

# **Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc – The FCA Response**

December 2020



# Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc – The FCA Response

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## Abbreviations used in this document

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<b>DES</b>	Delivering Effective Supervision change programme
<b>EMO</b>	Enforcement and Market Oversight
<b>FCA</b>	Financial Conduct Authority
<b>FSCS</b>	Financial Services Compensation Scheme
<b>FOS</b>	Financial Ombudsman Service
<b>FSA</b>	Financial Services Authority
<b>JSET</b>	Joint Supervision & Enforcement Taskforce
<b>LCF</b>	London Capital & Finance plc
<b>SFO</b>	Serious Fraud Office
<b>UBD</b>	Unauthorised Business Department

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# 1 Foreword

- 1.1** London Capital & Finance's (LCF) collapse has had a profound impact on the lives of many individuals who invested money they could not afford to lose. We are very sorry for the errors we made in our handling of this case. **We accept and will implement each of the 9 recommendations made to the FCA** in Dame Elizabeth Gloster's report on our regulation of LCF (the LCF Review). The LCF Review has also made 4 additional recommendations for the Treasury and wider Government and we will provide them with any advice and support they need as they consider these.
- 1.2** We are investigating whether LCF's collapse was caused by serious misconduct by individuals and third parties linked to the firm. Investigations into fraud and misleading the regulator by the Serious Fraud Office (SFO) and ourselves continue. We are grateful to the bondholders who have supplied us with evidence of suspected serious misconduct in this case. We will do everything we can to support the timely conclusion of those investigations.
- 1.3** Our programme of work to improve is continuous and we have already brought in or are making changes to address many of the LCF Review's recommendations. The work we have already undertaken to better enable us to identify issues, join up intelligence and assess risks includes:
- Deploying 100 full time equivalent staff working on different aspects of pension scams and related issues.
  - Creating a cross-FCA central intelligence, information and insight capability to improve how we manage and triage flows of information around the FCA ahead of the appointment of a Chief Data, Intelligence and Information Officer.
  - Restricting investments by inexperienced investors in peer-to-peer lenders.
  - Implementing a temporary ban on marketing speculative illiquid securities, such as those issued by LCF.
  - Investing significantly in online warnings linked to searches for high return investments.
  - Establishing the Joint Supervision & Enforcement Taskforce (JSET) to focus strategically on the drivers of harm we identified through our work in 2019 on mini-bonds and other high-risk investments, ensuring a co-ordinated response across the FCA.
  - Alerting CEOs of firms involved in approving financial promotions for unauthorised persons in January 2019 and April 2019 that we would hold them to their obligations to ensure that these promotions were fair, clear and not misleading. In November 2019 we refreshed our guidance for authorised firms which approve the financial promotions of unauthorised persons, setting out our expectations for the due diligence they should perform.
  - Evaluating core competencies across staff overseeing firms, with new and updated training and guidance to help them identify risks in business models and financial information.
  - Investing £98m over 3 years to build the technology and skills needed across the FCA for our strategy focused on data analytics.
  - Developing data analytics and visualisation tools to help our people join the dots and better identify the risk of harm.

- 1.4** We are also taking forward policy changes to give consumers better protection, including:
- We have made permanent the temporary restrictions we imposed on the marketing of speculative illiquid securities, such as those issued by LCF.
  - We will undertake a 'use it or lose it' exercise, with firms that have not used their regulatory permissions to earn any regulated income for the last 12 months at risk of having their Authorisation revoked, to reduce the risk of firms having a permission to carry out regulated activity purely to add credibility to their unregulated activities.
  - We have issued a Call for Input to seek views on how the consumer investment market can be improved, focused on how consumer confusion, which leads to poor choices, can be reduced. The Call for Input closes this month, after which we will take further action to improve the market.
- 1.5** We are working with online platforms to see that they rapidly deliver on their public commitment to preventing harm from online advertising, and we have seen some improvement in checks on advertisers, although considerable work remains to be done. We agree with the LCF Review's recommendation that serious consideration be given to the coverage of financial harm in the proposed Online Harms Bill.
- 1.6** This response gives more detail on these and other initiatives we have taken and will take to implement fully the LCF Review's recommendations.
- 1.7** The recommendations also highlight the need to tackle 2 critical issues:
- 1.8** First, our processes, systems, capabilities and how we allocate resources must keep pace with external developments. LCF happened against a backdrop of significant increases both in our responsibilities and in the number of firms we supervised; the implementation of the UK's withdrawal from the European Union; more investment freedom for consumers; and the proliferation of online marketing. With these and other priorities competing for our resources, we did not keep pace with these changes in the way we handled information and intelligence about LCF, or join up our separate functions to address the issues with LCF. While some of these issues may be beyond our control, we are addressing those that lie within it through our continuing transformation programme to intervene faster and more effectively.
- 1.9** We have already invested significantly to improve the way we use data and are recruiting a Chief Data, Information and Intelligence Officer to our Executive Committee to drive fundamental change in the way we manage and use our information and intelligence, in line with our [Data Strategy](#) launched in January 2020. However, we know that fully achieving this strategy will be extremely challenging and take time. We are also changing our senior management structure to better join up all our supervision, policy and competition activities.
- 1.10** We will continue to report on the progress of our transformation programme in our Annual Report and at 6-monthly intervals to demonstrate that we are implementing the programme as promised.
- 1.11** Second, as the investments and investment choices confronting retail consumers have become more complex, so too has the legislative framework that underpins consumer protection. With the Government, we want urgently to find ways to simplify the legal framework, with clear distinctions in how regulation applies and the extent

of consumer protection, so that we can give retail consumers greater confidence to invest with better awareness of the risks they are taking.

- 1.12** We will learn the lessons from the LCF case and are committed to tackling the harm in this market as effectively as we can. Regulators, Government and, ultimately, Parliament will need to be very clear for the future about the extent to which freedoms for investors should be curtailed, including for high net worth and sophisticated investors, so that all consumers can be better protected.
- 1.13** A clearer legal framework will help us balance the resources we allocate to protecting consumers from high risk investments with the other resources we need to allocate to other consumer harms as the UK economy recovers from the pandemic, including increased risk of harm from unsustainable credit and lack of access to a range of basic financial services.

## 2 Introduction

- 2.1** LCF issued non-transferable securities to investors. Issuing non-transferable securities is an unregulated activity, including when they are issued by a firm like LCF which was initially authorised for credit related activities. In December 2018, we directed LCF to withdraw all its promotional material because the way it was marketing the investment products it issued to retail consumers (often referred to as 'mini-bonds') was misleading, unfair and unclear. On 30 January 2019 LCF failed and entered administration.
- 2.2** LCF's collapse has had a profound impact on the lives of many individuals who invested money they could not afford to lose. We are investigating whether LCF's collapse was caused by serious misconduct by individuals and third parties linked to the firm. The Serious Fraud Office (SFO) is pursuing criminal investigations into allegations of fraud. We are also investigating whether LCF, and related individuals, failed to deal with us in an open and cooperative way. The Financial Reporting Council has launched investigations into 3 separate audit firms, which reported no irregularities in their audits of LCF. We are doing everything we can to support the conclusion of those investigations.
- 2.3** On 23 May 2019, following a request from the FCA Board, the Economic Secretary to the Treasury directed the FCA to carry out an independent investigation into our regulation of LCF during the period 1 April 2014 to 30 January 2019 (the Relevant Period). Dame Elizabeth Gloster was appointed to carry out this investigation. The LCF Review has now been published, and this is our response to it.
- 2.4** We accept and will implement each of the LCF Review's 9 recommendations to us, as we set out in more detail below. We will continue to report on the progress against our action plan and our ongoing transformation programme.
- 2.5** We also recognise that in complex high-risk markets, we cannot prevent all harm from happening. It is important that our approach does not prevent informed risk-taking by those who can afford to do so. In this context, we would welcome an open conversation between regulators, Government, and ultimately, Parliament about the extent to which investor freedoms should be curtailed, including those for high net worth and sophisticated investors, so that all consumers are better protected. We have started this discussion in September this year by publishing a Call for Input on the future of the consumer investments market.

## 3 Our response to the LCF Review's recommendations for us

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

**3.1** We accept this Recommendation.

**3.2** We could have done more to ensure that our staff were aware how, and to what extent, they could consider an authorised firm's unregulated activities in their work. We agree with the LCF Review's suggestion that we should do more to encourage staff to look beyond the regulated activities of a firm; for example, when we receive credible evidence of fraud or serious irregularity, or when an overwhelming proportion of a firm's business does not require authorisation but is in the financial sector, creating a greater risk of consumer confusion about the scope of our regulation.

**3.3** We have already taken steps towards implementing this recommendation. For example, through our 'Delivering Effective Supervision' (DES) change programme:

- We assign every firm to a 'portfolio' of firms with similar business models. Each portfolio is supervised by a team with expertise in and knowledge of the firms' business models and an understanding of the associated risks of harm.
- We have implemented a Portfolio Assessment Model. This means supervisors can produce a holistic overview of the portfolio, the potential harms from the business model and how effectively the firms are reducing or preventing them.
- We have introduced a requirement for supervisors to give risk scores for events based on a holistic consideration of the firm's regulatory history. This includes both regulated and unregulated activities. This process will be reinforced by completing a 'single view of the firm', which will allow us to join the dots more easily between different pieces of information and intelligence from different areas.

**3.4** Additionally, authorising firms is now a central part of our portfolio approach to supervision, with risks at the gateway considered for each portfolio of firms. The portfolio risk rating also affects how we treat firms' authorisations. Following our improvement programme in Authorisations, the percentage of applications withdrawn has doubled. This programme also improved the handover from the Authorisation case team to a firm supervisor, as Authorisations staff play an important part in portfolio assessment. This year we have also worked with the Treasury on a consultation to establish a regulatory 'gateway' which a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms.

### 3.5 Going forward:

- We will review our policies and guidance to make it clear when case officers should consider the firm and its business model holistically (including when they should consider an authorised firm's unregulated activity) to determine the appropriate course of action. We will also review our governance and quality assurance processes to ensure that we give complex cases appropriate attention.
- We are recruiting additional prudential specialists to act as quality assurance and assess firms with complex business models, including where they combine regulated and unregulated activity, within our Authorisation Division.
- By the end of the first quarter of next year, all frontline Supervisory, Authorisation and Enforcement staff will have completed mandatory training on 'FCA Powers and Unregulated Activities', 'Financial Accounting' and 'Business Model Analysis'. We will also add to our existing training on supervisory tools to give staff greater confidence in knowing when and how to intervene using relevant intelligence held across the FCA.
- We will undertake a 'use it or lose it' exercise, with firms that have not used their regulatory permissions to earn any regulated income for the last 12 months at risk of having their Authorisation revoked, to reduce the risk of firms using a permission to carry out regulated activity purely to add credibility to their unregulated activities.

**Recommendation 2: the FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the nonregulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.**

### 3.6 We accept this recommendation.

### 3.7 We receive hundreds of thousands of calls to our Contact Centre every year – over 200,000 in 2019/20 – and believe that we handle the overwhelming majority of them appropriately. However, we agree that our Contact Centre policies ought to be clearer about when staff should refer allegations of fraud or serious irregularity for further consideration. We will review and update our 'how-to' guides and policies in the Contact Centre. This will include:

- Instructing our staff to take as much information as possible if they receive allegations of fraud at an FCA-authorised firm, whether this involves regulated or unregulated activities.
- Instructing our staff to escalate the case to firm supervisors, and guide case handlers to not give any reassurance about a regulated firm's unregulated activities, or wrongly state that a product they offer or activity they undertake is covered by the Financial Service Compensation Scheme (FSCS).
- Enhancing our training of staff in these areas, which will form a core part of ongoing mandatory training and coaching.
- Additionally, our Data Strategy will use data analytics to analyse consumer calls to help staff identify and escalate calls that raise particular issues appropriately, and join the dots more effectively between different types of contact or information, such as calls mentioning fraud or repeated calls from one person.

**Recommendation 3: the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA.**

**3.8** We accept this Recommendation.

**3.9** We processed 4,233 applications for authorisation and 2,646 for a variation of a firm's permission last year, and our supervisors dealt with some 36,000 cases in our Supervision Division, in addition to their scheduled activities in supervising some 60,000 firms.

**3.10** While it is not proportionate for all our staff to have formal accountancy, audit or financial analysis qualifications, or to be able to conduct detailed analysis of a firm's financial statements, we will do more to improve the financial capability of relevant staff in our Authorisations and Supervision Divisions. This will help them consider firms' business models more deeply and to escalate concerns to specialists.

**3.11** We have already implemented a capability programme in Supervision and Authorisations. Training focuses on the four core skills of our capability framework: judgement, engagement, delivery and self-management. This includes:

- Undertaking a survey to establish the capability levels of staff in key areas, including their financial analysis capability.
- Launching a 'faculties' system to develop and deliver an extensive range of training and knowledge-sharing in key areas including financial analysis, financial adequacy, liquidity and capital.
- Providing training programmes on financial analysis run by an external provider to new joiners, which will be rolled out to existing staff.

**3.12** As explained above, by the end of March 2021, all Supervision, Enforcement and Authorisations front-line staff will have completed mandatory training on 'FCA Powers and Unregulated Activities', 'Financial Accounting', and 'Business Model Analysis'. In addition, we will develop and roll out further training and testing for relevant staff in line with this recommendation within 6 months.

**3.13** We are increasing our specialist expertise within Supervision and Authorisations, to provide additional scrutiny and expertise to assist with making judgements on firms' financial accounts in appropriate cases. We are currently finalising a round of recruitment, and will advertise further jobs shortly.

**Recommendation 4: the senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the day-to-day supervision and authorisation of firms.**

**3.14** We accept this Recommendation.

**3.15** As the recommendation reflects, we have to make difficult judgments about which risks are sufficiently serious to prioritise above others.

**3.16** We have already taken steps to ensure that staff know about key product and business model risks, in line with the prioritisation decisions that direct our work:

- We are developing a dashboard of Key Risk Indicators (KRIs) for each portfolio, to be used by our supervisors, and which we will continuously improve and refine, as well as common KRIs that apply across all portfolios. Among other things, we will use these dashboards to help supervisors identify firms with outlier KRIs, requiring deeper investigation.
- Each portfolio is RAG (Red, Amber, Green) rated to reflect its inherent level of harm to consumers and markets. This allows us to prioritise and use FCA-wide resource most effectively, with red portfolios having higher levels of proactive supervision.
- We have taken action so our Financial Promotions team flags any action they take for a firm to the relevant portfolio supervisors. This means that supervisors can take into account the risks of the firm's financial promotions in their wider work with the firm. We recognise that for this engagement to be effective we also need to do more to foster a culture of curiosity and scepticism and to make our authorisation and supervision more highly attuned to harm which arises at or just beyond the limits of our regulation.
- Better tagging of risks within our systems so those working on cases or dealing with queries are better aware of the risks of that particular portfolio of firms.

**3.17** More recent examples of our prioritisation in 2020 have involved responding to the effects of the Covid-19 pandemic with interventions to ensure consumers have greater flexibility in repaying loans and mortgages. We have also prioritised giving small businesses clarity about the extent of their business interruption insurance, and by reprioritised our supervisory resources to address the risks of firms failing in a disorderly way. We have also moved over 40 people to strengthen our resources in assessing the resilience of firms and the risk that they may cause harm if they fail as a result of the economic effects of the coronavirus, bringing this team up to over 100 people, and assessing over 40,000 firms. This has meant we have had to deprioritise other work, such as consulting on banning exit fees on investment platforms and introducing a single easy access rate for cash savings. These decisions are difficult, and can mean, in some areas, that harm persists for longer than it should. But we take them with the aim of preventing far greater harm arising immediately elsewhere.

**3.18** We accept we could do more to ensure that we give staff in frontline activities regular updates on the key product and business model harms we identify.

**3.19** Going forward, we will review our Management Information and other staff training and communications to ensure these staff receive regular relevant updates and continually assess the way in which they tag information and intelligence to ensure its relevancy and its usefulness.

**Recommendation 5: the FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.**

**3.20** We accept this Recommendation.

**3.21** During the period covered in the LCF Review, we changed our approach to financial promotions:

- Our Enforcement and Market Oversight (EMO) Review in 2016 delivered significant changes in practice and process at the line between Enforcement and Supervision. In particular, it resulted in:
  - earlier referrals for investigation where we suspect serious misconduct
  - opening more investigations into individuals and senior management misconduct, and
  - new performance measures, including how long an investigation takes us
- From June 2018, when our DES change programme created firm portfolios, our Financial Promotions and Supervision portfolio teams have worked in closer coordination where concerns have been raised about a firm's financial promotions.
- We published our [Approach to Enforcement](#) and issued new Investigation Opening Criteria in 2018. Our bolder approach to intervening means we are investigating more cases generally. As at September 2020, there were currently 611 cases open in Enforcement, compared to the 237 that were open at the same point 5 years ago.
- In September 2019, we reinforced this closer working between Supervisory and Enforcement teams, by establishing the Joint Supervision and Enforcement Taskforce (JSET). Its remit is to focus strategically on the drivers of harm we identified through our work in 2019 on mini-bonds and other high-risk investments, ensuring a co-ordinated response across the FCA.

**3.22** Going forward, we will also review our policies and approaches to ensure our escalation procedures are sufficient for serious infringements and multiple breaches of the financial promotions rules. This review will also ensure that it is clear in what circumstances we need to probe further, for example, where we have concerns about the underlying product, the firm's business model, its marketing strategy or its sales approach.

**3.23** Promotions need only comply with FCA rules if they are communicated or approved by an authorised person. We alerted CEOs of firms involved in approving financial promotions for unauthorised persons in [January 2019](#) and [April 2019](#) that we would hold them to their obligations to ensure that these promotions were fair, clear and not misleading. In November 2019 we issued [guidance](#) for authorised firms which approve the financial promotions of unauthorised persons. We set out our expectations of the due diligence into the products being promoted that is required to ensure that a promotion is fair, clear and not misleading. This year we have worked with the Treasury on a [consultation](#) to establish a regulatory 'gateway' that a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms. Effective due diligence by qualified firms should ensure that fewer harmful products are promoted.

**3.24** We are aware of evidence that suggests some unregulated companies (often known as introducers), which appear to be separate from firms offering investments, coach investors to self-certify as high-net worth or sophisticated so that they can assert

their promotional activities are exempt from having to be approved. Although this type of practice can be difficult for us to identify and stop, we have a number of cases under investigation. We discuss the exemptions further under Recommendation 13 below.

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

**3.25** We accept this Recommendation.

**3.26** We broadly cover our response to this in our actions for Recommendations 1 and 2. We also plan to roll out specific training on our approach to the scope of our regulation within 6 months. This will cover both FCA-wide training and specific training for individual roles. The failures that the LCF Review identifies suggest we need a wider cultural change. To lead by example, it is essential that we hold ourselves to account on our own culture. Fast-tracking a more unified FCA and greater pace and agility in addressing harm are overarching priorities for our transformation programme. This requires a cultural and behavioural shift to enable us to anticipate issues, scrutinise intelligence and challenge business models with a sceptical mindset – and respond at pace.

**3.27** More broadly, we take our role towards fraud very seriously, as shown by our determination to tackle it in recent years. Over the period covered by the LCF Review:

- We ran successive consumer campaigns on investment, insurance, mortgage, pension and authorised push payment fraud. For example, we have worked with banks and other regulators so more victims of push payment fraud are reimbursed.
- We adjust our ScamSmart campaigns regularly to tackle emerging scams. Our investment fraud campaign for the over-50's, for example, reached 71% of our target audience, and successive campaigns have seen hundreds of thousands of visits to the campaign website and views of the associated video.
- Our Unauthorised Business Department (UBD), which deals with those firms undertaking regulated activity without our authorisation, has dealt with increasing numbers of cases in recent years. UBD prioritises areas which are scams and unregulated activity, such as pyramid or Ponzi schemes, land banking, share fraud operated by boiler rooms, pension liberation schemes and unauthorised consumer credit. The number of reports sent for formal investigation to the UBD increased by 89% in the last 3 years. Last year they received over 20,000 reports, and are on track to receive over 24,000 this year. In 2020, UBD issued 1195 consumer alerts to potential scams. This is a 94% increase on last year, and an over 210% rise since 2014.
- In July 2020, we relaunched our enhanced Financial Services Register to include information on consumer protections and actions against individuals and firms to help users avoid scams.
- We also have a dedicated pension scams team, and currently have over 100 full-time equivalent staff working on pension scams and similar issues, within our Supervision, Pension Scam Intelligence, Whistleblowing and Campaigns teams, as well as the firm and customer Contact Centre, and other business areas.

**3.28** We will continue to work closely to share information with a range of partners, including the Financial Ombudsman Service (FOS), FSCS, law enforcement, firms and consumer groups, both to tackle and prevent harm and raise consumer awareness of the increased risk of scams to help them protect themselves. But our powers to investigate and prosecute fraud remain limited. For example, we do not have statutory powers to investigate fraud and gather evidence at unauthorised firms, unless there is a link to an offence committed under the Financial Services and Markets Act 2000.

**Recommendation 7: the FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (eg artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.**

**3.29** We accept this Recommendation.

**3.30** As noted above, we accept our systems did not keep pace with the rapid increase in our remit. We receive a huge volume of information. In 2019/20 we received over 200,000 calls from consumers and firms. We managed and assessed over 1,100 whistleblower reports consisting of nearly 3,000 allegations. We receive and monitor 38 million market transactions a day and receive over 500,000 regular data submissions from firms each year. We also receive information from other regulators, law enforcement agencies and from our own proactive reviews of market intelligence and data sources. It is vital that we make the best use of this intelligence. Since 2015, when we introduced a new case management system – Intact – used across Authorisations, Supervision and Enforcement, we have been working to transform our IT systems. Given the size of the FCA's legacy systems, some inherited from our predecessor bodies, this is a significant undertaking.

**3.31** We have already:

- Created a single standard system of labelling issues and products in our supervisory system.
- Created taxonomies of harm and causes of harm.
- Combined with this, implemented a revised risk-scoring approach in Supervision. This maps clearly to the cross-FCA Risk Management Framework, providing information we can immediately analyse.
- Brought in visualisation tools to enable staff to produce dashboards so they can consider and analyse information about firms and groups of firms more efficiently and effectively. We have also brought together data from many sources into a 'data lake' (a central, searchable data bank) to combine and analyse it. We will be continuously expanding and improving the data lake.
- Started implementing a 'decision hub' system to automate lower level processes and decisions. This is an 'alerting' tool that staff can programme to scan and analyse a range of FCA-wide data.

**3.32** We also have major plans to improve our existing systems to deliver our information and intelligence strategy so that we become a more data-driven regulator. These changes will allow us to proactively identify, assess and address emerging, as well as actual, harms.

**3.33** Going forward:

- We are creating a central intelligence, information and insights function with a new Chief Data, Information and Intelligence Officer, reporting to the Chief Executive. This will continue to build our capability to assess and triage the intelligence we receive and set out the actions required in response.
- The Chief Data, Intelligence and Information Officer will be responsible for delivering our overall Data Strategy to supervise the 60,000 firms we regulate more

effectively and for ensuring we correctly and swiftly assess, triage and act on the information and intelligence we receive.

- We will roll out 'a single view of the firm' within Supervision and Authorisations. Staff from these areas interacting with a firm will be able to access the same intelligence, allowing them to make better decisions based on consistent, up-to-date information. This will allow us to join the dots more easily between different pieces of information and intelligence from different areas, taking full advantage of the FCA's new data lake.
- We are already investing £98m over 3 years to deliver the Data Strategy to harness the power of data and advanced analytics to better monitor harm, improve our analysis of data sources to detect and prevent misconduct, identify where we need to intervene and use automation to help us act more quickly. This includes over £6m this year to bring in additional data analytics skills.

**Recommendation 8: the FCA should take urgent steps to ensure that all key aspects of the DES Programme that relate to the supervision of flexible firms are now fully embedded and operating effectively.**

**3.34** We accept this Recommendation.

**3.35** Going forward:

- Our Risk & Compliance Oversight and Internal Audit teams will complete a joint review of Supervision in 2021 to assess whether DES has been fully implemented and embedded effectively, and to identify areas for improvement, reporting to the Board's Audit Committee.

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

**3.36** We accept this Recommendation.

**3.37** Information sent by regulated firms through our existing channels is crucial to our work. Most firms are keen that we stop those who give their industry a bad name. In 2019 we received over 1,100 separate whistleblowing disclosures, covering nearly 3,000 separate allegations. We receive vital information from people working in the industry and firms through our firm Contact Centre, and we speak widely with firms and trade bodies as part of our supervision and policy-making.

- We already have a dedicated whistleblowing function which acts as the point of contact for all external whistleblowers, which we continually improve. This team assesses the information received, before anonymising it to ensure whistleblowers' identities are protected. Where the whistleblower has more detailed information or would like to speak directly to us, we arrange for specialist staff to debrief them, often accompanied by subject matter experts. Any access to whistleblowing case information is strictly controlled.
- We are, as discussed in our response to Recommendation 7, currently recruiting a Chief Data, Information and Intelligence Officer to oversee improvements to the way we gather intelligence from all sources, including regulated firms.

## 4 Our own recommendations, and the LCF Review's recommendations for others

- 4.1** The LCF Review recognises that responsibility for solving the problems in the high-risk investments market is shared between the FCA and a range of other public bodies, including the Government, law enforcement agencies and Her Majesty's Revenue & Customs (HMRC). We will work constructively with all relevant bodies to deliver the fundamental changes this market needs to function better.

### The legislative framework

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- 4.2** After we identified mini-bonds as one of many potential areas of risk to our objectives in 2013, we restricted marketing of these investments and required firms to give clear warnings to consumers about risk. After this point, consumers who wished to receive direct offer financial promotions about mini-bonds had to sign a warning that they could lose all the money invested and that they were investing no more than 10% of their investable assets, were either high net worth or were a sophisticated investor, with experience of investing in similar products.
- 4.3** The LCF Review adds significant evidence that, despite marketing restrictions or warnings about the status of the investments, the risk of losing all their money and lack of cover from the FSCS, some retail consumers are still persuaded, including by unscrupulous operators, to invest their money in unsuitable products. Some may take these decisions with money they are prepared to risk losing, but others may be confused by the complexities in the scope of regulation and protection and risk money they can't afford to lose. The unscrupulous can take advantage of these complexities with marketing strategies, including online marketing, deliberately designed to mislead consumers. This is why the LCF Review's suggestion that we should do more to avoid a 'halo' effect from FCA authorisation which firms can misuse to mislead consumers about applicable protections is particularly challenging for us to respond adequately to within the complex current legislative framework.
- 4.4** Reducing harm to consumers from high-risk investments is one of our main strategic goals. We welcome the recommendations the LCF Review makes about this. We can make some further changes to this market without legislative change, and we are working closely with the Treasury to make it tougher for authorised firms to approve the financial promotions for products or activities undertaken by unauthorised firms. However, to achieve all that we think is necessary requires us to work closely with our partners in Government and with other regulators to bring about other changes.
- 4.5** These other areas include the issue of what we do and don't regulate, the current tax policy framework, the freedom of consumers to exercise choice and responsibility and the nature and extent of protection from the FSCS and FOS. New products, services and technologies are constantly emerging. We have now published 2 annual Perimeter Reports – in [June 2019](#) and [September 2020](#) – which aim to give greater clarity on our role and highlight where harmful issues are emerging at the edges of the legislative framework for investor protection. Additionally, many of the problems in

the investment market are systemic. To identify these, we asked a series of questions in our Call for Input in September 2020, looking across the whole market to identify problems that need to be fixed in order properly to meet the public interest.

- 4.6** Alongside other questions, the Call for Input asks whether more investments would benefit from 'prospectus-like' disclosure, and whether they should be subject to continuing disclosure requirements after they are issued. As the LCF Review recognises, this is a matter for the Treasury. We will give the responses to these questions to the Treasury to aid its consideration of **Recommendation 11** of this report, which recommends considering specific legislative changes to extend protections to non-transferable securities.
- 4.7** The Call for Input also asks questions about whether the current exemptions from the Financial Promotion Order for high net worth and sophisticated investors remain fit for purpose. As **Recommendation 13** of the report notes, there is evidence of a rise in unregulated introducers abusing these exemptions to market unsuitable high risk and scam products to retail clients. To avoid (or at least purport to avoid) the requirement for a financial promotion to be approved by an authorised person, unregulated introducers get consumers' contact details with the aim of coaching them to self-declare as sophisticated or high net worth. If the consumer does this, a firm can then market unsuitable investments to them. This is inherently difficult for us to police as it often involves individuals who are not authorised by us misrepresenting their activities as a legitimate use of the exemptions. Many prove difficult to trace and are sometimes based overseas. Where they can be traced, building a criminal case against them often requires action by other agencies who have powers that we do not.
- 4.8** The thresholds for determining who is a high net worth and sophisticated investor are determined by the Treasury and currently require certification of investment experience or annual income of £100k or assets of £250k. These thresholds have not been changed for 20 years and we consider that there is a case for the Government to review them and their operation. In addition, in the follow up to our Call for Input, we will consider whether it is appropriate to make clearer to investors what protections they are giving up by being certified as high net worth or sophisticated. Further, regulated financial advice from an authorised financial adviser to invest in high-risk investments is covered by the FSCS. We are concerned that this means that unsuitable advice to invest in high-risk investments is, in effect, subsidised by good advice to invest in less risky products through the FSCS levy.
- 4.9** The legislative and regulatory framework should provide clarity about when people are protected. But it has grown more and more complex and confusing at the same time as retail consumers are presented with more choices and more complex investments. We would like to work with Government and other regulators to reduce this confusion around consumer protection and the scope of regulation.
- 4.10** In our Perimeter Report, published in September 2020, we committed to a discussion this year with the Economic Secretary on its contents and for the outcomes of that meeting to be made public. Given the recommendations of the LCF Review and the need for these to be considered alongside those of the Perimeter Report, this meeting between the Economic Secretary and the FCA's Chief Executive will take place in the New Year. This meeting will also provide an opportunity for the Treasury and us to consider the responses to the Call for Input, with the aim of:

- Eliminating complexities in consumer protection across the different regulators and in the degrees of protection for different products.
- Drawing clear lines between products which can be sold to ordinary consumers and those which cannot, and the permissions that firms require to manufacture and market them.
- Drawing clear lines between those products and services which are eligible to be complained about to the FOS and those which are not, and which are protected by the FSCS and those which are not. This work should consider in particular whether the FSCS cover for advice on investments by authorised advisers remains appropriate for all investment products.

**4.11** The Call for Input closes on 15 December, and we will consider all responses before making recommendations and suggesting changes we can make to our own policies. But this is an area where we will have to work with others if we are to make real changes to the confusion caused by the complications in consumer protection.

**4.12** The LCF Review has raised other issues which we believe would also benefit from a wider discussion.

**4.13** Closer co-operation with financial regulators during the development of tax, regulatory and pensions policy would help ensure the implications for consumer protection and behaviour are accounted for when, for example, policies create incentives to make different financial decisions.

**4.14** This would also mean that we would have more opportunity to develop regulatory policy and proactive authorisations and supervisory strategies that anticipate the potential harm from new developments in tax and pensions policy.

**4.15** Tax and investments policy could also be developed with greater consistency with consumer protection to help reduce the widespread confusion about where protection from the FCA and FSCS does and doesn't apply. For example, claims against the operator of a peer-to-peer platform which provides Innovative Finance ISAs are not covered by the FSCS but claims against the manager of an authorised fund held in a stocks and shares ISA may be covered by it.

## 5 The progress of our transformation programme

- 5.1** Our continuing, multi year transformation programme is significant and will take some time to implement. Our transformation plans are based on the assumption that there is limited scope to finance our plans by increasing the fees we raise, which are ultimately borne by consumers of regulated activities. We note that in 2013 the Parliamentary Commission on Banking Standards recommended that we reduce our costs, and that during the Relevant Period both the Government and the Treasury Committee did not support increases in our fees.

## 6 Accountability and responsibility

- 6.1 We note the comments in the LCF Review which clarify that the allocation of responsibility to individuals is not a finding of personal culpability.
- 6.2 Nevertheless, the FCA Board has decided that discretionary pay awards for Executive Committee members which have been deferred in respect of the 2019/20 year will not be paid.

### Complaints

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- 6.3 We know that this is an uncertain time for bondholders. We will determine complaints against the FCA arising from LCF as quickly as we are able to. In line with our published Complaints Scheme we will consider all complaints on an individual basis.

## 7 Next Steps

- 7.1** We will fully incorporate the recommendations of the LCF Review into our assessment of how effectively our current actions are delivering, as well as our action plan and ongoing transformation programme, which is a key focus of our Chief Executive and Executive leadership team. We will report on the progress of our transformation programme in our 2020/2021 Annual Report and at 6-monthly intervals until the recommendations from this and the Reviews into Connaught and interest rate hedging products have been substantially implemented. The implementation of the LCF Review's recommendations will be subject to comprehensive assurance activity as recommended in the LCF Review, and our Board and its Audit and Risk Committees will oversee this. The Chairs of the Board and these two Committees will issue a report within our Annual Reports explaining how those bodies have performed this oversight role.
- 7.2** Alongside the SFO, we continue to pursue our investigation into serious misconduct by individuals and third parties linked to the firm.
- 7.3** It is vital we learn the lessons set out in the LCF Review. We are determined to do so to enable us to better drive higher standards in the vital consumer investment market.

## Annex 1

# Costs of the Independent Investigation

- 7.4** An independent report of this length and complexity inevitably calls for a high level of specialist expertise. The total external costs of the investigation since it was commissioned to the end of November 2020 are approximately £6.7 million including VAT. There will be additional costs beyond November 2020.

<b>Service</b>	<b>Amount incl. VAT (million)</b>
Independent Reviewer and Direct Support Team	£5.2
Legal advice and other support for FCA and employees	£1.5
<b>Total</b>	<b>£6.7</b>







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