonstrate that we are prepared to take a case on the integrity of the firm's directors, where we believe that they have misled their funders and also investors in the fund... This is not just a message that would be felt by the bridging industry, but is applicable to all authorised firms... Action against Blue Gate, Capita and/or the IFAs would also send strong messages to the industry about the responsibilities of regulated operators of UCIS, and advisers".* However, this recommendation does not appear to have been taken forward at the time with Enforcement or the Complex Events Team (see paragraph 139 below).

128. From March 2012 until the end of 2012, the Regulator adopted the following strategy<sup>79</sup>:

*"Our supervisory strategy is to mitigate the risk of loss to UK consumers through the UK regulated entities involved: i.e. Tiuta, BGCL (the operator of the Series 1 fund); and the UK IFAs that sold the funds.*

*A strategy paper was presented to ESRC on 29 February 2012. We have notified OFT our concerns about the proliferation of UCIS-backed unregulated bridging firms and the risks these present to UK investors. We have obtained, direct from CAM, details of the IFAs that have sold the Series 2 fund and their investors, and have also received this information from GFSC. Supervision is discussing with Enforcement the possible referral of Tiuta's directors for honesty and integrity failings, and BGCL for negligence in their role as the operator of UCIS funds. We have alerted Press Office to the Series 1 and 2 suspensions and possible administration, have updated our Consumer webpage, and informed HMT "<sup>80</sup>.*

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<sup>79</sup> As set out in an internal Supervision note dated 1 March 2012.

<sup>80</sup> The letter from the FSA to the OFT dated 13 March 2012 stated: *"We understand that since 2008, some bridging lenders have been replacing traditional private and bank capital with UCIS funds. UCIS have a number of specific risks, which include liquidity risk, exit terms, cancellation rights, potential loss of rights to the FOS/FSCS and difficulty in underlying asset valuation. Additionally, the quoted "annual interest payments of 7-12% are considerably above bank and building society deposit rates. These high rates are likely to be of particular attraction to less sophisticated investors who may require high levels of income from a fixed capital sum, but may also be risk averse, with low capacity for loss.... In view of these concerns we recently conducted some further work to identify whether UCIS were funding other FSA regulated bridging firms. The work at that time did not identify any similar situations, but we have seen that UCIS are actively*

129. It appears that during the eighteen months from December 2011 to May 2013 there had been no decision from Enforcement as to whether any individuals should be referred to Enforcement for investigation. In December 2012, the Complex Events Team (see below) were still gathering evidence in order to decide whether to refer Tiuta and its management to Enforcement.
130. The case was passed to the "Crystallised Risk" team, which later changed its name to be the "Complex Events" team ("CET"), in August 2012. This was a new unit that had been set up to deal with cases where risk had "crystallised" and Supervision was no longer considered to be the best resource to deal with the case alongside all the other day-to-day supervisory activities. The team was experienced in reviewing events and cases that cut across different Regulator teams and areas, and was able to take a more holistic view of events. This made a significant difference to the way in which the Regulator's further investigations were approached; in particular, in CET's engagement with experts and information from across different disciplines and teams, and the way in which this enabled the Regulator to understand better the relationship between Tiuta, CAM, the Fund and BGC.
131. On 18 December 2012, the CET provided Supervision with an update on Tiuta and CAM. The CET's key findings were as follows:
- (a) Funds were not invested in accordance with the Information Memorandum since its inception;
  - (b) There were severe problems with the loans that Tiuta entered into (e.g. recycling of loans, no security given, security as a second charge rather than a first charge);
  - (c) There were various issues with related debentures and guarantees that were meant to be issued for benefit of the Fund but which were issued for the benefit of other companies within the structure instead;
  - (d) Other, unregulated entities in the structure (namely, TIL and Wimbledon Development Finance Limited) were carrying on regulated activities;
  - (e) Many of the loans were used for developing properties and were not bridging loans as they are normally understood. The underlying properties which were provided as security were at different stages of completion, which made it more difficult for the administrators to recover monies (for example, one such property was merely a hole in the floor, which the administrators were having to meet the cost of covering due to the risk it posed to the public); and
  - (f) The losses in the Fund were estimated by the administrators of Tiuta (Duff & Phelps) to be closer to 70% - 80% than 50% as originally anticipated by the Accountants.
132. In relation to individuals, the CET's findings included:

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*funding non FSA regulated niche lenders (although we are not clear how prevalent that is)". The Regulator notified the OFT in March 2012 and HMT in April 2012.*

- (a) Those at Tiuta and CAM appeared to have been acting in concert the whole time to the extent that it appeared that both firms were well aware of the "wrongdoings" at Tiuta;
- (b) Nigel Walter appeared to be a main player in the structure from the outset to the end despite having formally resigned from CAM in 2009;
- (c) It appeared that directors at Tiuta and CAM had deliberately misled the public (through the Information Memorandum, quarterly reports etc.) and the Regulator (by providing doctored information); and
- (d) Evidence on file suggested that directors at Tiuta and CAM were well aware of the wrongdoings with the loans from 2009 onwards.

133. In relation to the other parties:

- (a) The CET were still waiting for final advice from GCD but their preliminary view was that it was unlikely that IFAs could be held liable for the losses suffered by investors; and
- (b) The CET noted that the roles of CFM and BGC as operators of the Fund were quite limited. CFM and BGC may have had liability for issuing misleading Information Memoranda (on which GCD advice was being sought), and they may also have breached Principle 11 for having failed to report wrongdoings to the Regulator. However, although the latter was a disciplinary matter it did not make them liable to investors. I also note that, ultimately, the Capita Final Notice included no finding that CFM had acted in breach of Principle 11.

134. The CET proposed a strategy: to stop further consumer detriment; to get as much redress as possible for investors; and to take enforcement action against relevant parties. Detriment had been controlled to some extent as the Fund was now closed, but it was recognised at this point that obtaining redress might prove to be potentially difficult. Tiuta and the other entities in the Connaught UCIS were insolvent, and preliminary advice from GCD was that a Court was unlikely to hold IFAs liable for investor losses. Similarly, and as CFM and BGC's role as operator was limited, this also was unlikely to give rise to liability. The CET resolved to work with the administrators to identify the size of the loan book and identify any money that might have gone missing. The CET was also considering whether to refer individuals to Enforcement.

135. Throughout the first half of 2013, the CET worked to identify means by which investors could achieve redress. The CET identified and considered a number of potential breaches of Principles by Tiuta and Capita, for example:

*"Tiuta plc. FRN 430956 – potential breaches of Principles 1, 2, 3, 4, 6 and 11*

- *There was evidence of financial mismanagement at the firm, e.g. the signed 'confession' by the firm's directors, their lack of understanding of the firm's financial position in interviews with the previous Supervision team and the firm's use of Fund money contrary to the terms of the Fund's IM. [1,3]*

- *Firm misreported its quarterly MLAR returns, which led the FSA to believe that the firm was meeting its capital resources requirements when this was not the case. [2, 4]*
- *Firm received funds from borrowers but failed to repay their loans to CAM. The result was that charges over the property in favour of Tiuta and CAS remained registered at the Land Registry unless the borrower or customer requested release. [6]*
- *Firm failed to notify the FSA of key events, e.g. its potential insolvency and the departure of George Patellis from the firm. [11]*

*Capita Financial Managers – potential breaches of Principles 6, 7 and 11*

- *Capita appeared to have notified the FSA only of its 'strategic' reasons for ceasing to act as operator of the Fund, rather than its specific reasons which were raised with other parties including CAM and Blue Gate. [11]*
- *Capita's communication to IFAs of its reasons for ceasing to act as operator similarly did not reflect the firm's specific concerns with Tiuta and the Fund. [6, 7]<sup>81</sup>.*

136. However, regulatory breaches do not necessarily give rise to a right to redress, and the CET were not able to identify an avenue for redress at this point. The collective understanding within the Regulator, informed by internal legal advice from GCD, was that redress from operators of the Fund would be difficult, given the lack of a contractual relationship between CFM and investors, and recovering from IFAs might also be difficult given that the alleged mismanagement and fraud on the part of other parties may have broken the chain of causation between IFA actions and investor losses. The view of Supervision in April 2013 was that "*any actions we take are unlikely to recover any investor losses*". I note from the Capita Final Notice that, notwithstanding the range of potential breaches considered by the CET at this point, CFM was ultimately found by the Regulator to have breached Principle 2 (to exercise due care, skill, and diligence) and Principle 7 (regarding communications with clients), but that the Capita Final Notice does not include findings that CFM had acted in breach of any other Principle.

137. In essence, the view was that the Regulator would only be taking action in order to be seen to be taking action, rather than because the action would act either as a credible deterrent or assist with providing redress to the investors. An internal email from Enforcement to the CET on 28 April 2013 summarised the dilemma thus:

*"In summary, it is not clear to me what the FCA taking action against those individuals would achieve given:*

- (1) *Enforcement action would [not] help obtain any redress for customers;*
- (2) *Given the misconduct at Tiuta would have been in relation to the unregulated lending, it is unlikely to have been within the scope of the individual's controlled*

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<sup>81</sup> Extracted from an internal CET note dated 19 March 2013.

*functions and neither could we say that they were knowingly concerned in the a breach of Principle by the firm as they only apply to regulated activities. As such we may not be able to fine the individuals;*

- (3) *Whilst the misconduct in relation to an unregulated activity could be used as evidence to support a prohibition on the basis that the individuals were not fit and proper, a full prohibition would not prevent the individuals from doing exactly the same thing again. (Tiuta did not need to be regulated to be the UCIS specialist partner). However, it would be hoped that the negative publicity from a prohibition would make it more difficult for them to do so.*

*So, putting to one side the caveats above for a moment, in summary the case does not hit a key supervisory priority and therefore the messages within it would have limited read-across to others in the market. The rationale for doing it would be simply because the conduct is so bad that the miscreants deserve to be punished - however it's not clear that we can punish them beyond a prohibition and public censure - which probably wouldn't look that credible. So we'd really be only doing it so we are seen to be doing i.e. the FCA's reputation would be hit if we didn't do it?"*

138. On 23 May 2013, the CET put forward an ERD on whether Tiuta or individuals should be referred to Enforcement for further investigation. The recommendation was that they should not:

*"Instead, we recommend that the FCA should support the Insolvency Service's investigation and continue to liaise with law enforcement authorities, including the Metropolitan Police and the Serious Fraud Office ("SFO") to facilitate action by them .... The evidence against the individuals is such that supervision would ordinarily recommend their referral to enforcement for further investigation. However, in light of discussions with HM Treasury and the Insolvency Service's action on the case (see further below), Supervision considers that Tiuta plc. and the relevant individuals should not be referred to enforcement ...*

*From Enforcement's perspective ... In our view, the referral of up to five individuals for full investigation of all the issues identified would require significant resource (equivalent to approximately 2-3 thematic cases) for only limited benefit...enforcement action would not obtain redress for customers ... would not result in a fine for the individuals, given the majority of the misconduct is in relation to unregulated activities; and would not prevent the individuals from doing exactly the same again, because the majority of Tiuta Plc's activity was unregulated commercial lending...Other authorities involved would be more effective at stopping the individuals from repeating their misconduct and any resultant publicity would also highlight the risk to consumers and other third parties dealing with these individuals".*

139. The decision was ultimately referred up to ERIC<sup>82</sup> in early June 2013. The ERIC paper recommended that:

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<sup>82</sup> ERIC is the Executive Regulatory Issues Committee, a sub-committee of the FCA Executive Committee. ERIC is responsible for taking decisions on regulatory issues escalated to it from across the FCA. This includes firm, sector or product specific issues. ERIC operated from 2013 to 2017.

*"the FCA does not pursue enforcement action against the regulated firms and individuals involved. We believe there has been significant failings by approved persons, but given the number of unregulated entities/activities and individuals involved, we believe that other authorities, namely law enforcement agencies and the Insolvency Service, are better placed to take action against firms and individuals and ultimately stop individuals carrying out similar practices in the future.*

The recommendation also proposed a public statement explaining the Regulator's decision<sup>83</sup>.

140. Following the meeting on 3 June 2013, ERIC approved the decision:

*"ERIC agreed it was too early for the FCA to make a decision on whether or not it would be taking any action against the regulated firms and individuals involved, pending the outcome of the investigations by other authorities but noted that the decision should ultimately be made by Enforcement. ERIC also noted that a public statement by the FCA could hinder the investigations by other authorities. Therefore it was agreed that the FCA should not issue a press release stating whether or not the FCA would conduct an investigation at this stage" (emphasis added)<sup>84</sup>.*

141. Between June 2013 and July 2014, the Regulator concentrated on supporting others, including the Insolvency Service and the liquidators, and providing information to both Her Majesty's Treasury and investors when appropriate. The CET also continued some investigations, particularly into the role of CFM as the operator and the handover between CFM and BGC in 2009. The CET submitted a formal request under section 165 FSMA to CFM in order to understand what information had been provided to BGC. The CET also continued to look into the potential redress from the operators and IFAs, and had instructed external Leading Counsel to give an opinion in January 2014 on the viability of various means for securing redress for investors.
142. In May 2014, ERIC re-examined the case in light of the investigation conducted by the Insolvency Service, advice from external Leading Counsel, a Parliamentary debate, and investigations carried out by the liquidators of the Fund that indicated that the losses were likely to be considerably higher than anticipated. ERIC took the view that the priority was to secure as much redress for consumers as possible and therefore the

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<sup>83</sup> An ERIC summary paper in June 2013 stated: *"Our recommendation is to communicate through a press release that the FCA will not be formally investigating the regulated firms and individuals involved and to explain our rationale for that decision, in particular that we will be supporting other authorities in their investigations. There are a number of unregulated parties involved, including the fund itself and the outcome of our actions is limited; as such other authorities are better placed to investigate these matters, with our assistance.*

*We would like to be clear that investors should not rely on the FCA to recover monies for investors and that this is the role of the liquidators/administrators of the fund and relevant companies involved. In particular, we would like to communicate our judgement that it would not be appropriate for the FCA to impose a restitution order on Capita and to communicate our rationale for that decision. Given that consumers have suffered significant consumer detriment, the FCA could volunteer to undertake a review into regulatory failure in this case. This report could draw a lessons learned exercise and also help explore whether the FCA has sufficient powers under FSMA to prevent a similar situation occurring in the future. The government is currently transposing the Alternative Investment Fund Management Directive (AIFMD) into UK Law and this could potentially extend FCA powers into previously unregulated areas".*

<sup>84</sup> Internal Regulator email dated 6 June 2013.

Regulator should work with the liquidators to bring all relevant parties to the negotiating table with a view to agreeing a redress package for investors. If a package could not be agreed, BGC and CFM should be referred to Enforcement. Following a meeting on 28 May 2014, it was decided as follows:

- *"Decision: ERIC agreed that the priority should be redress for investors ahead of tackling the misconduct by Capita and Blue Gate with respect to the Connaught Income Fund Series 1.*
- *Decision: ERIC agreed with the recommendations made for securing as much redress as possible for investors from Capita and Blue Gate.*
- *Decision: ERIC agreed with the recommendations on how redress should be pursued, **namely the immediate commencement of negotiations with Capita and Blue Gate with a view to agreeing a redress package for investors. If unsuccessful then there should be referral of Capita and Blue Gate to Enforcement in relation to both redress and discipline.***
- *Decision: ERIC agreed that in addition to any Enforcement action against Capita and Blue Gate, supervisory action should be considered against the role of the top 10 IFAs who sold policies to investors for Connaught.*
- *Decision: ERIC agreed that Supervision should share the agreed next steps with Duff & Phelps (the "fund's liquidators"). Additionally, Supervision should continue to liaise with and support other internal stakeholders (Authorisation and Policy) and external authorities on this issue" (emphasis added)<sup>85</sup>.*

143. On 13 June 2014, it was decided that the Regulator should act as a broker for negotiations between the liquidators, CFM, and BGC. On 10 March 2015, the Regulator withdrew support for the negotiations. That decision is dealt with in section H below.

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<sup>85</sup> Internal Regulator email on 30 May 2014.

**E. WHETHER THE FSA'S REGULATION OF TIUTA PLC, CAPITA AND BLUE GATE, AND THE INDIVIDUALS ASSOCIATED WITH THESE ENTITIES, AND ITS RESPONSE TO INTELLIGENCE, WAS APPROPRIATE AND EFFECTIVE [TOR1]**

**TOR 1(a) The approach to supervision and its implementation including judgements made, the proportionality, effectiveness and timeliness.**

2011

144. The critical year for supervision and regulatory intervention was 2011. In November 2010, the Regulator had received whistleblowing complaints relating to BGC and alleging financial difficulties with the Fund. Unfortunately, I have not seen any detailed records of what those allegations of financial difficulties with the Fund were or precisely what was done to address them. It is possible that an opportunity arose then for the Regulator to learn more about some of the emerging issues and to begin to address them but, in the absence of further information, that is not something I have been able to investigate fully. More importantly, however, on 18 January 2011, George Patellis, the CEO of Tiuta, brought serious allegations about Tiuta to the Regulator's attention. The Regulator's response to that information was initially inadequate and its subsequent responses were generally slow and not sufficiently coordinated or robust for the rest of that year. The Regulator's actions, while well intentioned, were not far reaching enough to address the issues at Tiuta and the Fund and to protect consumers who invested in the Fund from January 2011 until it was suspended in March 2012. During this period, approximately £13m of investments were placed in the Fund, and substantial fees were incurred by the Fund, including fees to CAM as asset manager comprising 1.5% of the aggregate sums invested in the Fund, paid yearly.
145. I am aware that supervision and regulatory intervention at this time took place against the background of the Regulator's response to the financial crisis. In 2011, a key focus of the Regulator was on resolving the significant issues and themes from the global financial crisis. However, the issues regarding the supervision and regulation of CAM were not simply a result of resources being focused or diverted elsewhere to larger firms more directly linked to the financial crisis, but arose from other systemic problems as set out below. These related not so much to the overall policy focus of the Regulator, but the way in which it reacted to the potential issues and risks that began to emerge from early 2011. This partly related to the way in which different parts of the Regulator worked together. According to the 2009 and 2010 business plan, the Regulator was working towards "*outcomes focused regulation*" with an emphasis on the requirement for an "*integrated approach to the supervision of individual firms*", with supervisors needing to "*have oversight of the full range of the firm's business and its prudential and conduct issues*"<sup>86</sup>. The events surrounding CAM and the related firms demonstrated that in 2011, this "*integrated approach*" had not yet been achieved.

Lack of coordination and clear end-goals

146. No decision maker (or group) within the Regulator took overall responsibility for the appropriate coordinated regulatory response to the issues which had emerged and were emerging. Subject matter experts in funds, funds regulation, and financial crime were

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<sup>86</sup> FSA Business Plan 2009/10, p. 9: <https://www.fca.org.uk/publication/business-plans/fsa-bp-200910.pdf>

not engaged at the outset. As a result, there was a lack of a proper understanding of the overall picture and the risks to new and existing investors and their investments in the Fund were allowed to continue. There was also no clear "plan B" after Tiuta refused to appoint an administrator in May 2011. The Regulator had been reluctant to take formal steps to appoint an administrator or pursue enforcement proceedings<sup>87</sup>.

147. Before December 2011, there was no concerted attempt to obtain assurances that the Fund was working properly, or further information regarding the Fund, from BGC (as the operator of the Fund), despite the concerns about the Fund's "Specialist Partner", Tiuta. Indeed, there was a reluctance even to alert BGC to the problems at Tiuta as it was thought that might potentially cause a run on the Fund. Instead, reliance was placed by the Regulator on senior management at Tiuta to "trade out" of Tiuta's difficulties without much challenge, testing, or follow up. The deteriorating situation was monitored by the Regulator without an independent investigation into what the facts were and what to do about them. The clearest regulatory lever at the Regulator's disposal was through BGC as the operator. Although it could have, the Regulator did not, in May 2011, seek detailed assurances and information to verify the situation from BGC that the Fund was operating as intended so that the investors were safeguarded from misleading promotions, from non-compliance with the Fund's Information Memorandum, and from potential fraud. If that had not been forthcoming or satisfactory, the Regulator could have reminded BGC of its obligations and options, and requested, or even potentially (in the unlikely event it was necessary) required, BGC to suspend the Fund until the issues were corrected. The Regulator, in effect, set this in motion in December 2011 after a visit to BGC. But it could have required such assurances from BGC earlier in the year. It had been aware of serious concerns regarding Tiuta since April 2011 at the latest.
148. From May 2011, the Regulator was in the position of monitoring a firm that it considered to be technically insolvent and which posed serious risks to the investors in the Fund, without any concrete plan to investigate or take action itself or to independently verify what it was being told. This problem was recognised by MGI in an email on 23 May 2011:
- "I am concerned that we could get into a series of further protracted discussions with the firm and still not be any further forward and we may not have the definitive answer on the solvency until [the Accountants] have completed. It is a judgement call and not an easy one but on balance of probability I think that we may have used up our regulatory forbearance quota as we are not really any further forward. As you just highlighted the appointment of administrator should not necessarily bring the firm down but in this case the withdrawal of the CAM funding probably would but we would have least acted in a way to protect new investors from further risk".*
149. The strategy of continued monitoring was agreed on 26 May 2011, but unfortunately resulted in the very issue identified in the above email of 23 May 2011, in that there was protracted correspondence between the Regulator, the Accountants, and Tiuta until March 2012, when the Fund was suspended, but no determinative action was taken by the Regulator other than persuading Tiuta to vary its regulatory permissions, issuing a consumer warning in May 2011, and contacting certain IFAs in June 2011. The

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<sup>87</sup> For a summary of the powers available to the Regulator, see Appendix 3.

Regulator had pursued a strategy of monitoring Tiuta without a clear plan as to when such monitoring should end, or what action should be taken to push the Accountants to come to a conclusion on whether Tiuta was in fact insolvent, as they had initially advised might be the case.

150. For example, there were a number of incidents between May 2011 and March 2012 which could have provided the impetus for the Regulator to act. On 12 August 2011, a Regulator employee analysed the Tiuta and the Accountants' reports and was of the opinion that Tiuta had taken insufficient steps to address risk, and would need to increase lending significantly in order for the business to be sustainable. However, significantly increasing lending would have given rise to further risks, given the other issues apparent at Tiuta; for example, its recent history of "recycling" loans. The Regulator requested Tiuta to demonstrate how it intended to turn things around. Tiuta and the Accountants responded throughout the period from August to December 2011 that Tiuta was taking steps to "trade out" of the difficulties, but it was unclear what these steps were or why the Regulator continued to accept the continued assurances. This was especially surprising given Mr Patellis' allegations regarding the quality of Tiuta's systems and controls and the alleged wrongdoing by its directors.

#### Lack of challenge to information provided by Tiuta

151. The Regulator does not appear to have attributed much weight to Mr Patellis' allegations, and did not properly investigate them at the outset. The gravity of the allegations was not adequately escalated to senior management at the Regulator – rather, they were presented as concerns from a disgruntled ex-employee. Some Regulator employees from Enforcement and Supervision stated that while a CEO reporting his own company to the Regulator was exceptional, there had been doubts over Mr Patellis' account and motivations due to the fact that he had gone back to the company after resigning in January 2011. However, Mr Patellis only returned to Tiuta for a brief period (three weeks) and appeared to have given a full account of the reasons for his return and subsequent departure, in addition to supporting evidence and documentation, during his interview with the Regulator and in his follow up letter in March 2011<sup>88</sup>.
152. The Regulator was also overly reliant on the information provided by the Accountants and appears to have focused on the findings in the Accountants' reports rather than investigating the allegations being made by Mr Patellis for itself. The Accountants were instructed by Tiuta with no duty of care or other specific obligations owed to the Regulator as regards their findings. The Accountants had made it clear to the Regulator that they were not verifying information provided to them from Tiuta, and were only looking at financial information "*as presented*". There had been three changes in the scope of the Accountants' retainer agreed with Tiuta. Moreover, the Regulator knew that the Accountants were not investigating the allegations of misconduct Mr Patellis had made concerning the Tiuta Board or in particular his allegations about misappropriation of funds. The Regulator also did not push the Accountants for certain key pieces of information regarding the alleged misappropriation of funds. It requested

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<sup>88</sup> An internal note of the meeting between the Regulator and Mr Patellis states that Mr Patellis returned to the firm upon the suggestion of his legal adviser that he return to help Tiuta confront the problems it faced.

information under section 165 FSMA on 19 May 2011 but did not follow up on this request<sup>89</sup>.

#### Mischaracterisation of matters at Tiuta

153. Following Tiuta's refusal to appoint an administrator on 23 May 2011, Enforcement and Conduct Risk recommended allowing the Accountants to carry out a further financial review of Tiuta (see paragraph 104 above) and in November 2011 Enforcement advised Supervision that they would not be opening an investigation.
154. An investigation could have been opened in mid-2011, and indeed the possibility of appointing a Skilled Person pursuant to section 166 FSMA to conduct a review of Tiuta was briefly considered by in May 2011. However, this suggestion was rejected on the basis that it would "*take too long to implement*". Although the appointment of a Skilled Person – or an exercise of other formal information gathering powers – may not have been the fastest or most effective way at the time to get information regarding Tiuta and the Fund, it could have operated alongside other measures, including engagement with BGC. An investigation could have provided the Regulator with its own means of obtaining and verifying information and ascertaining potential investor harm.
155. At the end of the year the conduct at Tiuta was characterised as "*minor*" in an email from Enforcement to Supervision (in December 2011): "*Given that much of the Firm and the individuals' alleged misconduct is minor in nature or degree, given that the underlying problems have been resolved, or are being resolved, and given that the firm does not present an on-going risk to consumers (the firm VVOP'd earlier this year and its regulated business should be wound down by the end of Q2 next year) we consider that the alleged misconduct can be dealt with by way of private warnings, rather than referral to Enforcement*".
156. It is unclear how this conclusion was reached. In addition to the evidence provided by Mr Patellis, the Regulator had other evidence at the time that Tiuta was recycling loans and had a history of outstanding mortgage release DS1 forms<sup>90</sup>. It had been given explanations for those irregularities by Tiuta to the effect that they were known to CAM, who had acquiesced. These explanations were not tested or explored as to the possibility of improper collusion between Tiuta and CAM. Communications subsequently obtained in the Insolvency Service's investigations provide evidence that this collusion took place at the latest from March 2009 onwards, when Tiuta was experiencing cash flow problems. Tiuta staff tried to cover up the true state of affairs and used investors monies to pay off outstanding loans. This was of course impermissible even if quarterly interest payments were being met. By January 2011 there were at least £20m of outstanding redemptions, a figure indicated by Mr Patellis which had been revealed to him by the CFO. Emails show that Mr Walter (of CAM, but who had resigned as a director of CAM in February 2009) was, at least to some extent, directing responses to Mr Patellis' allegations and to the reports in the media that senior staff at Tiuta had resigned shortly thereafter. Mr Walter's role may not have been visible to the Regulator at the time, but the nature of the relationship between Tiuta

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<sup>89</sup> For full details of the exchange, see footnote 55 above.

<sup>90</sup> These forms are supposed to be filled out by the Lender and sent to the Land Registry on receipt of redemption monies. As noted earlier, Mr Patellis had alleged that Tiuta had been withholding these because it had applied redemption money towards its own costs.

and CAM would likely have been revealed had Mr Patellis' allegations been properly investigated. The Regulator, through the CET, did eventually conclude that Tiuta and CAM were acting in concert throughout, but only almost two years later (see paragraph 132 above).

157. It is also unclear how Enforcement in December 2011 reached the conclusion that the underlying problems were being or had been resolved and that there was no on-going risk to consumers, without any independent means of verifying that. The reasoning appears to have been that there was no ongoing consumer detriment because the regulated business was being wound down after the VVOP had been put in place. However, that did not address the position of the investors in the Fund. The risk of harm to these investors if Tiuta, and hence the Fund, collapsed had been recognised by at least May 2011.
158. There was a clear difference of opinion between Enforcement's assessment of the seriousness of the case and Supervision's assessment, and a lack of a clear unified and coordinated strategy within the Regulator. From Supervision's point of view, the case was serious and urgent. In August 2011, the Acting Head of MGI was pushing for an administrator to be appointed if the position did not improve. In September 2011, there was an exchange of emails within MGI highlighting a need to act urgently:

*"We must act urgently (and in conjunction) with GCD and Enforcement on this. I am concerned that, once again, Tiuta are breaching principle 11 in that they are not keeping us informed of what is happening (this in addition to Principle 5 and six breaches). The fact that they aren't doing anything to release the charge until the vendors solicitor starts pushing for the release is clearly unacceptable. It is interesting to note that their (Tiuta) legal advice is that the clients are not being adversely affected. Any letter that we send to Tiuta should be reviewed by, and have input from, GCD on this issue - I am becoming increasingly uncomfortable with the way in which Tiuta appear to be acting at the moment - which is giving me cause to question their professionalism and fitness and propriety";*

*"I agree re the concerns that this does appear to be crystallising into a Ponzi scheme. Once we have GCD view we may need to act very quickly including contacting Guernsey".*

#### A cautious approach

159. The Head of MGI, who took up the position in September 2011, described how they felt at the time that they were exploring a variety of options, but kept "*hitting a brick wall*" in terms of actions that could be taken. GCD advised that administration was unlikely to be justified as there was no "*unquestionable evidence*" that the firm was insolvent. GCD advice to MGI on 9 December 2011 was that while Tiuta might be sailing "*very close to the wind*", the Accountants "*have not been able to state with conviction that the firm is indeed insolvent*". This issue is related in part to the difficulty referred to in paragraph 152 above, in that there was no plan in place requiring the Accountants to give a firm opinion of Tiuta's solvency position by a particular deadline. When it became apparent that Tiuta was recycling loans, GCD's advice remained that use of the Regulator's insolvency powers would be a disproportionate exercise of the Regulator's powers given the small proportion of Tiuta's business that was regulated.

160. The approach at the time to perimeter issues within GCD, and the Regulator as a whole, has been described by various staff and former staff at the Regulator as cautious. Consistent with wider policy within the Regulator at the time, GCD took a strict, legalistic approach to the limits of regulatory jurisdiction on the basis that this was a matter for Government and Parliament which had deliberately delineated the scope of the Regulator's powers. As a result, the legal analysis was not geared towards – if considered necessary – pushing and testing the extent of the perimeter to find practical, creative solutions to problems<sup>91</sup>. In the case of Tiuta and the Fund, the caution appears to have arisen out of a perception that the Regulator lacked jurisdiction and powers over the majority of Tiuta's business and the other relevant entities involved. As a consequence, the Regulator formed a narrow view of its own jurisdiction in this regard. This is dealt with in more detail in section F below.
161. The approach regarding the proportion of regulated business was illustrative of a feature which ran through the Regulator's attitude to the serious issues at Tiuta. The Regulator's understanding was that only 5% of Tiuta's business was regulated at the time, with the vast majority of its commercial lending outside the Regulator's remit. Tiuta was also regulated as a small firm. It was therefore deemed disproportionate to take action and use resources against it in the circumstances. This approach did not give weight to the potential impact of the failure of Tiuta on the investors in the Fund.
162. In addition, from interviews with Regulator staff and former staff, Enforcement's attitude at the time was to open investigations only if they had a good chance of achieving successful enforcement outcomes. Enforcement was reluctant to open investigations to identify potential misconduct and to gather specific information purely on the basis that it might prevent harm before it occurs; for example, to take immediate intervention actions to require a suspension of a Fund. Enforcement had a generally low risk appetite at the time and would normally only take cases where there was a high probability of "success". Regulator staff agreed during interviews that the regulator today has a different approach. Since 2015, there has been an evolution whereby more investigations are opened for information-gathering purposes in order to achieve just outcomes expeditiously. There has been a recognition that the philosophy of only taking on cases with a good chance of achieving a successful enforcement outcome had resulted in messages being sent and penalties imposed only *after* significant episodes of loss and harm had occurred. The Regulator today is more ready to open investigations and, if necessary, to close them. There also seems to be greater recognition that firms like Tiuta, which might be small, could have a much wider and significant consumer impact if issues are not properly investigated and dealt with.

### The steps taken

163. The steps the Regulator did take during the Review Period, such as issuing a consumer warning, contacting IFAs and changing Tiuta's permissions, were well intentioned, but not sufficient to protect investors. With regard to the consumer warning issued on 26

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<sup>91</sup> GCD's advice at the time concluded: "*Bluegate could be asked, if there was sufficient evidence to show that its activities were harmful to consumers, to suspend its activities, or if required compelled to suspend by use of the OIVoP power...The FSA can use powers against authorised entities to discover information about selling practices, and could assess compliance and take action, including Enforcement action, if appropriate*".

May 2011<sup>92</sup>, a number of stakeholders felt that it should have contained more information regarding the Regulator's concerns about Tiuta. However, in my view it would not have been appropriate to make a public statement about such matters before they had been investigated. The consumer warning was intended to prompt customers who had invested in CAM to contact their IFAs. The relevant IFAs were also contacted as regards the suitability of the investment for the investors. There was a genuine concern at that stage not to cause a run on the Fund, and this was another reasonable consideration the Regulator took into account in determining the content of the consumer warning.

164. However, I believe the Regulator should have considered asking Tiuta to correct or clarify the statements it had made regarding the reasons for the VVOP that was in effect imposed on it on 14 May 2011. Tiuta misrepresented the reasons: for example, in an article dated 26 May 2011<sup>93</sup>, it presented the VVOP as culmination of a commercial decision to withdraw from regulated business and to reflect changes to Tiuta's business model<sup>94</sup>. The Regulator was aware of this article and that the information contained within it was misleading. It would have been appropriate to contact Tiuta to request it to withdraw the article, or correct it, and if Tiuta had refused the Regulator might have published a correction itself.

**TOR 1(d) The extent to which the internal departments co-ordinated the use of intelligence and the appropriateness of any response.**

165. There was insufficient coordination and information sharing between Regulator departments. Part of the issue with information sharing was a practical one. There was no easily accessible centralised records system at the time where "red flags" could be reported and Regulator staff could get a clear overview of the regulatory history of a company or individual. Different departments used different data recording and case

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<sup>92</sup> FCA Press Release: "Investors warned over Connaught Income Funds", published 26 May 2011: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>, for full text see footnote 68.

<sup>93</sup> Mortgage Solutions: "Tiuta withdraws from regulated loans", dated 26 May 2011: <https://www.mortgagesolutions.co.uk/news/2011/05/26/tiuta-withdraws-regulated-loans/>

<sup>94</sup> Ibid., "The decision marks a reversal of its strategy from last year, when Tiuta secured open-ended funding from Connaught Asset Managers to expand into the specialist lending sector and longer-term finance. It claimed that regulated business was making up around a third of its new business.

*However, today, ... Tiuta, said that regulated loans made up just 2% of its entire loan book value and it felt 'the additional time and resource this takes can no longer be justified'.*

*In addition, Connaught Asset Management chairman Mike Davies said it fully supported the move to bridging loans for professionals, given that the residential mortgage market has never been its focus.*

*He said: 'We have always discouraged regulated loan activity for this reason which is why it has always been such a small part of Tiuta's business'.*

*Tiuta has now voluntarily removed its permissions to offer regulated loans, but will remain authorised by the FSA to manage and administer its regulated loan book.*

*[Tiuta] highlighted that [it] is on course for its best trading month on record this month, with an even more positive outlook for June...:*

*'Following a complete review of the business strategy Tiuta has decided that it will stick to what it excels at, namely secured bridging lending to professional and experienced customers.*

*"There is an enormous demand for such loans in the UK and we have the funding lines and expertise to remain the number one provider in this market. Our current bridging loan lending figures are increasing month by month which shows this part of the market continues to thrive"*.

management systems, which were not necessarily or easily accessible to individuals in other departments. For example, the Supervision team used the "Remedy" system, but that system was largely confined to use within Supervision and there were a limited number of licences available for access. Therefore staff members within Enforcement would rarely access the Remedy system directly for themselves and would rely on briefings from Supervision colleagues. A number of individuals I have spoken to have described how Remedy was clumsy to operate, and difficult to search.

166. This somewhat fragmented nature of information and intelligence sharing was also reflected in what I observed about the relationships between different teams within the Regulator during the Review Period. Each team was working to its own individual priorities and responsibilities, with vertical lines of reporting and management within teams. This siloed structure was not well equipped to deal with the regulation of financial models such as the Fund, where different components were supervised by different departments within the Regulator (and some components not supervised at all). Between 2007 and 2011, Tiuta was supervised by MGI, which was part of the small firms division within Retail Supervision. Tiuta did not have a specific relationship contact within the Regulator at this time and instead communicated with the Regulator through the Firm Contact Centre. CFM, as the operator of the Fund, did have specific relationship contacts from 2010 onwards but was supervised by WSF. Initial regulatory permissions were considered by Authorisations. Concerns about CAM operating unauthorised business were dealt with by the UBD. Matters regarding the Fund's Information Memorandum were dealt with by Financial Promotions.
167. The mix of regulated and unregulated business within the Tiuta business model also complicated matters. Its practical impact during this period was that different teams within the Regulator dealt with the various concerns raised regarding Tiuta, but the concerns were not properly drawn together and no one group or person had overall responsibility. While Regulator interviewees assured us that communication between teams was good (and in the later period, from 2012 onwards, documents show that there was better communication and coordination between departments – certainly at a higher management level at least), coordination appears to have largely relied upon "ad hoc" contact between various teams and the contact itself at times relied on incomplete information within the teams.
168. It is of note that Tiuta was visited by members of MGI in August 2009 and February 2010, whilst at around the same time UBD were investigating whether CAM was carrying out unauthorised activities, and CFM was notifying WSF that it (CFM) was resigning as operator of the scheme (see detail at paragraph 169(e) below). However, there appears to have been little coordination between the three teams, other than a brief email exchange between UBD and WSF regarding CFM exiting as operator, months after the event<sup>95</sup>.

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<sup>95</sup> On 24 December 2009 the WSF, which was responsible for supervising CFM and BGC, requested confirmation from UBD about the position reached in relation to CAM's authorisation: "*I just wondered if you could let me know if you were able to resolve your concerns about Connaught Asset Management possibly operating a CIS without authorisation and whether, off the back of that, we would have any issue with the other operator, Capita Financial Managers, transferring their interest to Bluegate?*" The response from UBD was as follows: "*I think our approach here will be to accept that Connaught is not operating a CIS if there is*

169. I have referred to the various red flags that had emerged prior to 2011 relating to the initial authorisation of Tiuta, regulatory issues and financial promotions by the operator and CAM, unsuitability or conflicts relating to individuals (Nigel Walter and Mike Davies) and whistleblower complaints at BGC. It is difficult to say whether any of them might have warranted different action at the time they arose. Some should certainly have been better followed up. They are each events that should have been identified, reconsidered and revisited as a whole in the light of Mr Patellis' allegations. Had the Regulator done so, and turned its mind in a more focused and coordinated way to Mr Patellis' allegations of financial misconduct and misappropriation, the facts which were revealed in the Insolvency Service investigation may have come out earlier. As a reminder, the history showed the following picture.
- (a) Concerns about some of Tiuta's ultimate owners, who among other things had admitted altering invoices, were raised when Tiuta applied for regulatory authorisation. Although those concerns were addressed at the time by requiring the owners to hold non-voting shares, they remained involved with the firm. This issue was not picked up during the visit by Supervision in September 2009 and February 2010, probably because the earlier information had not been accessed by the Supervision team.
  - (b) It is clear from the evidence I have seen that the Regulator had serious concerns about Nigel Walter, who remained involved with CAM. In February 2007 the Regulator noted that Mr Walter's previous business, UKLI, was linked to CAM, which Mr Walter had stated was "*wholly owned and controlled*" by him, that the purpose of CAM was to offer asset management services for FSA-authorised operators, and that CFM would be involved in the first scheme. In a report on 2 March 2007 regarding the withdrawal of Mr Walter's application, the Authorisations department noted under "*action*" that they should be alert to further land banking applications being received, but did not refer to the link between Mr Walter's previous land banking scheme, UKLI, and CAM. By 2009, the Regulator had significant information about Mr Walter, his perceived unsuitability, the winding up of UKLI (which had received £69m from investors in June 2008<sup>96</sup>), his further intentions, and his link to CAM. The Insolvency Service, after investigating his conduct, disqualified Mr Walter from being a director for nine years<sup>97</sup>.
  - (c) There had been concerns within the Regulator that CAM may have been carrying out business without proper regulatory authorisation. These concerns appear to have been addressed at the time. The Regulator closed the inquiry into CAM in January 2010, accepting (somewhat reluctantly) that CAM did not need to be authorised on the basis that CFM (and later BGC) was involved. However,

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*an authorised firm carrying on the actual management. The fact that Capita is no longer involved makes this easier. Happy to discuss".*

<sup>96</sup> FSA Press Release: "*FSA seeks to close down UK's largest illegal 'landbanking' scheme*", 4 June 2008: <https://webarchive.nationalarchives.gov.uk/20090224123635/http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml>

<sup>97</sup> UK Government Press Release: "*Connaught Asset Management directors banned for 16 years*", dated 19 December 2014: <https://www.gov.uk/government/news/connaught-asset-management-directors-banned-for-16-years>

this should also have been relevant to the Regulator's overall perception of CAM and its activities in 2011, in combination with other potential red flags.

- (d) Questions were raised in March 2010 about whether CAM's financial promotions were misleading. In March 2010 there was a query from Financial Promotions regarding potentially misleading statements in the Fund's promotional material comparing a bridging loan fund investments to cash. Financial Promotions contacted UBD on the grounds that the material also raised concerns that CAM was carrying out regulated business. On 26 March 2010, UBD replied stating that UBD had looked into CAM in the past and decided not to take inquiries forward. This, however, did not address the potentially misleading statements and, for reasons which are unclear, Financial Promotions does not appear to have taken any further action with regard to the marketing materials at this time, although they could have taken the matter up with BGC<sup>98</sup>. Misleading statements to investors were subsequently an important factor in the Capita Final Notice. If this issue had been revisited in 2011 (as was suggested within Enforcement in December 2011), it would have given important background and wider context. It might have led to an investigation of Mr Patellis' allegations.
- (e) There had been a change in the Fund's operator from CFM to BGC in September 2009, at a time when the Regulator had concerns around the way in which CFM had been operating other CIS. There had been section 166 reviews into CFM's systems and controls arising out of its role as an Authorised Fund Manager in April 2009 (it was responsible for 300 - 400 funds) and also in August 2009 in relation to the Arch Cru Fund specifically<sup>99</sup>.
- (f) There were subsequent whistleblowing complaints, in October and November 2010, relating to BGC and including allegations that the Fund was in difficulties, as well as allegations regarding BGC's solvency and the promotion of UCIS products to retail investors. It is unclear whether the allegations regarding the Fund being in difficulties were properly resolved and, if so, how.
- (g) A conflict of interest had been identified in Mike Davies' functions in September 2009, due to the fact that he was acting as Chairman of CAM and compliance officer at Tiuta. The Regulator was told at the time that this was a temporary arrangement, but it appears to have remained the position in 2011. The visiting team from Supervision accepted verbal assurances from Steven Nicholas at Tiuta as to what was on the face of it a clear conflict of interest of a senior person in both entities. If this had been revisited in 2011, it might have led to questions concerning the links between Mike Davies and the Tiuta Board, and confirmation that Mr Walter (whom the Regulator had concerns about, arising out of his prior involvement with land banking schemes) was still involved at

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<sup>98</sup> Later, in August 2011, the Regulator did require Tiuta to instruct CAM to change its marketing materials so that they no longer described the Fund as "Low Risk" or "Guaranteed".

<sup>99</sup> As noted earlier in this Report, these Skilled Person reviews related to CFM's systems and controls as regards its role as the Authorised Fund Manager for a regulated investment scheme. According to the Regulator's records, these reviews did not assess CFM's systems and controls as regards its role as Operator for unregulated funds such as the Fund, and I have seen no suggestion that such a review was conducted.

CAM. The Insolvency Service, after investigating his conduct, subsequently disqualified Mr Davies from being a director for seven years<sup>100</sup>.

170. The red flags were each dealt with at the time in accordance with the knowledge various individuals at the Regulator had. In and of themselves, certain red flags may not have resulted in any markedly different regulatory action at the time, but they at the very least make manifest the issues around information retention, recording, and sharing. What is of primary concern is that these issues formed part of the important context and background for Mr Patellis' allegations, but do not appear to have been referred to or reviewed following his meeting with the Regulator in March 2011.
171. There were issues more generally at the Regulator with the sharing of information and "joining the dots". For example, in December 2011, Enforcement still seem to have been unaware that BGC was the operator of the Fund. Enforcement was also not aware of clear conflicts of interest in senior management at the firms: most notably, Mike Davies held a senior position at both CAM (Chairman) and Tiuta (Compliance Officer). Nor does it seem that Enforcement were aware that there had been authorisation issues concerning Tiuta, of the UBD history regarding CAM, or that there had been intelligence from Jersey regarding Nigel Walter's role at CAM, or of the concerns about CFM's involvement in Arch Cru (see paragraph 59 above). Although the Acting Head of MGI was informed of the nature of the information that had been provided by Mr Patellis, it does not appear to have been brought to their attention promptly, and it is fair to say that, despite the seriousness of Mr Patellis' allegations, discussions between MGI and Enforcement regarding a potential referral to Enforcement did not begin in earnest until months later, a first draft of the ERD being circulated to Enforcement for discussion in late July 2011. The Head of MGI was also not aware that Mr Patellis had brought supporting documents to his meeting with the Regulator.
172. One other important consequence of the lack of coordination was that the Regulator was not able to deploy different areas of expertise as effectively as it might have. For example, although there were individuals within WSF who had the expertise to deal with complex fund structures, they did not become actively involved, in a decisive way, until late in 2011. When they did become actively involved, that in turn led to more effective engagement with BGC, referred to above at paragraph 111 et seq. There were also financial crime experts at the Regulator at the relevant time, who may have been able to provide an insight into the issues at Tiuta and the Fund. As I have mentioned, there was a notable improvement in the way the investigation progressed once the CET became involved, with their greater focus on working across teams.

**TOR 1(b) The consideration and effective management of potential conflicts of interest within the FSA**

173. Allegations have been made that the Regulator's dealings with the Fund and Tiuta were compromised due to the fact that a Regulator employee within Supervision who dealt with Tiuta had previously worked at the same firm as Mike Davies. Having considered the material available, I have seen no evidence that the decisions made by the Regulator with regard to Tiuta and/or the Fund were in any way influenced by the employee

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<sup>100</sup> UK Government Press Release: "*Connaught Asset Management directors banned for 16 years*", dated 19 December 2014: <https://www.gov.uk/government/news/connaught-asset-management-directors-banned-for-16-years>

having previously worked at the same firm as Mike Davies. The employee properly raised the matter with senior staff on a timely basis and the Regulator considered and managed any potential conflict of interest or appearance of a conflict of interest in a timely and appropriate manner.

174. To put matters in their proper context, the employee, in Supervision, had worked in the same firm as Mike Davies for around eight months between March 2007 and November 2007. Thereafter, the employee joined the Regulator's MGI department and encountered Mike Davies again by chance at the Mortgage Expo in November 2008, having been asked to attend on behalf of the Regulator. Whilst attending the Expo, Mike Davies became aware that the employee was working at the Regulator and came to speak to them at the Regulator's stand for approximately 3-4 minutes.
175. Some years later, on 24 March 2011, the employee on behalf of the Regulator wrote to Tiuta to ask them to cease regulated lending, following which the employee received a telephone call from Mike Davies on 28 March 2011 explaining that Tiuta was happy to undertake to cease regulated lending. Mike Davies advised that he had been acting as a compliance consultant to Tiuta but was also the Chairman of CAM and was intending to join Tiuta for its meeting at the Regulator. Mike Davies followed up by email providing details of travel plans and possible dates for that meeting.
176. The phone call on 28 March 2011 was unsolicited and the employee therefore properly informed their manager in an email on 29 March 2011 that they had previously worked with Mr Davies and stated the details of the call. A decision was made not to include Mr Davies in the meeting with Tiuta and thereafter the employee had very limited contact with Mr Davies. On the basis of the documents considered in this Review, the last contact from the employee to Mr Davies was an email on 4 May 2011, and the last recorded contact from Mr Davies to the employee was on 16 May 2011. There is no evidence that these communications were anything other than professional and appropriate.
177. Following the suspension of the Fund in March 2012, it became public knowledge that the employee had previously worked with Mr Davies and there was a suggestion that the employee's involvement in supervising Tiuta was inappropriate. Unfortunately, the allegations escalated and became personal in nature, including the employee being named in a number of blog posts on the CAG website in August, November, and December 2012. It was, in my view, wrongly suggested that the employee had been influenced by Mike Davies during the course of their involvement with the supervision of Tiuta. There was also an article in Private Eye referring to the employee in November 2012 and another in April 2013. This attention may have arisen because Mike Davies, in a meeting with investors on 12 August 2012, had allegedly "*boasted*" about "*his*" contact at the Regulator, naming the employee<sup>101</sup>. Whatever impression Mike Davies may have given investors, there is no evidence that he, Tiuta, or CAM, received any favourable treatment as a result of the employee's conduct or involvement. To the contrary, from the material I have examined and the interviews I have conducted, it is clear to me that the employee in question behaved professionally and properly at all times and sought to investigate and escalate concerns about Tiuta and the Fund. On the

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<sup>101</sup> Letter from Connaught Action Group dated 23 November 2012 to solicitors acting for the Regulator and the employee in question (see paragraph 179 below).

basis of what I have seen, the allegations that the employee's judgment and independence were compromised by their previously having worked at the same firm as Mr Davies, for a period of eight months some three years prior, have no basis.

178. An internal meeting was held within the Regulator regarding these allegations of conflict of interest on 22 October 2012, and it was concluded that there was no conflict of interest. I am satisfied that this was the correct view. Understandably, the public and widely disseminated allegations had a negative impact on the employee. The Regulator therefore decided that the employee should be allowed to step down from the case, which they did. Having reviewed the documentation, I have no reason to criticise the Regulator's conclusions, and it seems to me that the decision to allow the employee to step down from the case was a responsible one in the circumstances.
179. The Regulator instructed a firm of solicitors to write letters to the CAG website requesting that the blog posts be taken down. In the particular circumstances, this was in my view an appropriate action for the Regulator to take in order to protect an employee in a matter directly linked to the employee's carrying out duties in the course of their employment.
180. Similarly, and for completeness, there was another employee within the MGI department who, also in March 2011, disclosed to the Regulator that they had had a previous working relationship with Bill Warren, who had been appointed as Tiuta's Compliance Officer earlier that month. The employee went on in their email to say that:
- "Bill has kept in touch over compliance matters in general, and I have met him a few times as CO of firms during visits, as compliance consultant for others and at trade shows.*
- There has never been a problem when talking with Bill as he never tries to cross the professional boundary or ask for comments off the record. He has, in fact, provided intelligence information against firms and brought other issues to our attention (such as suspected unauthorised business) and has kept in touch with ... the [Regulator's] sector team.*
- I am prepared to stay with the [Tiuta] issue if needed, or will back off now if you consider it prudent".*
181. The mere fact of a previous employment relationship of this kind does not in my view give rise to a formal conflict of interest (i.e. a situation where the employee concerned owed conflicting duties, or had conflicting interests, due to their role at the Regulator and their previous relationship). In addition, the Independent Reviewer's Team has reviewed relevant correspondence from or to the member of staff in question, including correspondence with Mr Warren. None of those documents suggests that the member of staff conducted themselves in any way that was inappropriate due to their previous relationship with Mr Warren. Although those seem to me to be the key points, I would also note that the member of staff was not the individual with primary or "assigned" responsibility for, and had relatively limited involvement in, the supervision of Tiuta. I am conscious that the Regulator may need to employ people who have previously worked in the financial services industry, and it is almost inevitable that sometimes those employees will have historical relationships with other individuals within the regulated firms they deal with. In this case, the member of staff disclosed their prior

relationship with Mr Warren proactively and promptly, and I have not seen any evidence to suggest that it affected their behaviour, or the behaviour of the Regulator, in an inappropriate way.

**TOR 1(c) The approach to whistleblowing, including interactions with whistleblowers, the action taken in response and the timing of that action.**

182. This section deals with the treatment of the key whistleblower in this case – that is, Mr Patellis – rather than what the Regulator should have done with evidence provided by Mr Patellis, which is set out in under TOR 1(a) and (d) above. There had also been other whistleblowing complaints connected to BGC alleging financial difficulties at the Fund, in late 2010. The details of what those allegations were and how they were dealt with are now unclear. I am therefore unable to make any findings with regard to how they were managed, other than observe that there is a possibility that it may have been another missed opportunity to address the problems that later emerged, and that the lack of comprehensive records is reflective of a problem at the time regarding data collation that I refer to at paragraph 165 above.

183. In 2011 the Regulator's guidance on whistleblowers was fairly rudimentary. The applicable guidelines consisted of five pages: "*Guidelines for dealing with Whistleblowing Calls under the Public Interest Disclosures Act 1998 ("PIDA")*". The guidelines advised that whistleblowers should contact the Regulator's whistleblowing desk if their own company did not have appropriate procedures or they had concerns that they would be non-responsive. The guidelines stated that the Regulator expected whistleblowers to contact them in writing and that interviews would be rarely conducted. If an interview did take place it would be attended by a minimum of two Regulator staff. The guidelines required an "initial assessment" of any information from whistleblowers, at which point:

*"Having taken a call or received a written communication from a whistleblower, the FSA Whistleblower should decide whether the information received is likely to fall within the remit of PIDA provisions, and, if so, it should be treated as such in accordance with PIDA guidelines<sup>102</sup>. The FSA Whistleblower will also consider whether the FSA is the correct appropriate Prescribed Body, or whether there may be another agency which may have an interest in the information, whether or not that other agency is also a Prescribed Body. If another agency is more appropriate than the FSA Whistleblower could arrange either for the whistleblower to contact that agency direct or for the information to be passed on to that other body by the FSA. The FSA*

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<sup>102</sup> PIDA is the Public Interest Disclosure Act 1998. Treating a person as a whistleblower under PIDA affords them certain protections. If a person was not deemed to fall within PIDA then "*If it becomes clear after limited investigation that the information from the whistleblower is not covered by the provisions of PIDA, then the information received should be passed to the relevant areas within the FSA, or to any other appropriate agency. The whistleblower should be informed, and the fact of transmission should be recorded – but there is no further duty on the FSA's Whistleblower to monitor its future progress*". In June 2013 the FSA changed its guidance on whistleblowing to take a wider approach to that defined under PIDA: "*The FCA has decided to take a wider approach to whistleblowing than that defined under PIDA. Information about wrongdoing within regulated firms is encouraged to be reported irrespective of whether the person making the disclosure works for a regulated firm. This approach ensures that all individuals and firms are provided with a confidential channel to report concerns about the financial services sector. The resulting information provides the FCA with the ability to proactively intervene to protect consumers and meet its regulatory objectives*".

*Whistleblower will make their best efforts to obtain the consent of the whistleblower before disclosing the information itself, although ultimately the decision on this would be at the discretion of the FSA, whether or not the whistleblower consents".*

184. The documents provided by a whistleblower should then be assessed and passed on to the relevant Regulator department and consideration given to any urgent external or internal referrals. With regard to contact with whistleblowers, the guidelines advised that:

*"Continuing Contact with a Whistleblower*

*In every case, there should be an internal agreement within the FSA as to the continuing contact person for the whistleblower. In certain cases, it may be appropriate for the purposes of an investigation for a supervision or enforcement officer to be that contact. It is the responsibility of the contact person to notify the whistleblower to that effect.*

*Feedback to a Whistleblower*

*The FSA will not normally disclose whether it is or is not investigating a particular matter. In many cases, statutory restrictions on the disclosure of information obtained by the FSA in the course of exercising its functions are likely to prevent such disclosure. The FSA will not disclose confidential information without lawful authority".*

185. The guidelines envisaged whistleblowers coming via the whistleblowing desk rather than direct to a particular division within the Regulator. In terms of documents provided by whistleblowers, the guidelines were somewhat vague:

*"In no circumstances should the FSA's Whistleblower Desk seek to encourage the whistleblower to attempt lawfully or unlawfully to proactively obtain or develop any additional information, or personally undertake any action or encourage any third party to undertake any action on their behalf, which may place them in any peril or danger or to encourage them to acquire unlawfully any documentation not otherwise available to them".*

186. An FSA review of FSA whistleblowing processes took place in September 2009. It concluded that the whistleblowing procedure was working well, and that:

*"We should avoid using a prescriptive policy to deal with whistleblowers; instead the management should continue to encourage the use of a flexible case-by-case approach. This is particularly important in acknowledging correspondence from whistleblowers and in providing feedback. The management should resist senior management pressure to conform to FSA service provisions of acknowledging all correspondence or in providing feedback to each whistleblower".*

187. The guidelines were updated in 2013 in order to provide greater clarity as to the policy to be followed in the event of whistleblowing, including more detailed systems for sharing information provided by whistleblowers and provision for feedback and

"aftercare" for whistleblowers. I am aware that further work has been done to improve Whistleblowing procedures after the end of the Review period<sup>103</sup>.

#### Application to CAM and Tiuta

188. Mr Patellis, as Chief Executive of Tiuta, did not contact the Regulator as a whistleblower per se. He did not come via the whistleblowing desk, but instead contacted the FCC at the Regulator to register the concerns that led to his first resignation in January 2011. Following his re-appointment at the end of January 2011 his main contact was MGI, with whom he was in regular contact as that department supervised Tiuta's regulated mortgages activity. The details of his contact with the Regulator are set out at paragraphs 72 - 83 above. In summary, Mr Patellis contacted the Regulator on 18 January 2011 and following formal correspondence attended a meeting on 16 March 2011. Prior to the meeting on 7 March 2011, Mr Patellis had e-mailed the Regulator to confirm the meeting in mid-March 2011 and to request clarity as to what documents he should bring with him to the meeting. On 11 March 2011, Mr Patellis asked if he would be required to come back to speak to the Regulator after they had had an opportunity to meet with Tiuta. He was informed that at present the situation was unclear, but it was more likely that future contact after the March meeting would be via conference calls and email.

189. Mr Patellis brought a substantial volume of documents with him to the meeting on 16 March 2011. The Regulator's note of the meeting states:

*"GP agreed to provide us with copy documents if we can identify the information we require. We replied that we could not be specific, as we don't know what documents and information he is holding. He was advised to review the documents and provide us with copies of all information that he considers the FSA should be made aware of in the interests of our regulatory duty".*

190. The Regulator told Mr Patellis to check with his wife and his lawyer before deciding whether to hand the documents to the Regulator. He did not understand why he should consult his wife, or why the Regulator thought that he should, and he had already consulted with his lawyer. On 18 March 2011, the Regulator emailed Mr Patellis to thank him for attending the meeting, and said that:

*"The FSA would be pleased to receive any documents, papers, financial statements etc. that you believe relate to information that we should be made aware of and that would assist us in our regulatory supervision. We would be obliged to receive such information by no later than 30th April 2011".*

191. Mr Patellis replied on the 18 March 2011 explaining the difficulties that he would have sending documents due to having no office facilities. However, he sent a lengthy letter

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<sup>103</sup> In December 2014 the Regulator published a whistleblowing e-learning module, available to all staff. In February 2015 the FCA published its approach to handling whistle blowers. In July 2015 the Regulator introduced the Specialist Intelligence Techniques Team responsible for debriefing whistleblowers requiring face to face meetings. A case management system for whistleblowing cases was in effect from May 2016. The relevant guidelines were further updated in January 2020 to provide greater detail and guidance particularly with regard to supervision dealing with whistleblowers.

on 24 March 2011 accompanied by 26 attachments via post, the details of which are summarised at paragraph 81 above.

192. Following the meeting on 16 March 2011, Mr Patellis sending the documents on 24 March 2011 and a brief email from the Regulator on 2 June 2011, there would be no further correspondence between the Regulator and Mr Patellis until November 2015, when he made a complaint to the Regulator regarding the Regulator's handling of both him as a whistleblower and the information he provided regarding the issues at Tiuta.
193. During this interim period, Tiuta and CAM both put a number of press releases and reports into the public domain<sup>104</sup> implying in effect that Mr Patellis had left Tiuta because he was responsible for the financial issues at Tiuta. Emails from Mr Walter to IFAs who had contacted CAM regarding concerns following the resignation of Mr Patellis in February 2011 (and four further staff in April 2011) also sought to place the blame on Mr Patellis. Further, a letter from Tiuta to the Regulator on 23 May 2011 painted a picture of Mr Patellis' departure that contradicted the information provided by Mr Patellis to the Regulator and which described his behaviour as (among other things) "erratic". Mr Patellis was under considerable stress at the time due to the information that was being disseminated by Tiuta and CAM regarding the reasons for his departure. Mr Patellis felt at the time that the Regulator could have taken steps to correct information in the public domain.
194. In the Frequently Asked Questions (FAQs) placed on the Regulator's website in March 2015 in relation to whether the Regulator had contacted the police about the allegations of fraud concerning Tiuta and CAM, there was the following response:  
  
*"The FSA is not aware whether Mr Patellis went to the Police directly at the time. The FSA did not do anything to prevent him from doing so".*
195. The second sentence seems to suggest that Mr Patellis might have taken the initiative and reported his concerns to the police. He did not do so as he was under the reasonable impression that the Regulator would do so. Mr Patellis feels that the Regulator should not have been attempting to shift responsibility for taking his concerns to other appropriate regulators or law enforcement agencies back to him. I can understand why Mr Patellis feels this way.
196. With regard to how the Regulator responded to the allegations and evidence provided by Mr Patellis, that is primarily dealt with under the section on TOR 1(a) above.
197. As to the specific issue of how Mr Patellis himself was handled by the Regulator as a whistleblower, there were a number of deficiencies in the Regulator's approach. First, the policy in existence at the time dealt only with people approaching the whistleblowing desk. There was no policy dealing with Approved Persons who, in the course of making a Principle 11 disclosure, would in effect be acting as whistleblowers. I have seen no evidence that MGI sought the advice of the whistleblowing desk in relation to Mr Patellis. As a result, matters such as document collection and ongoing contact with Mr Patellis were dealt with in an unstructured, ad hoc manner. Mr Patellis

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<sup>104</sup> See Tiuta Audited Accounts published in September 2011: <https://beta.companieshouse.gov.uk/company/04974070/filing-history/MzA2MTg4NTg1MGFkaXF6a2N4/document?format=pdf&download=0>

received confusing messages as to whether and when he should provide documents and what further contact there would be following his meeting in March 2011. Consequently, he felt isolated and unsupported in his allegations and as regards what would be done about the information that he provided.

198. I do not suggest that it would have been appropriate for the Regulator to counter publicly the claims made by Tiuta and CAM regarding Mr Patellis' departure while in the course of the ongoing dealings with Tiuta, or to provide Mr Patellis with detailed updates. However, what the Regulator could have done is kept in contact with Mr Patellis, even if that contact simply amounted to enquiries as to his wellbeing and to give him general updates. Mr Patellis was justified in feeling aggrieved that, having taken the highly unusual (and, on some views, courageous) step as a CEO to report his own company to the Regulator and provide extensive confidential material which showed a plausible evidential basis for serious financial irregularities to be investigated, he then heard nothing.
199. Mr Patellis, as set out at paragraphs 192, 193 and 195 above, felt that the information he provided had not been followed up, that Tiuta had disseminated untrue information about him in the press that was not corrected and that he was not supported by the Regulator. The Regulator compounded Mr Patellis' perception that he had been unfairly treated due to the phrasing of its responses to the March 2015 FAQs, which might reasonably have been understood to imply that Mr Patellis himself could or should have gone to the police to report his concerns about Tiuta. It is clear from the March 2011 meeting note that Mr Patellis was not advised by the Regulator that he could or should go to the police. It was mildly disingenuous in the circumstances to suggest that the Regulator did not prevent him from doing so. Having informed the Regulator of serious issues regarding a regulated entity's operations and precarious financial position, it was reasonable for Mr Patellis to assume that the Regulator would then take matters forward, including if it thought appropriate to notify other relevant regulators and law enforcement agencies, particularly when he had made it clear to the Regulator that he was willing to help in any way possible. It was therefore reasonable for Mr Patellis to be surprised and concerned to read in 2015 that the Regulator was suggesting that he could have gone to the police of his own volition.
200. In all the circumstances, whilst the Regulator interacted with Mr Patellis in a timely manner following his initial contact in January 2011, after the meeting in March 2011 appropriate interaction and follow up was wholly lacking. In May 2016 Mr Patellis made a complaint to the Complaints Commissioner<sup>105</sup>, following a complaint made to the Regulator in November 2015 that Mr Patellis felt he had not been properly treated. In December 2016, the Complaints Commissioner concluded (among other things) that Mr Patellis had not been handled correctly as a whistleblower and the Regulator should provide a public apology<sup>106</sup>. The Regulator issued an apology but did not publish it and the apology was potentially ambiguous. Following discussion, the Regulator clarified

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<sup>105</sup> Complaints Commissioner's response to Mr. Patellis' "Complaint against the Financial Conduct Authority" – dated 12 October 2016: <http://frccommissioner.org.uk/wp-content/uploads/FCA00114-Patellis-George-Stage-2-Final-Decision-24-11-16.pdf>

<sup>106</sup> Complaints Commissioner's response to Mr. Patellis' "Complaint against the Financial Conduct Authority" – dated 12 October 2016: <http://frccommissioner.org.uk/wp-content/uploads/FCA00114-Patellis-George-Stage-2-Final-Decision-24-11-16.pdf>;

that the apology was not qualified, and confirmed that it was content for Mr Patellis to publish it.

201. Mr Patellis was not the only whistleblower to approach the Regulator during the Review Period. In October 2010, three whistleblowers with information related to BGC were recorded as having contacted the Regulator to register concerns about UCISs being promoted to retail investors and also financial difficulties at BGC in relation to CAM. It appears that the concerns raised were discussed with BGC in January 2011 during a visit to BGC and that these appear to have been addressed at the time. The Regulator's records of this visit and these whistleblower reports, however, could have been clearer as to precisely where, when, how, and (if known) by whom the information was provided to the Regulator. The documents requested and reviewed as part of this Review do not appear to record the above details, and nor do they include, for example, the wording of the actual reports provided by the whistleblower(s); rather, they paraphrased the matters reported in summary form. I understand from the FCA that it was, and is, Regulator policy to paraphrase whistleblowing reports into an intelligence log, for record-keeping purposes and *"to protect the confidentiality / anonymity of those reporting to us whilst retaining both the essence and details of the allegation safely"*. Whilst these aims appear sensible and worthwhile, it is of course important that critical aspects of a whistleblowing file are not lost during this process, as appears to have happened here.
202. Regulatory supervision of Tiuta, which was necessarily light-touch and reactive, given the large number of small firms within the Regulator's supervisory jurisdiction, was not focused on the investors in the Fund who provided Tiuta's capital. It was focused at a high level on the issue of whether the customers of Tiuta (the borrowers) were treated fairly, and on the capital adequacy of the lender (Tiuta), as demonstrated by the visits from Supervision in August 2009 and February 2010. As such, Supervision was in part dependent upon whistleblowers or stakeholders like Mr Patellis bringing issues to its attention and such information needed to be taken seriously. It was therefore particularly unfortunate that Mr Patellis' allegations were not followed up in the circumstances.
203. As set out at paragraph 187 above, the current whistleblowing policy is far more comprehensive, and places a greater emphasis on logging information and the importance of a clear strategy in handling both whistleblowers and any information they may provide. Therefore, one expects that in a similar situation the mistakes made in relation to Mr Patellis will not be repeated. However, improving the treatment of whistleblowers is an ongoing process subject to continued evaluation, and the Regulator should ensure that policies are properly implemented in practice.

**TOR 1(e) The consideration of and approach to sharing intelligence with other regulators and law enforcement agencies; and**

**TOR 1(f) The consideration of and approach to co-ordinating with other organisations including, the Financial Ombudsman Service and the Financial Services Compensation Scheme**

204. In this section I deal with the Regulator's interaction with the City of London Police ("COLP"), the Serious Fraud Office ("SFO"), the Financial Services Compensation Scheme ("FSCS"), the Financial Ombudsman Service ("FOS"), the Office of Fair

Trading ("OFT"), the GFSC, and the JFSC. While COLP/SFO and the Insolvency Service could have been notified earlier, and communication with GFSC was confused due to a lack of clarity regarding GFSC's regulatory responsibilities with regard to the Fund and CAM, the interaction with regulators, law enforcement agencies, the FSCS and FOS was generally appropriate.

#### City of London Police and the Insolvency Service

205. On 21 August 2012 a member of the UBD team notified the Insolvency Service, and a number of email addresses understood by the Regulator to be linked to COLP, of certain allegations that had been set out in a letter received by the Regulator on 1 August 2012. The email sent by UBD stated that the Regulator was not a fraud prosecutor, and that UBD would not be getting involved, as the matter was not within UBD's remit:

*"The allegations are more properly matters for FSA supervisors of the named authorised firms in respect of their conduct, and for the police in respect of the alleged fraud. We are also disclosing this to the Insolvency Service for their consideration over any company law matters.*

*I am aware that the FSA issued a Consumer Warning about the Connaught Income Funds on the FSA website at <http://www.fsa.gov.uk/consumerinformation/firmnews/2012/connaught.shtml>. This appears to have been regularly updated (latest update in July 2012)".*

206. This was the first date on which COLP was informed of the allegations of fraud regarding Tiuta from the Regulator. However, neither Supervision nor Enforcement appear to have been aware that COLP had been informed by UBD of the issues regarding Tiuta. Neither Enforcement nor Supervision were included on the email above. COLP, Supervision and Enforcement only started corresponding in October 2012. COLP had in fact been made aware of allegations regarding Tiuta via an earlier letter from the same sender in July 2012. On 20 December 2012 the Regulator was informed that having "scoped" the allegations COLP "*didn't feel it should fit with them and it has been referred to the Met*". On 25 February 2013, following a meeting between the Regulator, the Insolvency Service and the Police, the CET sent a briefing document to the Met outlining the Regulator's key findings regarding CAM and Tiuta. The CET also provided information to Surrey Police and Avon and Somerset Police in response to requests in July and December 2013. It appears from the documentation that in April 2014 Metropolitan Police decided not to take any further action regarding the allegations of fraud, noting in the correspondence that they would not consider further involvement without "*a report detailing potential criminality*".
207. A criticism I have considered in the course of the Review regarding the Regulator's information sharing with the police is that the Regulator should have contacted police earlier than August 2012. The Regulator has stated that it did not do so because it did not have sufficient evidence of fraud to pass it straight on to the police. In my view, the Regulator could have contacted the police earlier, and should have considered doing so in mid-2011 after George Patellis first gave his account and clearly raised allegations of fraud. The Regulator (as explained at paragraph 199 above) does not appear to have given appropriate credence or weight to the seriousness of Mr Patellis' allegations. The Regulator also could have contacted the Insolvency Service earlier than August 2012, and it is unclear why it did not do so.

208. Another criticism I have considered is that the Regulator "misbriefed" the Connaught All-Party Parliamentary Group ("APPG") by informing them that the Regulator had contacted the police as soon as they became aware of wrongdoing. However, the minutes from the APPG of 15 July 2014 indicate that the Regulator stated that it had contacted law enforcement agencies in "late 2012", which accords with the documentation. That is also the position adopted by the Regulator in letters to MPs and in the FAQs it issued; namely, that the Regulator did not contact the police or other authorities when Mr Patellis first came to the Regulator, on the grounds that the Regulator decided to deal with the matter via Supervision. I have not seen any evidence that the Regulator misbriefed the APPG or any other bodies as to the contact that the Regulator had with law enforcement agencies and when that contact occurred.

#### The Serious Fraud Office

209. It does not appear from the documentation I have seen that the Regulator contacted the SFO. The SFO was informed of allegations regarding Tiuta by the liquidators in October 2012. The SFO requested further information from the Regulator on 22 April 2013, having closed the file pending further evidence:

- *"The SFO received a referral on the case in October 2012 from Duff & Phelps. Allegations were made that individuals at Tiuta made 'bad loans' to close associates and there may have been theft by employees of the firm. The figure quoted was £15m.*
- *At the time, the SFO say that D&P did not provide evidence to back up the allegation and so SFO closed their evaluation in the hope that D&P would provide them with any findings. They have not yet received anything further.*
- *SFO therefore asked for any new evidence. I explained that we had been liaising with D&P, the Met Police and the Insolvency Service on the case. I informed them that we were aware of the fraud allegations and told them that we viewed D&P as best placed to assist with evidence of fraud as they are investigating the loan book.*
- *I also said that we were still considering whether or not to refer the case to Enforcement. I offered the SFO a meeting with us so we could provide a full briefing and suggested that all the relevant parties should meet at some stage to decide what to do with the case – SFO were open to this.*
- *I have provided the SFO with details of our contact at the Met so they can speak directly. SFO will let us know if they have any update after speaking to the Met and to D&P (they have Geoff Bouchier's details already)"<sup>107</sup>.*

210. An update on 27 May 2014 indicated that the SFO was not taking any further proactive steps in investigating the allegations against Tiuta:

*"In short, they were contacted two years ago by D&P suggesting there may be a fraud in relation to Connaught Fund, Tiuta Plc and Tiuta International Limited. Since then*

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<sup>107</sup> Internal Regulator email dated 22 April 2014.

*they have had two meetings (one in Autumn 2013 and one a few weeks ago). These meetings were also attended by the Met police fraud squad, who are lead.*

*To date, there have been no specific allegations of fraud and D&P have advised that they are focusing on civil recovery and will not be completing a report to the SFO in the near future (or at all). D&P have provided a paragraph to the SFO (see below, with an email chain from Met police), which sets out the position"<sup>108</sup>.*

211. The Regulator's interactions with the SFO were generally appropriate. It provided information when requested to do so, suggested a meeting, and provided the SFO with contact details for the relevant officer at the Metropolitan Police.

#### The Financial Services Compensation Scheme and the Financial Ombudsman Service

212. The Regulator's sharing of information with the FSCS and FOS was appropriate and timely. The Regulator's team kept the FSCS and FOS informed throughout, however each body had a distinct remit and approach. The Regulator shared legal advice with the FSCS and FOS, but it was the responsibility of those bodies to come to their own legal assessment. There is no evidence I have seen of collusion or improper influence between the Regulator, the FSCS, and/or FOS.
213. The FOS and FSCS operate to deal with different types of complainants and make decisions as to whether to award compensation under different rules. The FOS settles disputes between consumers and financial services providers. It decides claims on the basis of what it believes is fair and reasonable in the particular circumstances of each case. To be able to claim compensation from the FSCS, an individual must be eligible under the FSCS compensation rules, which are today set by the FCA and PRA.
214. The MGI department contacted the FSCS on 23 May 2011 to alert them of potential issues regarding Tiuta. MGI continued to provide the FSCS with updates as to progress of the investigation throughout 2011 and 2012. On 5 December 2012, there was a meeting between the Regulator and the FSCS, and the Regulator informed the FSCS of the current status of the investigations and the investigations by the liquidators. By that point, the FSCS had received no complaints by investors and therefore had no cause to act. Correspondence between the FSCS and the Regulator continued throughout 2013 - 2015, in particular because the FSCS requested updates regarding the Regulator's views on IFA liability, as that would affect the approach the FSCS took to claims involving IFAs. In 2014, the FSCS confirmed that it had taken a decision in 2014 to reject all

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<sup>108</sup> Internal Regulator email dated 27 May 2014. The full draft text of the paragraph provided by D&P to the SFO was as follows:

*"The joint liquidators continue to investigate the affairs of these entities with the primary aim of seeking to achieve recoveries for creditors (who are essentially the investors in the Fund). They have developed and are implementing a strategy focused on pursuing recoveries through the civil route which they hope will be fruitful, and which involves moving in certain directions before others, which means that it may be some time before (a) investigations are complete and (b) the results are known. The liquidators and KWM are not in a position to give a view on whether the information and evidence they have reviewed to date gives rise to grounds for a criminal investigation and/or any evidence of any criminal activity. In order to do so, specialist criminal advice would need to be taken which would involve instructing specialist criminal lawyers and compiling a dossier at significant cost. Given the liquidators' primary strategy on recoveries through the civil route (which is considered to be more effective and in the best interests of creditors/investors), undertaking an evaluation on a potential criminal investigation is not regarded as a priority for the liquidators at present".*

claims made against IFAs in default in relation to the Fund. This was on the basis that IFAs could not be held liable for the losses, which resulted from the misappropriation of money (i.e. misconduct on the part of Tiuta and the Fund).

215. The FOS and Regulator were in correspondence throughout 2014 and 2015 with regard to claims that had been made by investors against IFAs. In a meeting between the Regulators and the FOS on 18 December 2014, the FOS clarified what effect the Regulator's actions had upon the FOS' approach, which was that the FOS was focusing on the advice given to investors and the consideration of suitability and was not minded to wait for the conclusion of the Regulator's investigations before resolving the cases brought to its attention.
216. There have been allegations that there was collusion between the Regulator and the FOS to shift the blame onto IFAs and require them to pay compensation when that was not justified. On the basis of the documentation I have seen and from the interviews I have conducted, there is no evidence to suggest that the Regulator sought to influence the FOS position. I am satisfied that the decisions made by the FOS were properly independent of the Regulator.

#### The Office of Fair Trading

217. On 6 March 2012 MGI contacted the OFT in order to share concerns regarding the risks posed to retail investors through UCIS funding in the bridging industry and to understand whether OFT had identified any similar issues. This was followed up with a letter from the Regulator to the OFT on 13 March 2012. At that time, the OFT was the regulator for consumer credit. The aim of the correspondence was to share knowledge and understand whether the OFT had identified bridging firms as high risk, and share information related to bridging firms regulated by the Regulator and the OFT. In my view the information shared was appropriate.

#### The Jersey and Guernsey regulators

218. The Regulator's sharing of information with the GFSC and the JFSC was also generally appropriate. It was, however, slow, which may have partly been a result of confusion (on the part of the Regulator and the GFSC) in relation to the regulatory responsibilities of the GFSC, and which entity or entities involved in the Fund it regulated, set out at paragraphs 93 and 94 above. The Regulator contacted the GFSC in May 2011 to alert it to issues regarding the Fund and Tiuta. In May 2011, the Regulator sent an email to the GFSC setting out the concerns regarding Tiuta and Connaught and the requested action:

*"We appreciate that you are contacting [the trustee and administrator of the Series 2 fund] however there are a couple of questions we would like help on:*

- *Do you have any documentation on the number 1 fund as this is no longer on the firms website?*
- *Do you have any details of holders within the number 2 fund?*
- *Given our concerns this would, we feel, be a notifiable event to the Guernsey Stock exchange - Are you aware of any such notification?*

*As the prime objective from our viewpoint is to stop further funds being invested dependant on what comes from [the operator of the Series 2 fund] what options are available to us" (emphasis added).*

219. The GFSC asked that the request from the Regulator came via formal channels i.e. a formal letter requesting assistance regarding the Series 2 fund. The letter that was sent on 25 May 2011 referred not only to the GFSC having responsibility for the Series 2 fund, but also potentially the (Series 1) Fund, because the (Series 1) Fund was erroneously described in the letter as being administered by CAM Guernsey. The request was delayed because the Guernsey authorities required that it be redrafted in order to include various requirements under Guernsey law to allow the GFSC to assist, and later in July 2012 the GFSC requested further information from the Regulator in order to process the request. Correspondence continued throughout 2011 and 2012 primarily regarding the Series 2 fund (but with occasional confusing references to the (Series 1) Fund as well), which was suspended on 26 April 2012.
220. From the correspondence it is clear that the Regulator took the initiative in alerting the GFSC to the problems regarding Tiuta and CAM. The Regulator shared information when requested with the GFSC and although the requests for assistance were at times confusing and implied that GFSC had responsibility for the Fund as well as CAM Guernsey, the action the Regulator actually requested from GFSC was in relation to the Series 2 fund, and it regularly chased the GFSC for updates regarding action taken with regard to the Series 2 fund. Communications with the GFSC were slow and at times confused due to the requirements of protocol in requesting assistance from a non-UK regulator, and confusion within the Regulator as to what the GFSC's responsibilities were and what the Regulator expected them to do.
221. The Regulator's focus on requesting the GFSC to take action was not an effective avenue of leverage in order to protect investors in the Fund. The Regulator's perception of the actions that the GFSC could take were confused, with some individuals being clear that GFSC could only act in relation to Series 2, but others expressing frustration that GFSC was not doing more in relation to CAM and both the (Series 1) Fund and the Series 2 fund as they were GFSC's regulatory responsibility, which was incorrect. The confusion regarding the role of the GFSC was an example of the lack of clear strategy in relation to the Fund and lack of communication between departments. Efforts would have been better expended by requesting that the operator (BGC) contact the Fund.
222. With regard to the JFSC, the documentation shows that on 9 February 2009 the JFSC wrote to Nigel Walter regarding CAM, outlining certain concerns relating to his previous involvement in UKLI. The Regulator's documents indicate that Mr Walter then agreed to resign and sell his shares in order to avoid potential concerns from the JFSC (or any other regulator). In January 2009, the JFSC had sent information to the UBD team at the Regulator regarding their concerns about Nigel Walter. It was this alert that led to the investigation by UBD set out at paragraph 58 above. There does not appear to have been any further contact between the Regulator and the JFSC regarding any of the relevant entities or individuals after 2009.

**F. WHETHER THE FSA'S JURISDICTION AT THE TIME IMPACTED ITS ABILITY TO MEET ITS STATUTORY OBJECTIVE OF PROTECTING CONSUMERS [TOR2]**

223. The question of what and who the Regulator regulated and what the boundary or perimeter of its jurisdiction is a thread that runs through most of the regulatory interaction I have reviewed in this case. The Regulator's perception of its jurisdiction did inevitably have an impact on its ability to meet its statutory objective of protecting consumers. First, from the evidence I have seen, it is possible that a lack of clarity about the regulatory perimeter may have affected how Tiuta, CAM, CFM and/or BGC conducted themselves and approached their activity and this may have contributed to the problems that investors suffered. Second, it is clear from what I have seen that this same lack of clarity about the extent of its jurisdiction affected the way the Regulator approached matters.
224. Rather than proactively intervening to find out what the issues and problems with Tiuta and the Fund were and what might be the most appropriate solution, the Regulator stood back and adopted a monitoring role, as a result of a lack of clarity about its jurisdiction. The supervisory focus from March 2011 onwards was to try to find a solution to prevent consumer detriment. However, the Regulator repeatedly returned to their understanding that only 5% of Tiuta's business was regulated and the Fund was either unregulated or (wrongly) thought to be regulated in Guernsey. The preoccupation with the jurisdictional issues and uncertainties with the perimeter remained throughout the year. The Regulator should have explored what could be achieved through the operator, but a lack of clarity about the role of operators in relation to UCIS prevented this and otherwise prevented the Regulator from acting in a swift, decisive, effective and focussed way.
225. The concerns around the regulation of UCISs and the work the Regulator carried out illustrated again the uncertainty concerning the regulatory perimeter. Firms were operating on its edges, with parts of their business inside and other parts outside; perhaps deliberately so. Regulator staff highlighted that issues regarding the perimeter were problematic because there was confusion, even within the Regulator itself, as to its extent and which entities and activities fell within and outwith the perimeter. This was in part exemplified by the confusion about the role and involvement of the GFSC and more generally by issues regarding the Fund structure, which was a mix of regulated and unregulated entities. Tiuta, CFM, and BGC were regulated, but CAM and TIL (to whom the monies were lent by the Fund<sup>109</sup>) were not.
226. By May 2011, the Regulator had identified that the major risk for consumers was in relation to the investors in the Fund. Notwithstanding this, the regulatory focus for most of 2011 was almost exclusively on Tiuta. This is in marked contrast to the Capita Final Notice, which found significant regulatory failings on CFM's part.
227. As the Capita Final Notice illustrates, the Regulator did, in fact, have the requisite powers to protect investors because the operators of UCISs were regulated. As discussed above, for example, the Regulator could have required BGC to provide

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<sup>109</sup> and which made bridging loans to borrowers at an average rate of interest of 17% p.a., paid the operator's and asset manager's fees, and took charges over the borrowers' property. TIL also paid the Fund a rate of interest that would satisfy the Fund's obligation to make interest payments to investors of approximately 8% p.a..

further information regarding CAM at a much earlier stage in 2011 than December. That might have led it to earlier decisive action, including an investigation and the suspension of the Fund earlier in 2011.

228. Further, under section 166 FSMA, the Regulator has the power to obtain a report from a third party Skilled Person about aspects of a regulated firm's activities. For example, in January 2011 the Regulator appointed Skilled Persons to examine 11 IFAs regarding misselling practices and UCISs. However, the Regulator did not exercise this power in this case. Instead, it chose to rely on the information provided by Tiuta senior management and Tiuta's Accountants. This reliance was misplaced in the circumstances. The Accountants were instructed by Tiuta (and on a narrow basis, given that the letter of engagement had been changed in scope three times) with no specific obligations to the Regulator as regards their findings. The scope of the retainer required the Accountants to examine Tiuta's finances but did not contain a requirement to verify information provided to it by Tiuta (which was taken by them as presented), or to examine the allegations of misconduct provided by George Patellis.
229. In addition, there was a lack of a clear deadline with regard to when the Accountants would be obliged to confirm the solvency position of Tiuta (see paragraph 159 above). These factors combined meant that the information provided and the scrutiny of it was not a satisfactory substitute for that which would have been provided by appointment of a Skilled Person.

#### Duties of Operators

230. The Regulator did not use its regulatory powers with regard to the operators, primarily due to uncertainty over the responsibility and duties of operators (and how that could be effectively enforced through FSA Principles), and also because it chose to focus on promotions regarding UCIS.
231. The Regulator did not consider going to operators as a first port of call when issues arose with regard to UCIS. CAM was not regulated, but CFM and BGC were and, as operators, had responsibilities to supervise the Fund. As the Capita Final Notice illustrates, they had real and substantive regulatory obligations in relation to the Fund in the circumstances that had arisen. Therefore the Regulator might have sought to solve issues regarding a lack of jurisdiction over CAM by going through either CFM or BGC. However, a perception that the responsibilities and duties of operators were narrow so that the Regulator's powers could not be used in an effective way meant that this approach was not taken. This perception was of course later revised, as is clear from the Capita Final Notice.

#### Perception of UCIS risk

232. UCISs were a priority risk identified by the Regulator because their structure and products and nature more generally were not suitable for most retail investors, who might be attracted to them for the much higher yields that they offered.
233. A project was commenced by the Regulator in October 2009 examining UCISs within small firms. However, it concentrated on point of sale issues to stop products reaching the wrong consumers rather than the structure or nature of any of the UCIS themselves.

According to a document published in July 2010, "Unregulated Collective Investment Schemes: Project Findings":

*"In 2009 our supervision and TCF1 assessment work identified issues surrounding the sale of unregulated collective investment schemes ("UCIS") by small firms. Our main concerns included:*

- *firms' lack of awareness of regulatory requirements for UCIS;*
- *firms' lack of understanding of the UCIS market and their risks; and*
- *UCIS promoted and recommended to customers who were not eligible for this type of investment.*

*Currently, six small firms that have been promoting and recommending UCIS to their customers are being investigated by our Enforcement and Financial Crime Division.*

*In October 2009 we informed all small financial adviser firms, via the Regulatory Round-Up, that we were about to conduct a project focusing on UCIS. We stated that we would look at firms' financial promotions and advice processes for the sale of UCIS and would assess whether firms are complying with our rules and regulations and providing fair outcomes for consumers. We also said we would start our work with an online questionnaire and subsequently conduct a further review".*

234. As a result of the January 2010 paper, in January 2011 the Regulator highlighted concerns about the promotion of UCIS in its Product Intervention Discussion Paper<sup>110</sup> (the "Paper"). The Regulator recognised in that Paper that earlier effective intervention in design, governance and how products functioned would be the new regulatory approach. There had previously been large-scale episodes of consumer detriment suffered due to breaches of Regulator principles and other rules, which had not been prevented by the focus upon financial promotions, disclosure and selling practices. Notwithstanding this recognition, the Regulator chose to take action mainly on the financial promotions side of regulation in this case. I understand that the Product Intervention Discussion Paper was part of a policy discussion within the Regulator regarding the appropriate regulatory approach, and that it had only just been published when the key issues and risks in this case began to come to the Regulator's attention. However, I see no reason why the points raised in the Paper could not have informed or been considered in connection with this case or other similar cases.
235. The Regulator also noted the previous supervisory work, which assessed if small firms were complying with the statutory restrictions on the promotion of UCIS to the general public. As a result, the Regulator required 11 firms to appoint a Skilled Person to review their UCIS promotions. In January 2011, the Regulator published a fact sheet for IFAs on UCISs, their promotion and the applicable rules. It was not until 22 August 2012 that the Regulator published a consultation paper on the ban on sales of UCIS to ordinary retail investors, supplementing existing restrictions on promotion of UCIS to

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<sup>110</sup> FSA Product Intervention Paper – dated January 2011: [https://www.fca.org.uk/publication/discussion/dp11\\_01.pdf](https://www.fca.org.uk/publication/discussion/dp11_01.pdf)

such investors. The actual ban came into force on 1 January 2014, which finally restricted UCIS products from being sold to ordinary retail investors<sup>111</sup>.

236. The general regulatory approach to the risks posed by UCIS, whilst actively and seriously considered by the Regulator, was focused (in terms of action) on the financial promotions and point of sales areas. As a result activity concentrated on the selling practices of IFAs. That may have been one reason why the Regulator did not, once made aware of insolvency and financial misconduct concerns at Tiuta, subject the relevant entities themselves (Tiuta, the operators and through them CAM) to appropriate scrutiny or analyse properly the risks to investors from the operation of the business model, and the lack of proper governance at Tiuta and the Fund. Investors were put at risk not only by the advice they received, the misleading disclosures in the scheme documentation, and poor selling practices of some IFAs (as found by the FOS). The design and operation of the scheme itself, in which there were clear deficiencies and a lack of oversight and governance, also contributed to the risks. Those features permitted the misconduct at both CAM and Tiuta to take place to the detriment of investors.

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<sup>111</sup> From January 2014, the range of persons to whom UCISs could be lawfully promoted was narrowed and, in particular, could only be promoted to an ordinary retail investor (i.e. one who was neither sophisticated nor wealthy) if:

- a. the communication was a personal recommendation on a UCIS i.e. it was investment advice on the merits of investing in a UCIS;
- b. the personal recommendation was made following a specific request by the investor for advice on the merits of investing in the UCIS; and
- c. the investor had not previously received a financial promotion or other communication from the firm making the recommendation (or a person connected with the firm) which was intended to influence the client in relation to investing in the UCIS. (COBS 4.12.4R(5) – Exemption 10; Exemption 11 and article 21 of the PCIS Order).

UCISs could still be promoted to other retail investors provided they were, for example, wealthy, sophisticated, or existing participants in a UCIS. (COBS 4.12.5R(5) – Exemption 2; or Exemption 11 in combination with articles 21, 22 or 24 of the PCIS Order; COBS 4.12.5R(5) – Exemption 8 or 9; or Exemption 11 in combination with articles 23, 23A or 24 of the PCIS Order; COBS 4.12.5R(5) – Exemption 1; or Exemption 11 in combination with article 18 of the PCIS Order).

**G. WHETHER THE APPROACH TO COMMUNICATIONS WITH INVESTORS WAS APPROPRIATE, TIMELY AND TRANSPARENT INCLUDING THE APPROACH TO INTERACTING WITH EXTERNAL STAKEHOLDERS ACTING ON BEHALF OF INVESTORS AND THE APPROACH TO ENSURING THAT INVESTORS WERE APPROPRIATELY INFORMED ABOUT KEY DEVELOPMENTS [TOR3]**

237. The aftermath of the Fund's collapse in 2012 unsurprisingly involved a strong and continuous demand for information from those adversely affected. The Regulator was contacted by IFAs, investors, MPs writing on behalf of investors, action groups set up to represent investors (for example the APPG on the Connaught Income Fund and the Connaught Action Group) and the financial press. From the documents I have reviewed (including considerable correspondence between the Regulator and the groups and individuals referred to above) I am satisfied that in dealing with this demand, the Regulator did communicate appropriately with those affected persons to the extent that it was able to.
238. Following the suspension of the Fund in March 2012, the Regulator posted periodic updates on the Regulator website:

***"March 2012 update***

*On 7 March 2012, Connaught Asset Management, which are not regulated by us, decided to suspend its Series fund 1. The fund will be suspended whilst a review is completed to establish the true value of the fund and determine whether there is any shortfall in money held in the fund.*

*On 13 April 2012, Connaught contacted its investors to inform them that the fund was unable to pay the scheduled quarterly interest payment to investors.*

***April 2012 update***

*On 26 April 2012, Connaught announced that it had suspended its Series 2 fund<sup>112</sup>.*

***June 2012 update – Series 1 and 2 funds to close***

*On 6 June 2012, Connaught announced that its Series 1 fund is being wound down, with a potential loss of at least £10m, or approximately 10% of the value of the investments of the Fund.*

*Furthermore, on 13 June 2012, Connaught announced that the Series 2 fund would also be wound down.*

*If you have any further questions at this stage you should contact the adviser that sold you the investment.*

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<sup>112</sup> Channel Islands Stock Exchange (CISX) (now known as The International Stock Exchange (TISE)) announcement, dated 26 April 2012: <http://www.cisx.com/listedsecuritynewsdisplay.php?newsID=188546>

### **July 2012 update – Series 1 and 3 Funds**

*On 13th June 2012, Connaught Asset Management took control of the portion of the loan book held by Tiuta International Limited, the specialist partner to the Connaught Income Series 1 Fund. On 5th July 2012, Tiuta International Limited was placed into administration. [The Accountants] have been appointed as the administrators.*

*Due to increased levels of redemption requests, the Connaught Series 3 Fund was suspended on 5th July 2012, and it will enter an orderly wind down process.*

*For both funds, investors should contact their financial advisor with any questions.*

### **July 2014 update – Series 1 Fund**

*The Financial Conduct Authority (FCA) is focused on securing fair redress for those who invested in Connaught Income Funds. At this stage, we believe that a negotiated settlement to address investor losses from the Connaught Series 1 Fund represents the best course of action for all parties. Therefore, for a limited period, we will support the parties concerned in an attempt to reach a negotiated resolution with a view to obtaining appropriate redress for investors as soon as possible.*

*We encourage the parties concerned to engage constructively with us and each other for this limited period to avoid potentially lengthy and costly alternatives to a negotiated settlement. This is a voluntary and confidential process, and so we will be unable to comment further on its progress until an agreement is reached or negotiations break down"<sup>113</sup>.*

239. In March 2014 the Regulator also posted FAQs on the Regulator's website which were, in general, informative and appropriate and covered issues such as proposals for a negotiated settlement, previous Regulator actions, allegations of fraud, progress on UCISs and investigations regarding CFM and BGC. With regard to the FAQs and the Regulator's comments on whether George Patellis should have gone to the police, that is dealt with at paragraph 199 above.
240. In addition to such "public" announcements, there were also individual email communications between members of the Regulator's Supervision and CET teams with representatives of investors and a number of face-to-face meetings, as well as letters passing between Regulator staff and investors. From the correspondence I have seen the Regulator was responsive to communications from investors, thanking them for information and providing such information as it felt able to in the circumstances. The Regulator engaged with the liquidators of the Fund and Tiuta, attending a number of meetings with them. The Regulator also dealt with Parliamentary scrutiny, replying to letters from MPs and sending representatives to answer questions from the Connaught APPG on 15 July 2014.

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<sup>113</sup> FCA Press Release: "Investors warned over Connaught Income Funds", published 26 May 2011: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>

241. Investors and those adversely affected by the events may have felt frustrated at the lack of "hard" information they were receiving as to the Regulator's finding and details of any enforcement action. However, in my view, the communication the Regulator undertook with investors was appropriate bearing in mind the difficult balance of keeping investors appropriately informed about key developments, but not breaching confidentiality and related concerns regarding on-going investigations, regulatory cases, litigation and potential enforcement action.
242. It has been suggested that the Regulator concealed information. However, I am satisfied that there was no conscious attempt by the Regulator to conceal relevant information from investors. There was understandable concern from stakeholders regarding the slow rate of progress towards resolution and some form of redress particularly in the years 2013 - 2015, but that was a fair reflection of the reality of the time it was taking to resolve matters and the complexity of the aftermath of the collapse. The Regulator could not publicly disseminate the still emerging facts until it had reached a clear position internally. It was also reasonable for it not to report events that were being worked through in real time.
243. Overall, the Regulator did maintain contact with investors in an appropriate manner in light of the information it was receiving and investigations it was conducting at the time.

## H. WHETHER THE FCA'S DECISIONS TO SUPPORT NEGOTIATIONS IN JULY 2014, AND THEN TO SUBSEQUENTLY WITHDRAW THAT SUPPORT IN MARCH 2015, WERE APPROPRIATE [TOR4]

244. On 28 May 2014 a paper was drafted by the CET for the consideration of ERIC. The paper outlined various options for obtaining redress for investors against various parties involved, namely CFM, BGC and IFAs. The paper outlined that ERIC was required to decide the Regulator's strategic priority, either to secure redress for investors, or to tackle the misconduct by getting out messages and deter similar failings in the future. The two options were either to move directly to Enforcement and refer CFM and BGC (if the priority were tackling misconduct) or to "*bring all relevant parties, including Capita and Blue Gate and their insurers to the negotiating table with a view to agreeing a redress package for investors*" if the priority were redress. The paper summarised the relative benefits of the two options as follows:
- "If we prioritise a negotiated redress package, we would hope to deliver more redress at less cost to us and to the parties (including investors) than would be achievable using our investigative and disciplinary powers, or by seeking a formal redress package. If we prioritise using our disciplinary powers, we would hope to deliver a strong deterrence message to Capita and Blue Gate and other operators and a sense of justice to investors who have lost out as they have seen the relevant parties be held to account".*
245. Following a meeting on 28 May 2014, ERIC decided that the priority should be securing redress for investors, and approved a strategy whereby the Regulator would endeavour to support a negotiated redress package.
246. There was a further paper on 13 June 2014 that outlined what role the Regulator should play in the negotiations between CFM, BGC, and the liquidators. The objective was described as being aimed at securing redress for investors by October 2014, for the outcome to be sufficient to avoid the need for any further disciplinary or civil proceedings, and also provide enough transparency for stakeholders to understand the Regulator's approach and provide visibility as to when it would decide to undertake disciplinary measures. It was recognised that any agreement was likely not to satisfy the objectives of all stakeholders.
247. The options were that the Regulator could act either as a "*broker*" between the parties, as a participant in tri-lateral discussion with the parties, or to take a leading role, acting on behalf of investors, in bilateral discussions with the parties. The Regulator adopted a strategy of acting as broker after setting out the respective advantages and disadvantages of such a position. Regulator staff explained that it was unusual for the Regulator to act as broker between operators and liquidators, or any parties in an enforcement context, but the situation was novel and warranted this approach. In my view, it is to its credit that the Regulator pursued it.
248. The timeline of achieving redress by October 2014 was ambitious, due the need to persuade the various parties to take part, agree the parameters of the negotiation, and due to the nature of the legal proceedings between the liquidators of the Fund and Tiuta, CFM, and BGC. Following a meeting with the liquidators of the Fund on 16 September 2014, the Regulator agreed to take a more proactive role in the negotiations. In the event, negotiations only began on 22 January 2015.

249. By March 2015, after negotiations had been on-going for six weeks, the Regulator had little confidence that there was going to be a financial settlement due to the various conditions imposed by the parties involved. The Regulator had closely monitored and taken an active part in the negotiations. The Regulator clearly set out the potential consequences of the various negotiation options and the ramifications of the Regulator's support or lack thereof on investors in a number of papers throughout January to March 2015.
250. Having reviewed the documentation and interviewed the relevant staff at the Regulator who dealt with this, I am satisfied that the Regulator's decision to take part in negotiations was a genuine and well-handled attempt to ensure that investors achieved redress and ensure that the various parties involved (the liquidators, BGC and CFM) came to the table. The mediation may not have gone ahead if the Regulator had not taken part in the negotiation. The Regulator deserves credit for this intervention.
251. I am also satisfied that the Regulator's decision to withdraw from negotiations was appropriate. The decision may well have taken the parties involved in the negotiation by surprise, but having examined the decision making papers and interviewed current and former staff of the Regulator who were involved, I am satisfied that the decision to withdraw was appropriate and ultimately beneficial to investors. When the prospects of achieving a better financial outcome for investors looked slim, the Regulator commenced enforcement proceedings against CFM, which ultimately resulted in an agreement to pay up to £66m and the return to investors of a considerable proportion of their losses<sup>114</sup>. This of course does not absolve the Regulator from the earlier failures to better protect investors in the way I have described, but is nonetheless important to recognise this. I have seen nothing to suggest that the Regulator's withdrawal from negotiations had an adverse effect on the final figure (£18.5m) reached between the liquidators and CFM as a result of the negotiations to settle the civil proceedings between those parties.

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<sup>114</sup> Capita Final Notice dated 10 November 2017. <https://www.fca.org.uk/publication/final-notice/capita-financial-managers-limited-2017.pdf>

## I. LESSONS LEARNED/RECOMMENDATIONS

252. I have identified the following "lessons learned". I have tried to make them relevant to today, given that it is over eight years since the Fund collapsed and, as is to be expected, there have been many changes at the Regulator which have addressed certain deficiencies. Those changes that I have been made aware of I have referenced below. I am grateful for the engagement I have had with stakeholders and employees of the Regulator (both current and former), many of whom were good enough to provide me with detailed and well thought out views and suggestions. The Regulator's actions in the first half of 2011 (including putting out a consumer alert, contacting IFAs, and voluntarily varying Tiuta's permissions) were well intentioned, but insufficient to protect those persons who invested in the Fund before May 2011 or who did so in the following period leading up to the collapse of Tiuta and the Fund in 2012. There was a considerable amount of well-intentioned effort and activity in 2011 and into 2012, but it resulted in insufficient measures to protect investors. I have set out my detailed findings on the reasons for this in the report.
253. Ultimately, investors did recoup a considerable proportion of their investment through a combination of £18.5m arising from the settlement of the litigation in January 2016 and up to £66m following the Capita Final Notice in 2017<sup>115</sup>. This was a positive outcome for Fund investors which the Regulator was instrumental in achieving. However, it does not answer the question of whether the Regulator's handling of the problems with the Fund was appropriate or effective before its collapse. I acknowledge the difficulties with effectively regulating UCISs against the prevailing issues with the perimeter and the internal environment in which the Regulator operated at the relevant time, which is different to today. However, even judged by the standards and approach of the day, the Regulator can reasonably have been expected to have done better in focusing on consumer protection. There are a number of areas in which the Regulator should consider making, and continuing, improvements.
254. The lessons and recommendations below identify five areas for the Regulator to consider. They relate to approach, policy, and practice. I am aware that the Regulator has already carried out significant work in some of these areas and has identified further initiatives for the future. It is encouraging that the Regulator appears committed to learning the lessons from past experiences so as to ensure its regulation in this area of financial services remains effective and appropriate.

### **Lesson 1: Issues were caused by a lack of clarity about the role of operators and other market participants and the nature and extent of the regulatory perimeter.**

255. There are four broad areas of risk with UCISs. First, they are complex investment schemes, and by their very nature involve unregulated entities and conduct. The schemes as a whole may not be subject to direct regulation, although confusion arises because individuals and entities involved may be regulated<sup>116</sup>. They may pose a high

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<sup>115</sup> Capita Final Notice dated 10 November 2017: <https://www.fca.org.uk/publication/final-notice/capita-financial-managers-limited-2017.pdf>

<sup>116</sup> The FCA website currently describes UCISs as follows: "*If a CIS is not authorised or recognised it is considered an unregulated collective investment scheme (UCIS). UCIS are not subject to the requirements that apply to authorised UK schemes and 'recognised' schemes from other countries in terms of their investment powers and how they are run*

risk to investors in circumstances where they are subject to less regulatory oversight. Firms operating both inside and outside of the perimeter, or along its boundary, sometimes deliberately so, can cause serious and widespread harm<sup>117</sup>. Second, such pooled schemes may carry inherent investment risks because of the kinds of assets they invest in. Third, the way they are administered, managed and the investments sold may cause significant further risk. Fourth, investors face a real possibility that any losses may not be backed by any financial regulator (i.e. the Regulator, FSCS, or FOS), without necessarily appreciating this.

256. There have been significant regulatory changes since 2011 and 2012 to address some of these issues. For example, a wide range of previously "unregulated" collective investment schemes are now subject to more detailed and onerous regulatory requirements, which their operators and other service providers must meet as part of the EU-wide Alternative Investment Fund regulatory regime, introduced in 2013. The Regulator introduced further restrictions on the promotion of UCIS to retail investors in January 2014<sup>118</sup>.
257. However, as I have explained, the issues that arose in this case were not caused by a lack of applicable regulatory obligations on businesses or individuals, or powers on the part of the Regulator. In my view, the real reason was a lack of clarity about the nature of those obligations. Added to this was the general uncertainty about the extent of the regulatory perimeter and how to police it. This affected the way the Regulator approached the issues when they arose. Greater clarity within the Regulator itself as to the perimeter would assist in ensuring that the Regulator is sufficiently confident to act in a more proactive and effective manner. I note that the Regulator has done work on emphasising staff training on business models however, internally, I would encourage more training and resource be applied towards giving detailed internal guidance (with case studies) to address attempts to circumvent regulatory and supervisory requirements in UCISs and to give staff greater confidence in challenging and testing information provided in the course of supervision and investigation.
258. The general uncertainty about the regulatory perimeter and how to police it may also have affected the way the relevant entities and individuals behaved – both before and after the Regulator became fully engaged in 2011. The Regulator may therefore wish to consider whether the changes that have been made to the regulatory regime have adequately addressed these factors, or whether further thinking and work should be

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[...]

*UCIS can be risky products. may not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong*

[...]

*Even if a scheme is not authorised or recognised, the people carrying on regulated activities in the UK in relation to UCIS will be subject to our regulation. These activities could include: providing personal recommendations; arranging deals; establishing, operating and managing collective investment schemes".* See: <https://www.fca.org.uk/consumers/unregulated-collective-investment-schemes>

<sup>117</sup> This has been recognised in the FCA's Perimeter report 2018/19: <https://www.fca.org.uk/publication/annual-reports/perimeter-report-2018-19.pdf>

<sup>118</sup> FSA website, "Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes", published 22 August 2012: <https://webarchive.nationalarchives.gov.uk/20120904082431/http://www.fsa.gov.uk/library/policy/cp/2012/12-19.shtml>

done to clarify the regulatory role of the various market participants. In particular, the role and expectations of operators should be examined. For example, greater clarity of the role of operators in this case might have assisted CFM and BGC to better understand what their responsibilities were in relation to the Fund (at a time when, instead, there was considerable uncertainty within the industry about that), and also their wider role within the regulatory regime in terms of proactively assisting or reporting information to the Regulator. Although it might be said that certain aspects of the regulatory regime relating to fund operators were clear in this period, the requirements relating to UCIS were largely limited to high level statements in the Regulator's Principles and similar statements in its Rules, as set out in the relevant parts of Annex B of the Capita Final Notice. That Final Notice illustrates that those Principles and Rules were capable of giving rise to detailed and important obligations in the right circumstances. However, the nature of the responsibility that arose in this case does not seem to have been readily understood at the time, either by the Regulator or other parties involved. Although the Capita Final Notice now provides some guidance on the Regulator's views in this area, it was obtained by settlement and is not strictly a binding legal authority, in the same way that Rules are. To some extent its usefulness is also limited to its particular facts. The Regulator may therefore wish to consider whether it would make sense to do more to clarify its expectations in this area.

259. Regarding the regulatory perimeter, I am conscious that the Regulator does not itself have the power to "move" or change the perimeter. I am aware that the regulatory perimeter is not a single piece of legislation but a complex regime stemming from both UK and EU law; therefore reforming and clarifying the extent of the perimeter so that it is easier for consumers to understand where the boundary lies, is an ongoing challenge. It is an issue that the Regulator is aware of; the first Perimeter Report (published in June 2019) focused on areas where perimeter issues are most likely to cause harm to UK consumers<sup>119</sup>. The Regulator's position is – rightly – that, to some extent, active monitoring of unregulated business would divert resource away from mitigating areas of harm within regulated business, but this does not adequately deal with situations such as that of the Fund, where the businesses it was connected to were both regulated and unregulated. Part of the solution is for the Regulator to provide a better understanding and clarity for consumers on the approach it will take when a firm undertakes both regulated and unregulated activities and the two are intertwined in the regulatory context. I understand that this is one of the main objectives of the Perimeter Report, which it intends to publish annually, and I encourage further activity in this area.
260. There may also be other actions it can take. For example, if there is an area where the legal regulatory position is unclear, the Regulator might clarify it, if necessary, through test cases. I acknowledge that the Regulator is rightly careful not to abuse its powers or to expend unnecessary resource, which is finite, but there perhaps needs to be less reluctance to embark on an application to the Court in order to "test" the position in relation to the perimeter in UCISs. If not, the result could be to prolong legal uncertainty, to the detriment of consumers and markets, as well as regulated entities and individuals.

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<sup>119</sup> FCA Perimeter report 2018/19, dated June 2019 – <https://www.fca.org.uk/publication/annual-reports/perimeter-report-2018-19.pdf>

## **Lesson 2: The Regulator should continue to improve information sharing between departments and its related IT systems and processes**

261. UCISs, because they are typically complex structures involving a number of different entities, can cause regulatory issues which span across departments and teams within the Regulator. As shown by the experience in this case, problems were caused because each department and team had its own set of information and analysis, experience, priorities, and concerns. Different elements of emerging risk (that overall gave rise to a picture of significant concern) were not adequately communicated between teams<sup>120</sup>.
262. Part of the problem was one of data capture and retention, which are functions of case management systems. An effective case management system is important in tracking all contact and data points in relation to each regulated entity or individual, and to ensure that complete regulatory history and intelligence are captured and stored in an appropriate, accessible way, not only for record-keeping purposes, but so that it can be searched effectively if and when the need arises. This is particularly important where, as was the case with Tiuta, there is no single point of contact between a particular firm and the Regulator<sup>121</sup>.
263. I have explained above some of the difficulties staff experienced with the Regulator's electronic case management system during much of the Review Period prior to the collapse of the Fund – known as "Remedy". These difficulties would not have made the Regulator's task easier after issues arose with the Fund, when attempts were made to investigate Tiuta, CAM, and related entities and individuals. I have seen clear evidence of the difficulties staff had trying to find relevant documents at important times. During its investigations, the CET was required to track down and get in touch directly with individuals from Supervision who had had prior involvement with Tiuta in order to obtain copies of important documentation, from historical emails and email attachments. I have also seen evidence that the Regulator felt it was unable to pursue issues due to deficiencies in its records.
264. I am conscious that the Regulator is responsible for the regulation of nearly 60,000 firms, most of which are small firms. I observe that the shortcomings with the Remedy system were thus particularly acute in relation to the supervision of small firms, which have no dedicated relationship managers at the Regulator but which were supervised, reactively, by a team of supervisors. In interviews with current and past employees, it became apparent that individuals involved with the problems generated in this case were not aware of key pieces of information. For example, the individual dealing with potential enforcement proceedings in 2011 was not aware of the previous regulatory history regarding Tiuta and CAM. In addition, the erstwhile Head of the MGI department, who had taken up the position in September 2011, was not aware of the true context or gravity of the allegations made by Mr Patellis against the other senior

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<sup>120</sup> For example, the Authorisations team dealt with Tiuta in 2006 and Nigel Walter and TBP in 2007, UBD dealt with concerns around CAM and authorisation in 2009, Financial Promotions and UBD in March 2010 (comparison to cash and bank account), the Small Firms and Contact Division within Supervision visited Tiuta in September 2009 and February 2010, while concerns regarding Tiuta that arose from Mr Patellis' visit to the FCA in March 2011 were dealt with by another team within Supervision (distinct from the team that had visited Tiuta in September 2009 and early 2010).

<sup>121</sup> See paragraph 37 above.

managers within Tiuta. Better information-sharing and technology would have assisted in ensuring that concerns were "joined up".

265. Remedy has since been replaced by another case management system. I am also aware that the Regulator is focussed on continuing to improve its use of data to share it more effectively and streamline work across the Regulator to make itself more efficient<sup>122</sup>. This is encouraging. The impact that inefficient information-sharing systems and processes can have on the Regulator was clearly observable in this case.

### **Lesson 3: The importance of effective coordination and oversight across different teams**

266. The lack of effective coordination and communication between teams was also an issue in this case. Well-intentioned individual commitment and effort within teams were evident. However, initially, there was no team or decision maker who "sat above the fray" and coordinated information and resources from across the various teams.
267. One particular problem was that staff in the MGI department dealing with Tiuta were (understandably) not experts in analysing and addressing the important and complex UCIS issues that arose in this case relating to the interaction between Tiuta and CAM and the risks to investors in the Fund. Those sorts of subject matter experts did exist within the Regulator but they sat within the Wholesale Firms Division, in the teams that supervised CFM and BGC. However, they only became fully engaged relatively late in 2011. The additional progress that was made as a result of their involvement at that time was evident.
268. This is an area in which the Regulator had already begun to improve during the Review Period, through the creation of the Crystallised Risk (later Complex Events) Team, whose remit was to gather resources as required from across different parts of the Regulator in order to deal with complex cases. Their involvement led to the engagement of the subject matter experts referred to above. I also observed many other efficiencies and improvements achieved as a result of the Complex Events Team's cross-team remit.
269. I would encourage further development and improvement in this area and am aware that work has been done to improve coordination between Supervision and Enforcement. In particular, the Regulator should continue to improve on the work done on cross-team coordination not just after risks have crystallised, but also at an earlier stage. The outcome of this case might have been different had the Crystallised Risk team (later CET) (or an equivalent intra-Regulator function) been involved earlier. The Regulator should also ensure that any policies encouraging greater cooperation between departments are implemented in practice.

### **Lesson 4: Continue to invest in and update systems regarding whistleblowers**

270. Mr Patellis, in March 2011, sought to provide key information regarding financial misconduct and solvency at Tiuta to the Regulator. In the event, the information he provided and the allegations he made were, to a large extent, borne out by subsequent events. There had also been other whistleblowing complaints alleging financial difficulties at the Fund, in late 2010. Although the details of those are now unclear, it

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<sup>122</sup> For example as part of the "data strategy" it announced at the beginning of this year: <https://www.fca.org.uk/publications/corporate-documents/data-strategy>

may have been another missed opportunity to address the problems that later emerged. The information provided by whistleblowers can be vital, and is often the only source of critical information where resource has not been applied for close supervision. Allegations of fraud should always be taken seriously and investigated properly as they can be a potential indicator of risk in themselves. Whistleblowers should be given proper "aftercare" following any reporting. In Mr Patellis' case, this did not happen and had serious consequences. As set out above, the Regulator has now implemented a much more comprehensive whistleblowing policy than existed at the time that Mr Patellis reported<sup>123</sup>. The current strategy places a greater emphasis on logging information and the importance of a clear plan in handling both whistleblowers and any information they may provide. Therefore, it is hoped that the mistakes made in handling Mr Patellis will not be repeated and the Regulator will continue improving the manner in which it interacts with whistleblowers and uses the information provided by them.

### **Lesson 5: The culture of the Regulator**

271. The Regulator's approach to Tiuta and CAM for the majority of the relevant period was cautious, reactive and often characterised by a focus on reasons to defer rather than reasons to take action. In the 2011 period in particular, this approach manifested itself in a confused strategy and a lack of early investigation through the regulated firms and individuals where there were regulatory levers (in particular, through the operators) and wider statutory powers available to the Regulator. It also manifested in the decision to monitor Tiuta on an insufficiently challenging basis after it refused to appoint an administrator in May 2011, and without having a clear "end goal" in place.
272. The evolution in regulatory confidence and approach which has taken place over recent years shows that the Regulator today is not the same as it was when it handled the issues I have reported on. I am aware that there is a different approach from Enforcement with regard to when it will be appropriate to open investigations (see paragraph 162 above), a more systematic approach to authorisation decisions, more proactive supervision of small firms and a Supervision / Enforcement model that uses the identification and prevention of harm as its starting point. I am aware of other developments as well, for example a more commercial, accessible and business-driven approach within GCD, clearer decision making models, and greater encouragement for staff to challenge and test the information they receive.
273. Generally, it seems to me that the Regulator has made positive attempts to evolve its culture in a sensible way and I would encourage it to continue to do so. It will always be difficult for the Regulator to make the judgment call as to the timing of intervention to protect investors where the risk of causing a "run on the fund" is a delicate balance. There is often the consideration of whether intervention which is too heavy or public will lead to greater consumer detriment than a "wait and see" approach with lighter mitigants in place. These difficult decisions can always be second-guessed with the advantage of hindsight by those who see how events transpire. The recommendations above, I suggest, would at least serve to ensure that such judgments made are better informed, improved, and more robust.

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<sup>123</sup> See paragraph 187 above.

**APPENDIX 1**  
**TERMS OF REFERENCE AND REVIEW PROTOCOL**

Terms of Reference – Lessons Learned Review commissioned by the Non-Executive Directors of the Financial Conduct Authority into the handling of the Connaught Income Fund Series 1 (the "Fund") and connected companies

1. The Board of the Financial Conduct Authority ("FCA") is commissioning an independent lessons learned review (the "**Review**") into the handling of the Connaught Income Fund Series 1 (the "**Fund**") and connected companies. The Review will cover both the actions of the Financial Services Authority ("**FSA**") and FCA.
2. The Review will cover the period from 01 February 2007 to 10 March 2015, when the FCA withdrew its support for negotiations between the Fund and the operators, Capita Financial Managers ("**Capita**" or "**CFM**") and Blue Gate Capital ("**Blue Gate**" or "**BGC**"), which were aimed at securing agreement to address investor losses.
3. The Review will consider the proportionality, appropriateness and effectiveness of the actions taken by the FSA and later the FCA. The Review will provide an assessment of the FSA/FCA's actions and set out the lessons (if any) that should be learned from the Review.
4. The Review will address the following questions:
  - i. Whether the FSA's regulation of Tiuta Plc, Capita and Blue Gate, and the individuals associated with these entities, and its response to intelligence was appropriate and effective, including:
    - (a) The approach to supervision and its implementation including judgements made, the proportionality, effectiveness and timeliness.
    - (b) The consideration and effective management of potential conflicts of interest within the FSA.
    - (c) The approach to whistleblowing, including interactions with whistleblowers, the action taken in response and the timing of that action.
    - (d) The extent to which the internal departments co-ordinated the use of intelligence and the appropriateness of any response.
    - (e) The consideration of and approach to sharing intelligence with other regulators and law enforcement agencies.
    - (f) The consideration of and approach to co-ordinating with other organisations including, the Financial Ombudsman Service and the Financial Services Compensation Scheme.
  - ii. Whether the FSA's jurisdiction at the time impacted its ability to meet its statutory objective of protecting consumers, including:

- (a) The regulatory framework in place at the time and the impact on the FSA's approach.
  - (b) The FSA's supervisory approach to activities which largely fall outside its jurisdiction.
- iii. Whether the approach to communications with investors was appropriate, timely and transparent, including:
  - (a) The approach to interacting with external stakeholders acting on behalf of investors.
  - (b) The FCA's approach to ensuring that investors in the Fund were appropriately informed about key developments.
- iv. Whether the FCA's decisions to support negotiations in July 2014, and then to subsequently withdraw that support in March 2015 were appropriate, including:
  - (a) The rationale and timing of the decisions.
  - (b) The FCA's consideration of the possible impact of these decisions.
- 5. The Review will be led by an Independent Reviewer, Raj Parker, who will prepare a report of the Review's findings. The Independent Reviewer may make recommendations to the FCA as they see fit.
- 6. The FCA will provide the necessary supporting resources to enable the Review to be carried out.
- 7. The Review will be completed within a period of nine months beginning on the date upon which an Independent Reviewer is appointed by the FCA.
- 8. If the Independent Reviewer considers that it will not be possible to complete the Review within the period of nine months mentioned in paragraph 7, the Independent Reviewer must inform the FCA of:
  - (a) the reasons for the delay in the conclusion of the Review, and
  - (b) a revised target date for the conclusion of the Review.
- 9. Subject to legal considerations, the FCA Board intends to publish the final report as soon as is practically possible.

## **PROTOCOL**

### **For the conduct of the lessons learned review commissioned by the Non-Executive Directors of the Financial Conduct Authority (FCA) of the handling of the Connaught Income Fund Series 1**

#### **A. Introduction**

1. Raj Parker (hereafter "you") have been appointed by the FCA, to carry out an independent review of the handling of the Connaught Income Fund Series 1.
2. The scope of the review is set out in the Terms of Reference published by the FCA on 20 June 2019.
3. This Protocol sets out the procedures under which the review is to be carried out, reflecting the requirement for this review to be, and to be seen to be, independent.

#### **B. Administrative Matters**

4. You will be given specific individual contacts at the FCA, including the Accountable Executive ('AE') to whom the Sub-Committee of the Board has delegated responsibility for oversight of this review.
5. The AE will be supported in his/her role by a Project Review Board which will provide advice to the AE when he/she requests it but which will not have any delegated decision-making powers. Any interactions you have (or may have) with the Project Review Board will be at the discretion of, and through, the AE.
6. To facilitate you in conducting the review, particularly in relation to requesting and obtaining relevant documents and information, a dedicated email inbox for communications relating to the review has been set up. You should send communications relating to the review to this inbox as this will ensure that they are logged and actioned efficiently.

#### **C. Documents, other information and meeting**

##### **Documents: requests and production**

7. You will send all requests for the production of relevant documents (to include, for the purposes of this Protocol, documents, information and communications in hard copy and in electronic form) to the email address referred to in paragraph 6 above. Such requests will set out the documents or class of documents requested for production.
8. Provided that the documents requested for production are within the FCA's power, custody or possession, they will be provided to you either in hard copy or in electronic form (via a secure IT route) as soon as possible. No such documents will be withheld from you.
9. Where documents are not within the FCA's power, custody or possession you should follow the procedure above and the FCA will contact the organisation holding the documents and request the documents on your behalf.

### **General information requests and general explanations**

10. In the event that you require other information and/or explanations relating to the FCA's activities, and falling within the scope of the Terms of Reference, you will send a request to the email address referred to in paragraph 6 above.
11. The FCA will respond as soon as possible to any such request.
12. In the event that you require other information and/or explanations relating to the activities of another organisation, falling within the scope of the Terms of Reference, you should follow the procedure above and the FCA will contact the relevant organisation to request its assistance and to obtain the relevant information and/or explanations for you.

### **Meetings with individuals**

13. In the event that you wish to meet with any individual currently or formerly employed by the FCA, you will notify the FCA of the individuals whom you wish to meet (using the email address referred to in paragraph 6 above, attaching a letter from you to the individual for the FCA to pass on to the individual).
14. The FCA will endeavour to secure the attendance at a meeting of any identified individuals who are current or former employees of the FCA. It should be noted, however, that attendance by an individual at a meeting with you is not required under statutory powers.
15. Any meetings with individuals not within paragraphs 13 and 14 will be arranged by your team (the Independent Reviewer's team).
16. Meetings will be arranged at a mutually convenient time for yourself and the individual. You will provide to the FCA, no less than six working days in advance of the meeting (i) a broad outline of the topics you wish to cover during the meeting and (ii) a list of the principal documents you may wish to reference during the meeting (together the "meeting information"). The FCA will pass the meeting information to each individual no less than five working days in advance of the meeting between that individual and yourself. Meetings will be recorded by your professional services team and a transcript provided to the individual.<sup>124</sup> The information obtained by reason of the interviews may be relied upon by you in preparing your report.
17. To the extent possible you will endeavour to hold any meetings at a mutually convenient location for yourself and the individual with whom you are meeting. If you require it, the FCA will make available for any meeting a suitable room at its premises at 12 Endeavour Square, Stratford.

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<sup>124</sup> For the avoidance of doubt, the transcripts will not be made available to the FCA. The transcripts, however, will be retained by the FCA after the review has been completed in a secure electronic area, in accordance with the FCA's Records Management Policies and Standards.

### **Third party assistance**

18. You may contact third parties directly for assistance in relation to the review and the FCA will, to the extent that it is able to do so, facilitate such assistance (for the avoidance of doubt this is not in relation to your professional services team).

### **Escalation**

19. The FCA is committed to providing you with assistance to facilitate your conduct of the review. However, in the event that you consider that the FCA is not providing you with the co-operation or information that you reasonably require to fulfil your responsibilities, please escalate matters promptly to the Chairman of the FCA.

## **D. Legal privilege and confidentiality**

### **Privilege**

20. It may be necessary for the FCA to provide you with information that is subject to the FCA's legal privilege. The FCA will not withhold documents from you on the grounds of legal privilege but, for the avoidance of doubt, the provision of such material to you does not constitute a more general waiver of legal privilege.
21. You may refer to privileged documents in your report but the Board Sub-Committee will decide whether to redact parts of the material provided to persons as part of the representations process referred to in paragraphs 25 and 26 below or of the final report before its publication on the basis that this is necessary to protect and preserve privilege. If the Board Sub-Committee decides to redact parts of the final report on that basis, it will include in the published report an explanation of the reason for the redactions.

### **Confidentiality**

22. It may be necessary for the FCA to provide you with information that is deemed to be confidential within the meaning of section 348 of the Financial Services and Markets Act 2000 ("FSMA").
23. You may refer to such confidential information in your report. If required it will be the responsibility of the FCA, for the purposes of such references, to obtain the consent of the person from whom the information was obtained by the FCA and, if different, the consent of the person to whom it relates. If such consent is not obtained, you may nevertheless refer to such confidential information in your final report and the Board Sub-Committee will then decide whether to redact parts of the final report before its publication on the basis of the restrictions in section 348 of FSMA. If the Board Sub-Committee decides to redact parts of the report on that basis, they will include in the published report an explanation of the reasons for the redactions.

### **Naming personnel**

24. Your final report will not name or identify the position of any personnel (whether current or former FCA or former FSA employees) who were below the level of Director at the time of their actions.

## **E. Representations Process**

25. Insofar as you intend in your report to criticise individuals, groups of individuals whose members are identifiable or organisations, including the FCA (both in its own right and/or as the successor of the FSA for actions pre-April 2013), you will (i) identify those individuals, groups or organisations (ii) provide them with a reasonable opportunity to make representations in relation to your proposed criticism and (iii) consider any representations made before finalising your report.
26. The contacts referred to in paragraph 4 above will (i) assist you, if so requested, in deciding which individuals, groups or organisations should be given the opportunity to make representations and (ii) provide you with such administrative assistance as you may reasonably require for the purposes of conducting the representations process.

## **F. Governance and reporting**

27. You will keep the AE informed in relation to the logistical progress of the review, including its costs, but not in relation to matters of substance.
28. You should raise directly with the AE any matter which you consider to be so urgent or important that it needs to be disclosed to him/her.
29. You will share a draft of your report with the AE for information only. The AE may at his/her discretion share, and discuss, the draft with the Project Review Board, Board Sub-Committee and subject matter experts.
30. To the extent that you consider it necessary for the FCA to address issues relating to factual accuracy, or confidential information pursuant to section 348 of FSMA or legal privilege, you may share the relevant sections of your draft report with the contacts referred to in paragraph 4 above. These contacts will, with your specific and express permission, be entitled to share these sections with appropriate individuals at the FCA for the purposes of assisting you and finalising the draft report.

## **G. Publication**

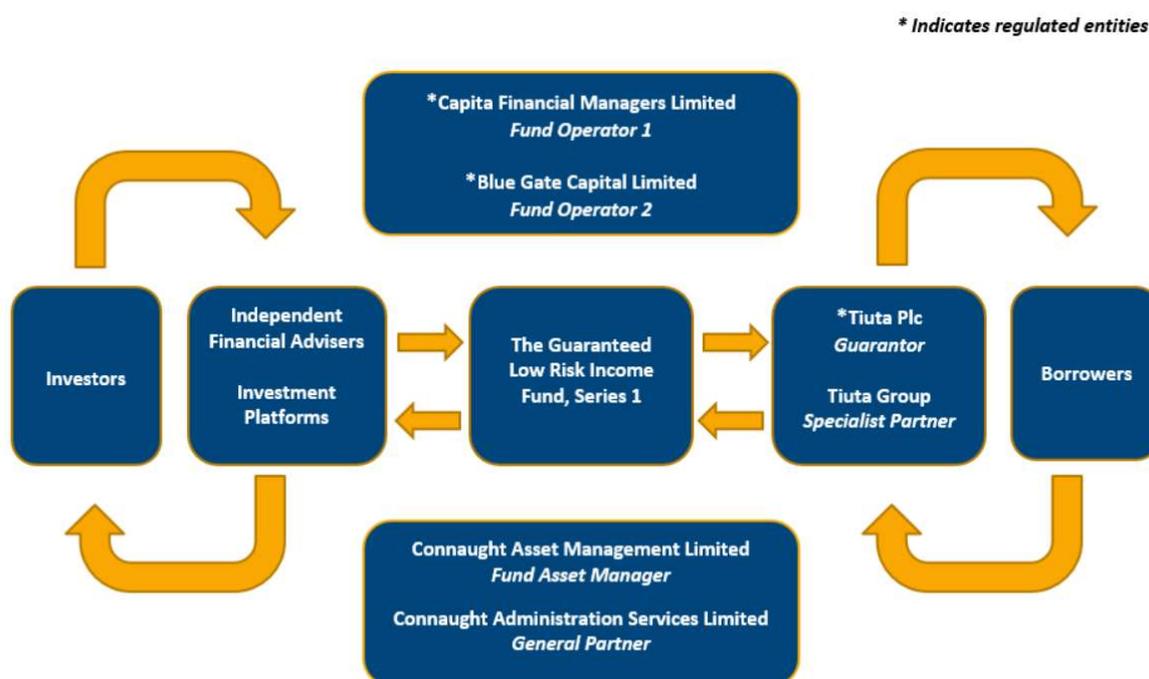
31. The FCA will arrange for the publication of your final report on behalf of the Board Sub-Committee.

## APPENDIX 2 CHRONOLOGICAL OVERVIEW

### Key entities of the UCIS

- *The Connaught Income Fund, Series 1* (the "**Fund**") – an unregulated collective investment scheme ("**UCIS**") originally named "The Guaranteed Low Risk Income Fund, Series 1". Investments in the Fund were placed through Independent Financial Advisers ("**IFAs**").
- *Connaught Asset Management Limited* ("**CAM**") – the founder partner under a Limited Partnership Agreement with CASL (see below) in respect of the Fund and the asset manager of the Fund, appointed as such by the operator of the Fund pursuant to Asset Management Agreements. CAM was not authorised or regulated by the Regulator.
- *Connaught Administration Services Limited* ("**CASL**") – a wholly owned subsidiary of CAM and general partner under a Limited Partnership Agreement with CAM in respect of the Fund. Responsibilities of CASL included formulating investment policy, evaluating short term loan applications, and responsibility for debts and obligations of the Fund. CASL was not authorised or regulated by the Regulator.
- *Tiuta plc* ("**Tiuta**") – a bridging lender, mainly for business to business loans, although approximately 5% of its business comprised regulated lending. Tiuta plc was authorised and regulated by the Regulator. Tiuta plc was the parent company of the Tiuta Group, and Guarantor of the payment obligations to the Fund. The loans advanced by an entity within the Tiuta Group to borrowers and the associated receivables comprised the assets in which the Fund invested.
- *Tiuta Group* – a group of companies of which Tiuta plc was the parent company. Tiuta Group (or any entity within the Tiuta Group) was the "Specialist Partner" to the Fund, as set out in the Fund's Information Memoranda. The loans advanced by an entity within the Tiuta Group to borrowers and the associated receivables comprised the assets in which the Fund invested.
- *Capita Financial Managers Limited* ("**CFM**") – operator of the Fund from around April 2008 to 25 September 2009, pursuant to an (apparently undated) Operator Agreement signed in 2008. Authorised and regulated by the Regulator.
- *Blue Gate Capital Limited* ("**BGC**") – operator of the Fund from 25 September 2009 until the Fund's liquidation in December 2012, pursuant to an Operation Agreement dated 25 September 2009. Authorised and regulated by the Regulator.

## Structure of the UCIS



What follows is an outline of some of the key events that took place during the Review Period, based on information made available during the Review and information in the public domain. It does not purport to be comprehensive, and is merely intended to provide a simplified overview of, and some reference points for, the factual background. Similarly, the list and structural diagram above are simplifications of the UCIS and each of the entities therein.

**7 April 2006** – Tiuta plc is authorised by the FSA for regulated activity.

**February 2007** – Nigel Walter, a director and co-founder at CAM, submits an application for authorisation relating to himself and his companies. The FSA refuses this application as an approved person because of his previous connections to UKLI, a land banking operation scheme later shut down by Enforcement (in June 2008)<sup>125</sup>.

**October 2007** – Regulator allegedly receives a consumer complaint that Tiuta is acting fraudulently. Tiuta state that it (Tiuta) was the victim of mortgage identity fraud.

**15 April 2008** – Regulator petitions High Court to wind up UKLI (of which Nigel Walter is a director). UKLI is wound up<sup>126</sup>.

<sup>125</sup> FSA Press Release: "*FSA seeks to close down UK's largest illegal 'landbanking' scheme*", 4 June 2008: <https://webarchive.nationalarchives.gov.uk/20090224123635/http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/052.shtml>

<sup>126</sup> FSA Press Release: "*FSA seeks to close down UK's largest illegal 'landbanking' scheme*", 4 June 2008; The London Gazette, Number 58670, Thursday 17 April 2008, p. 60: <https://www.thegazette.co.uk/London/issue/58670>

**April 2008** – The Fund is established with CFM as the FSA-authorized operator. The Fund's first investment memorandum issued by CFM.

**15 June 2008** – The Fund is launched.

**July 2008** – The FSA advises Mike Davies (Chairman of CAM and a director and Compliance Officer for Tiuta at the time) that each subsidiary of Tiuta would need its own regulatory permission.

**16 September 2008** – Supervision of Tiuta is transferred from the FSA's Retail Firms Division to the Small Firms and Contact Division. Tiuta is categorised as a "low impact" firm.

**8 December 2008** – Mortgage Lending and Administration Return Alert Reports high mortgage arrears at Tiuta.

**January 2009** – Jersey Financial Services Commission notifies FSA Unauthorised Business Division ("UBD") regarding concerns about a director of CAM's (Nigel Walter) intention to carry out regulated activities in Jersey.

**9 February 2009** – UBD perform a "Shared Intelligence Search" (i.e. against the FSA's database of financial intelligence) on Nigel Walter and Capita.

**March 2009** – CF Arch Cru Investment and CF Arch Cru Diversified funds, two UK open-ended investment companies for which CFM were acting as Authorised Corporate Director, are suspended due to insufficient liquidity in the sub-funds. Soon afterwards, CFM is subject to a "Skilled Person" review pursuant to section 166 FSMA. In August 2009, CFM is subject to a further section 166 review.

**April 2009** – An enquiry is opened by UBD as to whether CAM is carrying out regulated activities and whether the Fund is being marketed as providing "*guaranteed income*".

**12 June 2009** – The FSA UBD write to CAM highlighting concerns that it is operating a Collective Investment Scheme (as defined under section 235 FSMA) – in particular, the "Strategic Land Funds" – without authorisation.

**23 July 2009** – CFM suspends the Fund from accepting new subscriptions because of concerns about the way the Fund is operated.

**August 2009** – Visit to Tiuta from member of the FSA Supervision team.

**18 August 2009** – In an internal Note For Record, UBD states that "*Ordinarily, the FSA would be satisfied with this arrangement on the basis that the regulated activities are (at least in theory) delegated to an authorised entity*", but notes that in this case the authorised entity is CFM, which is "*the subject of a supervisory Quality of Controls exercise*". The UBD enquiry is later formally closed, and the reasons are recorded and communicated to CAM in January 2010 (see below).

**2 September 2009** – The FSA issues mostly positive feedback to Tiuta following its file reviews of regulated bridging loans.

**25 September 2009** – BGC take over from CFM as the FSA-authorized operator of the Fund.

**23 October 2009** – Mike Davies (in his capacity as Chairman of CAM) informs the FSA that CFM is no longer acting as operator, and that on advice the terms "*low risk*" and "*guaranteed*" had been removed from the Fund's name.

**October 2009** – FSA starts project to look at financial promotions of UCISs in small firms<sup>127</sup>.

**20 November 2009** – George Patellis is appointed CEO of Tiuta<sup>128</sup>.

**23 December 2009** – The FSA receives Capita's resignation as the Fund's Operator, noting an exit from UCIS products to focus on its core business.

**21 January 2010** – UBD's scorecard notes the reasons for formally closing its enquiries regarding CAM: the uncertain position as regards legal interpretation of the relevant statutory provisions, an absence of consumer complaints, CFM's resignation as the Fund's operator, and the fact that the Fund is targeted at high net worth individuals through IFAs only.

**22 January 2010** – UBD emails Mike Davies, Chairman of CAM, disagreeing that functions performed by CAM were not part of the operating arrangements for the purposes of section 235 FSMA, whilst also indicating that it does not intend to pursue the issue in the absence of a specific judicial ruling on the point and there were other legal interpretations that potentially had merit.

**February 2010** – Further visit to Tiuta by member of the FSA's Supervision team.

**2 March 2010** – The FSA provides feedback to Tiuta from its supervisory visit. The feedback is positive with regard to TCF concerning Tiuta's borrowers. The FSA requests that Tiuta provides information on all new regulated and unregulated products because of their significantly different features.

**8 March 2010** – Financial Promotions team and UBD discuss concerns regarding Fund promotional material comparing the risk in the investment to bank accounts. No further action is taken.

**July 2010** – The FSA's thematic review of UCISs identifies that in more than 75% of the cases examined, the UCIS investment was missold by IFAs in that the promotion of the UCIS was not compliant with the applicable rules.

**October 2010** – The FSA is alerted to three whistleblowing reports relating to BGC. One report relates to the promotion of UCIS products to retail investors. The other two reports allege that BGC is in financial difficulties. This is not followed up with BGC until January 2011.

**14 December 2010** – The Head of Savings & Investments at the FSA gives a speech about the findings from its thematic review of UCISs. It advises small firms to consider their own approach to the promotion and advice processes for the sale of UCIS products<sup>129</sup>.

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<sup>127</sup> FSA Report: Unregulated Collective Investment Schemes: Project Findings, dated July 2010. See: paragraph 1.3: <https://www.fca.org.uk/publication/archive/fsa-ucis-findings.pdf>

<sup>128</sup> [https://register.fca.org.uk/ShPo\\_IndividualDetailsPage?id=003b000000LV5ikAAD](https://register.fca.org.uk/ShPo_IndividualDetailsPage?id=003b000000LV5ikAAD)

<sup>129</sup> Unregulated Collective Investment Scheme (UCIS), speech by Linda Woodall on 14 December 2010: [https://webarchive.nationalarchives.gov.uk/20110201182211/http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/1214\\_lw.shtml](https://webarchive.nationalarchives.gov.uk/20110201182211/http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/1214_lw.shtml)

**January 2011** – The FSA publishes a Discussion Paper, titled "Product Intervention". Amongst other things, the Paper highlights concerns about the promotion of UCISs in its Product Intervention Paper<sup>130</sup>. The Regulator also puts 11 firms (IFAs) through section 166 reviews regarding UCIS promotions<sup>131</sup>.

**18 January 2011** – Mr Patellis makes a Principle 11 disclosure to the Regulator regarding the financial position of Tiuta. He resigns as CEO the same day but is reinstated on 28 January before resigning again on 23 February<sup>132</sup>.

**19 January 2011** – Tiuta engages the Accountants, as financial advisers, to review its financial position. The scope of the Accountants' review is amended on several occasions.

**20 January 2011** – As a result of the whistleblowing intelligence received in October 2010, the FSA meet with BGC primarily to discuss its capital adequacy. The issues are resolved to the FSA's satisfaction and no further supervisory action is deemed necessary. BGC's Compliance Officer agreed to review its accounts and reporting methods as a matter of urgency. The file is closed on **8 April 2011**.

**27 January 2011** – UBD open an enquiry to consider if CAM's website includes misleading statements about whether it was regulated or authorised by the FSA. It appears that this enquiry was opened as a result of a consumer complaint.

**16 February 2011** – The FSA contacts Tiuta to arrange a meeting to discuss Mr Patellis' departure and the issues arising. However, given Mr Patellis' reinstatement and Tiuta's engagement of the Accountants, it is subsequently decided to defer the meeting until after the Accountants issue their report on Tiuta's financial position.

**17 February 2011** – the Accountants inform the Tiuta Board that Tiuta is insolvent on the basis of all tests.

**28 February 2011** – The FSA's Retail Conduct Risk Outlook highlights the risks to investors of UCIS products in search for high yields.

**11 March 2011** – The FSA writes to Mr Patellis asking him to attend an interview at the FSA offices on 16 March 2011.

**14 March 2011** – The Accountants write to Tiuta setting out the findings of its financial review. These include the finding that a lack of management accounts and other key information and documents have made it difficult to assess Tiuta's financial position, that Tiuta Group was not generating sufficient income to cover its costs, and that Tiuta was not treating funds advanced from the Fund or loans redeemed by borrowers properly.

**16 March 2011** – Mr Patellis meets with the FSA staff regarding allegations about the financial position of Tiuta, and makes detailed allegations of serious misconduct.

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<sup>130</sup> FSA Product Intervention Paper – dated January 2011: [https://www.fca.org.uk/publication/discussion/dp11\\_01.pdf](https://www.fca.org.uk/publication/discussion/dp11_01.pdf)

<sup>131</sup> Ibid., p. 42.

<sup>132</sup> See: <https://beta.companieshouse.gov.uk/officers/BqAvAjpgVTflv3F0mz8aPXdl0Zv0/appointments>

**18 March 2011** – The FSA emails Mr Patellis requesting copies of specific documentary evidence discussed during the meeting on 16 March 2011.

**24 March 2011** – The FSA proposes that Tiuta ceases all regulated lending activity. The FSA is concerned about Tiuta's financial position, the failure to inform the FSA of the CEO's resignation, and the changes made to the scope of the Accountants' engagement.

**24 March 2011** – Documents are received by the FSA from Mr Patellis regarding issues within Tiuta.

**25 – 29 March 2011** – FSA employee discloses potential conflict of interest with Mike Davies at CAM.

**5 April 2011** – Press Statement is issued by the Chairman of CAM (Mike Davies), affirming its support for Tiuta following the resignation of four senior staff, which had been reported in the media.

**11 April 2011** – The Accountants write to Tiuta, referring to a meeting with Nigel Walter of CAM. The Regulator receives a copy of this letter by 16 May 2011 at the latest.

**12 April 2011** – Supervision ask Enforcement whether there would be a possibility of bringing action against Tiuta. In December 2011 a decision is made to take no action, following advice from the General Counsel's Division ("**GCD**").

**20 April 2011** – Meeting between Tiuta and the FSA during which Tiuta provides the FSA with a presentation on the Tiuta Group's finances and the actions being taken to address liquidity issues highlighted by Mr Patellis. Tiuta explains that the liquidity issues have no impact on the firm's regulated activity, and that the reduction in lending is due to management's poor understanding of the business model. Tiuta agrees to cease its regulated business.

**May 2011** – The FSA engages in a course of correspondence with the Accountants regarding the reasons behind the revisions to the scope of their engagement by Tiuta since their initial engagement in January 2011. During this exchange, the Regulator requests documentation pursuant to section 165 FSMA, but the Accountants do not comply, asserting that – contrary to the FSA's view – section 165 FSMA did not apply in the circumstances. Following a meeting with the Accountants on 16 May 2011, the FSA notes that the Accountants had provided a financial forecast model to Tiuta, but "*had no control over the assumptions made in terms of information being fed into the model*".

**9 May 2011** – Financial Promotions conclude that CAM's website compared the Fund to bank accounts, and failed to state that capital was at risk and that no FSCS protection was available.

**11 May 2011** – The FSA asks Tiuta to consider a Voluntary Variation of Permissions ("**VVOP**") whereby all regulated activities are suspended.

**13 May 2011** – VVOP is finalised following Tiuta's agreement to cease regulated activity.

**16 May 2011** – Meeting takes place between the Accountants and the FSA during which the Accountants indicate that Tiuta is in severe financial difficulty and is technically insolvent. The FSA's preference is to appoint an administrator and issue a consumer alert rather than suspend the Fund, take other action to close down operations, or conduct an independent investigation.

A decision is made not to publicise the VVOP due to concerns about adverse publicity before a decision had been made as to whether to pursue actions against Tiuta or CAM.

**20 May 2011** – Meeting between Tiuta and the FSA in which Tiuta is informed that the FSA is of the opinion that they should appoint an administrator. The FSA follow up with a letter on the same day.

**23 May 2011** – Tiuta refuses to go into administration and proposes an alternative plan to trade out of the financial difficulties. A proposal based on Tiuta's plan is agreed by the FSA on 24 May 2011, whereby Tiuta will continue to be subject to the FSA's supervision.

**23 May 2011** – Financial Services Compensation Scheme ("FSCS") is told by the FSA of possible claims concerning the Fund.

**25 May 2011** – The FSA contacts the GFSC regarding solvency concerns and Tiuta's guarantee to the Fund.

**25 May 2011** – The Regulator is informed by BGC that the Fund is working as expected and they have no reason to suspend or close the Fund.

**26 May 2011** – The FSA issues a Consumer Warning regarding CAM stating that "*very low risk*" and "*low risk*" marketing materials are misleading, as are suggestions of fixed income guarantees, and that investment advisers should be consulted<sup>133</sup>.

**June 2011** – The FSA is in contact with the FSCS regarding Tiuta's regulated loans and the number of IFAs who have placed investments in the Fund.

**12 July 2011** – Financial Promotions team review the material approved by BGC for the Fund.

**28 July 2011** – The FSA contacts IFAs who had placed investments in the Fund to review the suitability of the investment advice given.

**11 August 2011** – The Accountants inform the Regulator that Tiuta is still loss making but expected to return to profitability in June 2012.

**12 August 2011** – FSA analysis of the Accountants' reports regarding Tiuta concludes that Tiuta has taken insufficient steps to address risk and will need to increase lending significantly in order for the business to be sustainable. The FSA requests that Tiuta demonstrates how it intends to turn things around.

**15 August 2011** – CAM affirms support of Tiuta.

**25 August 2011** – FSA writes to Tiuta regarding multiple concerns and asks for responses by certain deadlines, and requiring that data is verified by the Accountants.

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<sup>133</sup> FSA Warning to Consumers re Connaught Income Funds dated 26 May 2011: [https://webarchive.nationalarchives.gov.uk/20110801163939/http://www.fsa.gov.uk/pages/consumerinformation/firmnews/2011/investors\\_warned\\_.shtml](https://webarchive.nationalarchives.gov.uk/20110801163939/http://www.fsa.gov.uk/pages/consumerinformation/firmnews/2011/investors_warned_.shtml)

**30 August 2011** – The FSA receives an email chain showing that Tiuta's Compliance Officer, Bill Warren, had removed Nigel Walter's name from all meeting records and replaced it with another CAM director before sending the information to the FSA<sup>134</sup>.

**23 September 2011** – The FSA advises Tiuta that failing to release land registry forms (DS1) despite borrower redemption of the relevant loan is a potential breach of Principle 6. Tiuta had £10m outstanding land registry forms (DS1) at this time. Steven Nicholas disputes that Tiuta had ever failed to release a charge over a property.

**27 September 2011** – The FSA is concerned about Tiuta's failure to rectify the redeemed loans issue (whereby the proceeds of redeemed loans were not paid back to the Fund and the charges over property released as provided in the Information Memorandum). Tiuta responds saying there has been a change of management and that it will not happen again.

**3 October 2011** – The Financial Promotions Team reviews the Information Memorandum issued by BGC and concludes there was not sufficient justification to take action against BGC.

**1 December 2011** – Supervisory visit to BGC, during which concerns regarding the nature of BGC's oversight of the Fund are identified.

**8 December 2011** – Regulator writes to Tiuta concerning directors' responsibilities and whether the Board considers that the firm can continue trading. On the same day, the Regulator asks BGC for information concerning protecting investors interests. It is unclear if this is provided.

**15 December 2011** – Enforcement indicates that it intends to decline Supervision's referral of Tiuta for an Enforcement investigation, suggesting that the alleged misconduct can be dealt with by way of private warnings. Enforcement also state that BGC may be a more likely candidate for referral to Enforcement than Tiuta, and suggest that the financial promotions might be revisited as well.

**20 January 2012** – UBD formally closes its previous enquiry into CAM's website regarding misleading statements as GCD confirm that CAM did not appear to be conducting any regulated activity.

**27 January 2012** – The FSA corresponds further with the FSCS regarding Tiuta, enquiring as to whether UK investors in the Fund would have recourse to the FSCS should Tiuta's financial position result in a run on the Fund.

**27 February 2012** – Accountants' report regarding Tiuta for January 2012 is received by the FSA. The report makes clear that Tiuta's financial position is not improving.

**29 February 2012** – The FSA discusses and decides a supervisory strategy to continue to monitor Tiuta, including through the Accountants and BGC.

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<sup>134</sup> According to the FCA's own records, this was received by the FSA on 30 August 2011. However, it seems more likely that the FSA did not receive this email chain until November 2012, following communications with the Administrators of CAM.

**9 March 2012** – BGC suspends the Fund. The FSA updates its website with this information<sup>135</sup>.

**13 March 2012** – Prompted by its concerns regarding Tiuta, the FSA advises the Office of Fair Trading in writing of concerns regarding bridging lenders, following a call on 6 March 2012.

**15 March 2012** – The FSA publishes its Retail Conduct Risk Outlook which highlighted concerns regarding UCIS due to multiple evidence of misselling<sup>136</sup>.

**16 March 2012** – The Financial Promotions team agrees that no action would be taken against BGC because investments in the Fund are only placed by sophisticated investors via investment professionals

**13 April 2012** – CAM informs its investors that the Fund is unable to pay the scheduled quarterly interest payments<sup>137</sup>.

**6 June 2012** – CAM communicates to investors that it has decided to wind down the Fund<sup>138</sup>.

**12 June 2012** – Tiuta enters into a further VVOP whereby it is required to obtain written approval from CAM before advancing any further loans, and to remit all loan redemption monies to CAM as soon as they are received.

**13 June 2012** – CAM acquires TIL Limited.

**20 June 2012** – The FSA sends a letter to CF10s at 270 firms, involved in arranging or advising on UCIS investment sales to retail clients, stating the FSA does not believe UCISs are suitable for the vast majority of the retail market<sup>139</sup>.

**3 July 2012** – The Accountants advise the FSA that TIL is due to be placed in administration imminently.

**5 July 2012** – TIL is placed into administration, and the Accountants are appointed as administrators.

**6 July 2012** – The Fund engages Duff & Phelps as investigative accountants.

**21 August 2012** – The FSA notifies City of London Police ("**COLP**") and the Insolvency Service regarding allegations of fraud at the Fund and CAM.

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<sup>135</sup> FSA News Story: "*Investors warned over Connaught Income Funds*", published 26 May 2011 (March 2012 update): <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>

<sup>136</sup> FSA Conduct Risk Outlook 2012, published 15 March 2012, p. 70: [https://webarchive.nationalarchives.gov.uk/20120904082403/http://www.fsa.gov.uk/library/publications\\_by\\_date](https://webarchive.nationalarchives.gov.uk/20120904082403/http://www.fsa.gov.uk/library/publications_by_date)

<sup>137</sup> Bridging and Commercial, "*Tiuta Plc enters administration*", dated 21 September 2012, [https://www.bridgingandcommercial.co.uk/article-desc-2613\\_tiuta-plc-en](https://www.bridgingandcommercial.co.uk/article-desc-2613_tiuta-plc-en)

<sup>138</sup> FSA News Story: "*Investors warned over Connaught Income Funds*", June 2012 update: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>

<sup>139</sup> Dear Compliance Officer letter re. UCIS dated 20 June 2012: [https://webarchive.nationalarchives.gov.uk/20120904132711/http://www.fsa.gov.uk/smallfirms/your\\_firm\\_type/financial/pdf/ucis-letter-retail-intermediaries.pdf](https://webarchive.nationalarchives.gov.uk/20120904132711/http://www.fsa.gov.uk/smallfirms/your_firm_type/financial/pdf/ucis-letter-retail-intermediaries.pdf)

**August 2012** – The case is passed to the Crystallised Risk (later the Complex Events ("CET")) team.

**22 August 2012** – The FSA publishes consultation paper on ban of sales of UCIS products to retail investors. The final rules for the ban are published on 4 June 2013, effective from 1 January 2014<sup>140</sup>.

**12 September 2012** – Fund investors vote to appoint Duff & Phelps as liquidators of the Fund and replacement administrators of TIL<sup>141</sup>.

**18 September 2012** – CAM is placed into administration.

**28 September 2012** – Tiuta is placed into administration.

**3 December 2012** – The Fund is placed into liquidation.

**1 April 2013** – The FSA becomes the FCA.

**June 2013** – The Regulator decides not to pursue Enforcement against Tiuta or other regulated firms and individuals involved.

**27 September 2013** – Tiuta is placed into liquidation.

**19 December 2013** – TIL is placed into liquidation.

**May 2014** – Legal proceedings issued by administrators of the Fund against operators. The FCA decides to facilitate a negotiated settlement between the operators and the Fund.

**July 2014** – All Party Parliamentary Group convenes for the first time.

**15 July 2014** – The FCA publishes a statement on its website confirming it would support the parties concerned to reach a negotiated resolution and obtain appropriate redress for investors<sup>142</sup>.

**29 September 2014** – The FCA becomes a party to negotiations between the operators and the Fund liquidators.

**November 2014** – Nigel Walter and Mike Davies (directors of CAM) are disqualified by the Insolvency Service for nine and seven years respectively. Neither Mr Walter nor Mr Davies disputed that they failed to ensure CAM carried out its responsibilities to the Fund, nor that CAM failed to review the progress on each bridging loan made by TIL with monies borrowed

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<sup>140</sup> Press release: "FSA to ban the promotion of UCIS and close certain substitutes to ordinary retail investors", dated 4 June 2013: <https://www.fca.org.uk/news/press-releases/fca-ban-promotion-ucis-and-certain-close-substitutes-ordinary-retail-investors>; Policy Statement: "Restrictions on the retail distribution of unregulated collective schemes and close substitutes", dated 4 June 2013: <https://www.fca.org.uk/publications/policy-statements/ps13-3-restrictions-retail-distribution-unregulated-collective>

<sup>141</sup> Money Marketing News: "Investors vote to place Connaught UCIS fund into liquidation", 14 September 2014: <https://www.moneymarketing.co.uk/news/investors-vote-to-place-connaught-ucis-fund-into-liquidation-2/>

<sup>142</sup> FSA News Story: "Investors warned over Connaught Income Funds", July 2014 update: <https://www.fca.org.uk/news/news-stories/investors-warned-over-connaught-income-funds>

from the Fund and ensure that all monies were repaid to the Fund following completion of loans repaid to TIL by its borrowers<sup>143</sup>.

**January 2015** – Mediation takes place between representatives of the Fund's liquidators, the operators, and the FCA.

**9 March 2015** – The FCA announces its withdrawal from negotiations. End of Review Period.

**30 June 2015** – EXCO decides that the Risk and Compliance Oversight Division should conduct a lessons learned exercise. The review should consolidate all previous lessons learned with the intention of assessing the adequacy of the changes implemented by the FCA since the collapse of the Fund and whether further improvement is needed.

**5 November 2015** – A Final Notice is published cancelling Tiuta's permissions and removing Steven Nicholas' controlled functions<sup>144</sup>.

**January 2016** – A settlement of the liquidators' civil proceedings against CFM is reached, pursuant to which CFM is required to pay to the liquidators approximately £18.5m for distribution to Fund investors.

**November 2017** – The Capita Final Notice is issued, pursuant to which CFM agrees to pay up to £66m for distribution to Fund investors<sup>145</sup>.

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<sup>143</sup> UK Government Press Release: "*Connaught Asset Management directors banned for 16 years*", dated 19 December 2014: <https://www.gov.uk/government/news/connaught-asset-management-directors-banned-for-16-years>

<sup>144</sup> Tiuta plc Final Notice dated 5 November 2015: <https://www.fca.org.uk/publication/final-notices/tiuta%20plc.pdf>

<sup>145</sup> Ibid, paragraph 2.11.

### APPENDIX 3 SUMMARY OF REGULATOR POWERS

1. This Appendix summarises some of the statutory powers the Regulator had during the Relevant Period.

#### **Information gathering and investigation powers**

2. Powers to gather information and investigate, including powers to:
  - (a) Compel the production of documents and information. The Regulator could require authorised firms (as well as certain persons connected with them) to provide specified information and documents, provided they were "*reasonably required*" in connection with the Regulator's statutory powers;
  - (b) Appoint a Skilled Person. In cases where the Regulator had power to request information or produce documents in accordance with the procedure above, it could require that authorised firms (and certain connected persons) produce a report by a "*skilled person*" that the Regulator nominated or approved;
  - (c) Other investigation powers (including enforcement investigations). The Regulator could appoint an investigator with certain powers to investigate a person or its business, as well as certain connected persons in various other circumstances. This included powers to appoint investigators from the Regulator's Enforcement team to investigate possible wrongdoing including, for example, potential breaches of the Regulator's rules (including its Principles).

#### **Disciplinary powers**

3. Certain disciplinary powers, including powers (after following various required processes) to issue:
  - (a) Private warnings. The Regulator could issue a private warning when it deemed that the nature of an offence in question did not warrant that formal public disciplinary measures be taken;
  - (b) Public censures. Where the Regulator considered that an authorised person had contravened a regulatory requirement it could publish a statement to that effect;
  - (c) Financial penalties. Where the Regulator considered that an authorised person had contravened a requirement imposed by FSMA, it had the power to impose a penalty "*of such amount it considers appropriate*", usually based on the turnover of the firm.

#### **Variation of permission**

4. Powers to remove or vary a firm's regulatory authorisation, including:
  - (a) Variation on the initiative of an authorised person ("VVOP"). Where an authorised firm applied to vary its own permissions, including by adding, removing, cancelling or varying a permission, the Regulator was empowered to vary or cancel that permission. The Regulator could also refuse to grant such

permission where it considered that this was desirable to meet any of its regulatory objectives;

- (b) Variation on the Regulator's own initiative ("OIVOP"). The Regulator also had various powers to vary, restrict, suspend, impose requirements on or cancel a firm's authorisation, in certain circumstances, for example if it appeared that the firm was failing to satisfy certain conditions or if the Regulator considered that it was desirable in order to meet its regulatory objectives. For example, at one stage in this case the Regulator considered whether it might vary BGC's permissions to require it to suspend the Fund.

### **Other disciplinary powers**

5. A number of other disciplinary powers, including:

- (a) Prohibition orders. If the Regulator considered that a person was not fit and proper to carry out functions in relation to a regulated activity the FSA could prohibit that individual from performing certain activities in connection with regulated businesses;
- (b) Withdrawal of approved person status. The Regulator could suspend its approval of an individual to perform controlled functions within a regulated business;
- (c) Injunctions. In certain circumstances the Regulator could apply to the courts to obtain an injunction, including in relation to the performance of regulated activities;
- (d) Administration powers. The Regulator could make an administration application in relation to a company or an insolvent partnership which was or had been authorised. Additionally, the Regulator could appear at the hearing of an administration application made by another party (such as the company itself or its creditors), or it could consent or block the appointment of an administrator by the company or its directors. The FSA could additionally have participated in insolvency proceedings;
- (e) Winding up petitions. The Regulator could petition the court for the winding up of a company on the grounds that it was unable to pay its debts, or that it was just and equitable that the company be wound up.

## **APPENDIX 4 REVIEW METHODOLOGY**

### **Internal and external data**

In total, over 22,000 documents spanning a period of over 10 years were collected and considered by the Independent Reviewer and his team (the "**Independent Reviewer's Team**") as part of the Review. This included, primarily, internal data from the Regulator, such as emails and other correspondence, internal policies, procedures and guidance, agendas, minutes, and other records of meetings, file notes, memoranda, presentations, financial analyses, other documents, and system records. It also included a significant amount of documentation and correspondence from external sources, including historical documents and correspondence as well as submissions and correspondence prepared in connection with the Review.

### **Interviews**

The Independent Reviewer's Team conducted interviews and meetings with 37 individuals. This included interviews with investors, IFAs, and other interested parties, carried out as part of a formal external stakeholder engagement process which invited interested parties to make written submissions and to attend interviews where appropriate. The Independent Reviewer's Team also conducted interviews with the liquidators of the Fund and of Tiuta, and with the Financial Regulators Complaints Commissioner's Office, the Insolvency Service, and the Financial Ombudsman Service. Information and documents were collected during this process and considered as part of the Review.

The Independent Reviewer's Team conducted interviews with 19 individuals who were current or former Regulator staff directly involved in the matters under review. The interviewees included (without limitation) staff at various levels of seniority who serve or have served in the following parts of the Regulator:

- Supervision
- Enforcement
- General Counsel's Division
- Executive Committee (including various senior current and former members)
- Complex Events
- Communications
- Financial Promotions
- Unauthorised Business Division

Pursuant to the Review Protocol, all interviewees met with the Independent Reviewer's Team on a voluntary basis. All interviewees from the Regulator (whether currently or formerly) cooperated in full and there was nothing to suggest that any interviewee was anything less than forthcoming with information or (if requested) documents.

Overall, the Independent Reviewer's Team is satisfied that the Regulator has cooperated with the Independent Reviewer's Team throughout the Review.

## **APPENDIX 5 LEGAL DISCLAIMER**

The findings and recommendations in this report are those of the Independent Reviewer based upon his assessment of information provided by the FCA, various external stakeholders, and those individuals whom he has interviewed, met and corresponded with.

Any conclusions the Independent Reviewer has drawn are reliant upon the accuracy of the information provided to him and his team during the course of the Review, and it should be noted that others considering the same information or documents could reach different conclusions.

The Independent Reviewer has not conducted a detailed independent audit of all the information made available to him.

No representation or warranty is provided as to the accuracy or completeness of any factual statements, findings, views, or recommendations in this report.

No responsibility is assumed to any persons other than the FCA. The Report's contents should not be relied upon by any other persons for any purpose. The Independent Reviewer accepts no liability or responsibility in respect of any loss or damage, whether direct or indirect, suffered by any person in connection with the report and/or as a result of any reliance placed by any person on the views, findings, or recommendations in the report.

This disclaimer extends but is not limited to any references to or comments upon legal or regulatory requirement standards or guidance. These references or comments reflect the views of the Independent Reviewer only, do not constitute legal (or other) advice, and should not be relied upon. No responsibility is taken for changes in market conditions or laws or regulations and obligations which may be said to revise this report which occur subsequently to the date of this report. If and to the extent that the report includes any legally privileged material, its inclusion is not intended to be a general waiver of privilege in any legally privileged material provided to the Independent Reviewer, which has been provided for the specific purpose of carrying out his Review.

The FCA has indicated that it believes it has provided all relevant legally privileged material to the Independent Reviewer's Team for the purpose of the Review. Save to the extent that such material is referred to in the Report, its confidentiality is maintained.

## **APPENDIX 6 ACKNOWLEDGEMENTS**

The Independent Reviewer would like to acknowledge and thank those who have assisted and provided him and his team with information, documents, and their views, for the purpose of this Review. Every effort has been made to consider and address all the points and materials submitted for this Review which are relevant to the Terms of Reference.

First, the Independent Reviewer wishes to thank the FCA team for their cooperation, support, and assistance throughout the Review. During the Review, the FCA team (amongst other things) facilitated delivery of over 22,000 documents spanning a period of over 10 years, and coordinated numerous interviews with current and former Regulator staff. The Independent Reviewer is grateful to all interviewees who agreed to meet with him to provide their evidence and perspectives, in circumstances where they were under no obligation to do so. Further information regarding the interview process may be found in Appendix 4.

The Independent Reviewer wishes to also thank all external stakeholders who responded to his request for evidence and representations, and who took the time to provide written and oral materials and submissions. Further information may be found under Appendix 4.

Last but not least, the Independent Reviewer wishes to thank the Independent Reviewer's Team for their excellent support throughout this Review. Particular gratitude goes to Anita Davies of Matrix Chambers, and Chris Chapman, Stephen Moi, and Findley Penn-Hughes from Mayer Brown.

## **APPENDIX 7 REVIEWER BIOGRAPHY**

Raj Parker is a barrister, arbitrator and judge. He is an associate member of Matrix and prior to joining in 2016 was a solicitor at Freshfields for over 30 years, 23 as a Partner. He was co-head of Freshfields' global financial institutions contentious practice during the financial crisis of 2008. He specialises in general commercial and financial services dispute resolution, international regulatory investigations, and sports law.

He has handled contentious and regulatory issues in the insurance, banking, pharmaceuticals, air traffic, leisure, diamond, energy, transport, reconstruction and insolvency, sport and media sectors.

He also specialises in corporate criminal investigations and white collar crime issues and is a member of the Governance, Investigations and Solutions – Matrix Integrity + team.

He is a part-time Grand Court Justice of the Cayman Islands (in the Financial Services Division). He also sits widely as an arbitrator and has been appointed as an independent reviewer and investigator in relation to regulatory matters and as an expert witness in relation to contentious commercial matters.