

Treasury Committee

Oral evidence: [The Financial Conduct Authority's regulation of London Capital & Finance plc, HC 1191](#)

Monday 1 February 2021

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Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Harriett Baldwin; Anthony Browne; Dame Angela Eagle; Mike Hill; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 63

Witnesses

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



Examination of Witnesses

Witnesses: Rt Hon Dame Elizabeth Gloster DBE, Dorothy Cory-Wright, Richard Frase and James Petkovic.

Q1 **Chair:** Good afternoon and welcome to the Treasury Select Committee's first evidence session as part of our inquiry into the conduct of the FCA's regulatory oversight of London Capital & Finance plc. I am delighted to be joined by four witnesses this afternoon, and I will ask them each to introduce themselves to the Committee very briefly.

Dame Elizabeth Gloster: My name is Elizabeth Gloster. I was appointed to be the independent investigator into the regulation by the FCA of London Capital & Finance, and I produced my report in November of last year.

James Petkovic: My name is James Petkovic. I am a junior counsel at One Essex Court and I assisted Dame Elizabeth with the investigation and the production of the report.

Dorothy Cory-Wright: Hello. I am Dorothy Cory-Wright. I am head of disputes at Dechert, and I led the Dechert team that supported Dame Elizabeth.

Richard Frase: I am Richard Frase. I am a financial services partner at Dechert and part of Dame Elizabeth's team.

Q2 **Chair:** Welcome to the Committee. I would like to start with a question to Elizabeth. Where I come from in Devon, or where my constituency is, they would describe your report as a "proper job." It is very, very thorough. It is also very damning of the FCA, with a litany of regulatory shortcomings, some of which, or perhaps all of which, have resulted in many people losing substantial amounts of money. Lives have been shattered as a consequence. In your report, you grapple with this distinction between responsibility—being responsible for areas where failings occurred—and culpability. Could you set out for the Committee the distinction you make between the responsibility and the culpability of those individuals concerned?

Dame Elizabeth Gloster: Yes, I can. You will have seen that there was quite a lot of pushback from certain interviewees and the FCA itself about my attribution of responsibility in my draft report, which I showed to those people as part of the Maxwellisation process. I thought it right to attribute responsibility to those individual people or the board in cases where I thought those people or that particular organ of the institution should be singled out as taking responsibility and, if criticism was merited or deserved for that, criticism should be attributed to them.

I thought it was wrong—and I was disappointed, as you may have seen—to have it suggested to me that I should not mention any names at all. However, I did not think it was appropriate to address, and I did not consider that my investigation was addressing, a very different issue,



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which I described as personal culpability. The fact somebody is responsible does not necessarily mean he or she is personally culpable. They are separate things, at least in the jargon that I used.

You will see that I dealt with the phrase “personal culpability” in my report. I tried to explain what I meant by it. Personal culpability is what I regard as what you might call the legal liability of a director or senior manager of a limited liability organisation at the suit of third parties for failings of the institution. That may be putting it too high, but in my view it is a very different concept from the idea that somebody has personal liability, that he or she personally is the cause of a particular detriment that a third party who may or may not be bringing a claim against the institution wants to get redress for.

I deal with this in 11.2 of my report. I did not find it necessary to deal with this, particularly because, if I had had to address, in legal liability terms, the personal culpability of a particular person, I considered—others may disagree with me—that it would have involved my looking, first of all, at the particular event or circumstance for which I was wishing to hold the person personally culpable. Secondly, it would have involved my looking at what that person was doing on a daily basis in relation to other matters. I would have to get an estimate or an analysis of his or her workload, and I would have to decide whether the blame, the liability, really lay with that person given what he or she was doing in the period.

Maybe I was approaching it too much as a lawyer, but that is how I approached it. I wanted to see whether one could say, in the context of an institution—the FCA has limited liability, so one is looking at all of these corporate legal issues—that this particular director or senior manager had legal liability for this particular event, and I did not think it was necessary for me to do that to answer the questions that the Treasury had raised.

However, going back to responsibility—I take responsibility very seriously—I did think it was appropriate to apportion responsibility to particular individuals, because the FCA itself requires the firms it authorises or supervises to have statements of responsibility from senior managers so that, when something goes wrong, it is clear who bears responsibility. In 2016, the FCA published a document applying those fundamental principles of the senior managers regime to itself.

That being so, in response to the representations I received from the FCA and various others asking me not to mention names, I thought it was indeed appropriate that I should mention names and attribute responsibility without going into all these legal issues and sub-issues about causation, whether a director was liable and all that kind of stuff, or whether I had looked at the individual diaries of particular people running up to a particular event. That is how I dealt with it. I hope that is some sort of an attempt to explain to you where I drew the line.



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We are not looking here at any allegations of impropriety or lack of integrity at the FCA. If I had been looking at those sorts of issues, my approach might well have been different, but I was not looking at that; I was looking at a failure of regulation.

Q3 Chair: The directions you were given in terms of how to pursue putting together the report included attributing responsibility but not culpability. If we step away from the legalistic way of looking at it, as I think you are terming it, what should the consequences be for individuals who have been found by you to be responsible for the level of failings that you cite within the report?

Dame Elizabeth Gloster: As you know, I have identified certain named individuals as having responsibility in various areas. My report, as I said a moment ago, does not preclude findings of personal culpability or findings that people should bear financial or other consequences for my criticisms or my allocation of personal responsibility. My investigation was focused on the FCA's regulation or lack of regulation of LCF. That is important when you are asking me, Chair, to say what the consequences should be. My investigation was not looking at the role of Mr Bailey or—

Q4 Chair: Yes, I totally appreciate that. I am just asking you, now that you are before the Committee and you are not constrained by the directions in relation to the report, or indeed anything in the report. Given how close you were to these matters and the fact you investigated these matters, you must have a view. Given that all those people out there have lost a lot of money and the extent of the failings here, what do you think the consequences should be for those individuals whom, as you say, you made a conscious effort, despite resistance, to name within the report?

Dame Elizabeth Gloster: What do I think the consequences should be? I do not want to give the Pontius Pilate answer, but it is not really for me to say what those consequences should be. Those who are informed by my report and are tasked with considering it, whether at the FCA, the Bank of England, the Treasury or elsewhere, will need to consider what the appropriate consequences are in light of the criticisms I have made in relation to the organisation and individuals. Consideration should be given to those consequences. I am sure the FCA, under its new CEO, is giving consideration to those consequences, and I am sure the relevant people are doing it as well in relation to others.

If you are asking me whether they should pay a fine or return their bonuses, I really cannot give you an answer to that.

Q5 Chair: I am not necessarily trying to draw you into a very specific answer on this. Having read your report and the extent of the failings and given the fact that, despite the resistance from various quarters to your publishing names, you chose to publish three names—you clearly felt it was important they were out in the public domain. One of those individuals, Megan Butler is now the head the transformation programme



within the FCA. Jonathan Davidson is still with the FCA. The Governor of the Bank of England, of course, is now the Governor of the Bank of England. People from the outside might be forgiven for thinking, "These people were responsible for some pretty dramatic and damaging things that have happened, and there have not really been any significant consequences as a result." Do you share that general unease? I am not trying to draw you into what you think the consequences should be.

Dame Elizabeth Gloster: I do not know what has happened internally to Ms Butler and Mr Davidson in relation to any clawback of bonus or anything like that. There may have been stuff in the press about it, but I do not have it at my fingertips now if there has been. Likewise, I do not recall what the position is in relation to Mr Bailey.

It is a matter for which consideration should be given not by me but by the chairman and the CEO of the FCA, and the Treasury so far as the Bank of England is concerned. They should give consideration as to what they consider it is appropriate to do in light of the serious criticisms and conclusions that I have made.

Can I say one other thing in relation to all three individuals? They were all very willing to give their time. In particular, Mr Bailey, as one might expect, was very articulate and very generous with his time. In many cases they were prepared to accept issues and systemic problems with the FCA that I raised with them. I felt they were dealing with me frankly and that I was getting co-operation.

I have made this point already, but there was no question of any lack of integrity. I did not come across any of that in relation to any of those three people. I was also—this is particularly so in relation to Mr Bailey—only looking at one aspect. Retail regulation is very important, but I was only looking at that aspect and, indeed, only in relation to one company at the FCA.

Q6 Chair: That is very clear. Moving on to Mr Bailey for a second, you will be aware he published an apology when your report appeared. I will quickly quote his apology, because I would like your reaction to it: "We took immediate steps to change the approach. The required changes in culture, mind-set and systems was a major programme of work across the organisation, which took some time to put into effect. I am sorry those changes did not come in time for LC&F bondholders."

Is that an appropriate response? Is it enough to say that the systems that were then being changed were not changed quickly enough? Should he not have been apologising for the fact that this all happened, in the first place, on his watch? It is not a case of having to wait for some institutional changes or a transformation programme to take effect; most of these mistakes should have been picked up and dealt with at the time. Under his watch, he failed to do that.

Dame Elizabeth Gloster: Although Mr Bailey is right in his apology in saying that he inherited a difficult situation—indeed, one of the



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management consulting reports just before he came on board he described as revealing a “shocker” in terms of the regulation of retail companies at the FCA—my report is clear that the issues he inherited did not excuse or mitigate the FCA’s overall failure to regulate LCF during the period of his guardianship.

I do not think it is enough. What he says in his apology is a matter for him, and it was not within my remit to comment on it. It does not really address the problem, because in my view the problems that were there were not so fundamental that they could not—this comes out clearly in my report—have been fixed by specific, focused changes.

My view is that it is not an adequate reason or excuse to say, “If only LCF had happened a bit later, all the changes we would have put in place would have stopped it happening.” These were defects that we did not think were in fact being picked up by the change programmes.

Q7 Chair: I am familiar with it. We are very clear about everything in the report. On that basis, I think you are agreeing with me that this apology actually makes reference to issues of cultural change and so on that are rather extraneous to the charge that he failed, on his watch, to make sure these deficiencies did not occur in the first place.

Dame Elizabeth Gloster: Mr Bailey absolutely recognised that there was a need for change and for culture change, both in relation to the perimeter and also in relation to the attitude to possible fraud. He also appreciated that there were problems over the regulation of what was referred to as flexible firms. It is my view, or the view of our report, that these issues were not addressed and were not fixed within a reasonable timeframe. I do not know whether Dorothy would like to add a point there, if you would allow her to.

Q8 Chair: Yes, absolutely. Just before I do that, I want to pursue another aspect of what you were saying earlier, on this issue of integrity. It might be said that you were quite forgiving—or it came across to me that way—of two things.

First, there was the issue of people trying to be kept out of the report. You stuck to your ground and you included them within the report, and you explained why you were resistant to that. Secondly, there was the issue of delays to the report, which were due to the fact that data was not forthcoming as quickly as it should be. Charles Randell gave the reason, among others, that the systems were not quite up to it, et cetera.

Somebody else might take a slightly different view and say, “This is an organisation with a deeply uncomfortable investigation. It is focusing specifically on very senior individuals near the top. There are these various delays and a reticence to be cited within the report. This is really just an example of an institution that is trying to ease the pressure, step back from its responsibilities and perhaps not co-operate as fully as might



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have been expected.” Was there anything in your mind on both those issues that made you think, “Maybe there is something going on here that is not simply the systems. We should be getting the information more quickly, and we are not”?

Dame Elizabeth Gloster: Chair, I was not being forgiving. Maybe I did not use the hyperbolic language I might have used if I had been a barrister rather than a former judge.

Q9 **Chair:** What would that language have been, out of interest? You are on the Committee now; you are outside of the confines of the report.

Dame Elizabeth Gloster: No, but I am still the report author. In relation to the first point, I said I was disappointed. A braver woman than me might have said “quite irritated” or “quite surprised”, but I was certainly disappointed. It seemed to me that it was inappropriate, in quite a serious way, to try to suggest to me as part of the legal Maxwellisation process that their names should not be mentioned. I was not pressured in any way at all. Those representations were made in legal submissions by the FCA and by the three senior directors I named. Lawyers say all kinds of things. I was surprised that none of the three individuals named suggested to their lawyers that that would not go down very well with me as the recipient. It is a lack of judgment to put forward that representation.

Q10 **Chair:** The fact you were pressing for information and then you go away and do some work and then—

Dame Elizabeth Gloster: I am sorry. That is a different point.

Chair: Yes, it is.

Dame Elizabeth Gloster: The first point was about the pushback on naming them. The second point you raised with me was about the delays. I was not light on Charles Randell. In fact, if you read the correspondence, on at least nine occasions I complained about the delay and the fact, which was worse than the delay in one sense, that the FCA had not been providing documents to the investigation that, on any basis, were clearly relevant. We were told it was a personal error, and I am sure that is right. I don’t think there was any deliberate attempt to conceal things from the investigation.

From November 2019 right through to September 2020, I was, both in correspondence and in phone and video calls with the chairman, Charles Randell, expressing my irritation and anger that we were not getting documents. I cannot remember what the adjective you used was, but I was not feeble or weak. Indeed, I do not think Mr Randell would agree with you.

Q11 **Chair:** I certainly would never say “feeble” or “weak” of you, Elizabeth. I said “forgiving”.



Dame Elizabeth Gloster: No, I was not forgiving either.

Chair: Thank you very much. That has been extremely helpful.

Q12 **Harriett Baldwin:** Thank you, Dame Elizabeth and your team, for providing such a strong report. It really cannot be emphasised enough how cross I am that my constituents were swindled out of this money and that now the taxpayers are going to have to pick up some of the compensation. I really appreciate your report. I want to carry on with the functioning of the board and the executive committee and the responsibility that you found in your report.

To carry on with the point the Chair was making about the Delivering Effective Supervision programme, you say, "The Board was unjustifiably relaxed in its oversight of the timing and delivery of the DES programme." This is in chapter 8. You say, "This finding has been disputed and challenged extensively in representations." Can you, just for the record, clarify who disputed those finding?

Dame Elizabeth Gloster: Can you refer me to a particular paragraph number? It was certainly the FCA.

Harriett Baldwin: I am focusing my questions on pages 154 to 158. Who disputed the finding that "the board was unjustifiably relaxed in its oversight of the timing and delivery of the DES programme"?

Dame Elizabeth Gloster: Can I just consult my team for a moment?

Dorothy Cory-Wright: I can assist on that. It was the FCA responding. They had spoken to various board members.

Q13 **Harriett Baldwin:** I am trying to clarify who at the FCA. That is really what I am trying to clarify.

Dorothy Cory-Wright: We were not told who individually had compiled the FCA's submissions. They were effectively put together and channelled through lawyers.

Q14 **Harriett Baldwin:** You then did additional investigation and reviewed the documents, and you remained of the view that the timing and delivery of the DES programme was unjustifiably relaxed. Can you confirm how much additional work went into reconfirming that conclusion?

Dorothy Cory-Wright: I will take that because, at Dame Elizabeth's request, I carried that out with some of my team. When we delved back in and went through the detailed timeline for the behemoth that was the DES programme, in fact we found there had been four extensions. There was an original date, which was not set in stone, but there were then three separate deadlines for it that were missed. They were red-flagged earlier. It had been alerted to the ExCo that they were likely to be missed.



When we saw that being reported up to the board, it was almost as an aside in the papers. We saw no scrutiny of that and no kicking of the tires. We actually did question a board member then—of course, the board is of an entirely different composition now—about whether they pushed back at all, and that person seemed to think that they had adequately checked that the whole thing was on track. We saw no evidence of that from our deep dive. It certainly was not reported in any board papers, et cetera.

Q15 **Harriett Baldwin:** Again, can you clarify who that person was who felt the board had been satisfactory in their supervision of this particular programme?

Dorothy Cory-Wright: That was the former chairman, who we interviewed.

Q16 **Harriett Baldwin:** The current chairman was present for the tail end of this relevant period. What responsibility do you see him as bearing?

Dorothy Cory-Wright: I will answer, if Dame Elizabeth is happy for me to carry on. It is her report. By that stage, in April 2018, there was relatively little that he could have done. Certainly in the board papers between then and when the DES programme was closed—that is an important phrase, because it is not then necessarily in effect because there was going to be an embedding process thereafter—there was not much board attention to it, from April 2018. We felt he could do relatively little by that point.

Q17 **Harriett Baldwin:** What about Sam Woods? He was a board member throughout a significant part of the relevant period and he remains there. His position is ex officio as CEO of the Prudential Regulation Authority. Should we be concerned that he remains on the board of the FCA given its performance over the relevant period?

Dorothy Cory-Wright: Just in relation to that, of course, Mr Bailey, as the CEO and the predecessor head of the PRA, also sat in that position. It is our understanding that, because of the ex officio nature of their role on the board, they actually do not take part in discussion of individual firms or individual problems. We were unable to tell from the board papers quite how much they would have—

Q18 **Harriett Baldwin:** We are talking generically here about the oversight of this Delivering Effective Supervision programme.

Dorothy Cory-Wright: He was certainly a member of the board and, as such, he had board accountability. From what we were told, there is a notable distinction between the role of the ex officio head of the PRA as a non-exec and the other non-execs. Maybe Dame Elizabeth would like to comment on that as well.

Dame Elizabeth Gloster: What is important here is that we did not interview every single board member. In a way, to pick out one over the



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other or to pick out one who said, "I do not think we could have done more," is perhaps not fair when we did not interview the whole lot. Certainly, in my view, they share board responsibility.

At the end of the day, the impression I got from the board papers I read on this was that they were just letting it all drift on. They were not going back and doing any sort of spot checks, cold-case reviews or practical fixes. They did not say, "We have identified these problems; is there anything we should be looking at?" I am not sure this would have picked up LCF, because they had glaring red flags on LCF that they did not pick up. Why should DES necessarily have picked up the LCF problem at all? I am not sure.

Q19 Harriett Baldwin: Turning to the executive team, the executive committee members, there are still a few members who were in the FCA during at least part of the relevant period. Should our Committee be concerned about that?

Dame Elizabeth Gloster: To my mind, yes, you should be concerned about it. There are more pressing areas of concern for your Committee as to what is being done to put the problem right and issues of compensation, consequences and all those sorts of issues. Whether your Committee should be examining each individual board member, which I did not do, is a matter for you. You will have seen that I interviewed quite a few of them but not all of them. I would not regard the utility as being plus-plus-plus myself.

Q20 Harriett Baldwin: You mentioned compensation, and clearly these are very, very well paid individuals by any standard in my constituency. In its response to your report, the FCA said, "We note the comments in the LCF Review which clarify that the allocation of responsibility to individuals is not a finding of personal culpability. 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." What does that mean? Is that appropriate?

Dame Elizabeth Gloster: I knew there was something in their response about what they were going to do. Again, I am not making an informed comment; I am just making a personal comment.

Q21 Harriett Baldwin: Is that enough, in your view?

Dame Elizabeth Gloster: With my knowledge, yes, that is appropriate.

Harriett Baldwin: Is it enough?

Dame Elizabeth Gloster: I do not know what the figures are.

Q22 Harriett Baldwin: Given that they are very substantially paid people, presumably they are fairly meaningful. Should our Committee try to find out what those amounts are?



Dame Elizabeth Gloster: You should ask some questions. I do not know what they get paid or whether it is relevant, or whether it is endorsing any criticism I have made for them to claw back those figures. It is certainly a question you should ask.

Q23 **Harriett Baldwin:** Should it apply to all of the executive committee, or would you particularly single out any of them further than you have mentioned already in your report?

Dame Elizabeth Gloster: No, I would not single out anybody further. This was board responsibility.

Q24 **Alison Thewliss:** I have some questions around the findings about the contact centre and the way in which correspondence was managed. These findings in the contact centre are pretty worrying. People phoned up looking for advice only to find that calls had not been escalated and things had not been passed on. Is this the kind of thing you would have expected to find at a conduct regulator? Did you get any sense of the importance placed on the functioning of the contact centre by the management?

Dame Elizabeth Gloster: The way in which what was communicated to the contact centre was not escalated appropriately was pretty appalling. In particular, as you will see in my conclusions and recommendations, I considered that there were not clear directions given to the contact centre as to how they should process information and to where they should refer it.

There are two issues about the contact centre. The first is how they should deal with allegations of serious irregularity or circumstances suggesting fraud. That is recommendation 3 of my recommendations. Secondly, it is very important that contact centre call-handlers should not reassure consumers about the activities that are not regulated of authorised firms. In other words, there must be clearer instructions given to call-handlers that they do not give off-the-cuff advice or so-called advice. If you look at appendix 6, for example, which sets out the information that the FCA received during the relevant period and how that was not, in our view, adequately passed up, we were pretty critical about all that.

Part of the problem here is not just training and clear instructions being given to call-handlers but also having appropriate data analytics or the appropriate technology to ensure this information is harvested, gathered and then available for people in supervision. What all my recommendations tried to achieve were practical ways in which operational staff could be directed to regulate better and take responsibility rather than changing policies at a high level. It is getting the message down to the operational levels that was deficient during the relevant period.



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There were lots of high-level policy statements that said, "There is a risk to the perimeter. We are not quite sure everybody knows what we are doing. There are question marks about this, that and the other." In a certain sort of way, all of that is irrelevant. What you need are clear operational directives or policies enabling the operational people, whether they are a call-handler, somebody in authorisations or somebody in supervision, to look at all of the information and say, "Yes, I need to put this together." I'm sorry, I am afraid that was a rather longer answer than your question really required.

Q25 Alison Thewliss: No, that is very useful indeed. Thank you very much. There are clearly levels at which different responsibilities would lie in the call centre. The investigation names Mr Davidson as being responsible for the contact centre failings, solely by virtue of the oversight of the contact centre falling within his remit.

You have talked about the different levels of that, from call-handlers to supervisors and all the way up through that chain. Are there particular points at which you feel failings could be identified, where things have not been progressed or where a stop should have been put on this before it escalated to the level it reached?

Dame Elizabeth Gloster: Yes, if financial promotions had taken into account the information from the call centre, if the variation of authorisation application had taken into account the various information or if there had been a joined-up system, things would have been very different.

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

Q26 Alison Thewliss: It sounds like there is a clear deficiency in the process by which information is gathered and then used. You said that call-handlers were giving advice that they should not have. Is there an issue around the training of those people on the frontline who answer those calls? Do we need to give them greater confidence in what they are doing either to report or not to give advice when they know that advice would be inappropriate?

Dame Elizabeth Gloster: Yes. One of our recommendations was around this specifically. Certainly, we considered that there were not sufficient training and policies in place. It is recommendation 2: that the FCA should ensure that its contact centre policies clearly state that call-handlers should not reassure consumers about the non-regulated activities of a firm based on its regulated status, and should not inform



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consumers incorrectly that all investments in FCA-regulated firms benefit from FSCS protection.

That is policy and training, and we set that out in some detail in chapter 12 as well as in chapter 14.

Q27 Alison Thewliss: In terms of the FCA's internal audit team, could they have followed up and exposed any of those weaknesses before it got to this stage? Looking at the quality assurance, looking at what was happening, they really missed something here, did they not?

Dame Elizabeth Gloster: You would have thought they would have. The audit report that we refer to is a 2015 internal audit report. That in itself, which we discuss in chapter 12, identified similar issues to those we identified, but no changes appear to have been made to contact centre training materials as a result of that internal audit report. We assigned responsibility to Mr Davidson for that.

The report itself in 2015, which was a useful document, identified a number of action items to remedy the problems, including refreshing all contact centre training materials to capture criteria for gathering and passing on consumer intelligence and rolling out refresher training. Nothing seemed to get done about that. That was a specific concern that we raised. You are quite right. It was picked up. There may have been others, but that was the one we saw.

Q28 Alison Thewliss: I am just about out of time, but I wanted to ask one last question. Given the excellent report you have now produced, if I phoned up with a complaint now, do you feel that sufficient lessons have been learned that that process will now be better?

Dame Elizabeth Gloster: I have not done any auditing of what has been done since the FCA received our report as to what steps it has taken in the light of its response. It says it has accepted all our recommendations; let us hope it implements them so that, if you or I were to ring up tomorrow and complain, we might be confident that something would be done about it. Let us hope that is the case.

Alison Thewliss: I would hope so, too. Thank you very much.

Q29 Julie Marson: Good afternoon, Dame Elizabeth. Thank you for being with us. This is following up on the previous questions a little bit, but I would like to focus on what you call the halo effect by which LCF was able to benefit from its FCA-authorized status to promote more risky and potentially fraudulent products. What impact did the halo effect have on how LCF carried out its activities? What benefit did it take? How did that impact its customers?

Dame Elizabeth Gloster: The engagement that I and my investigation had with bondholders was, as you will have seen, fairly extensive. We had a website where bondholders were able to communicate with the



investigation. We exhorted them to provide information about their contact in particular with the FCA but also, where relevant, with LCF.

We also had a meeting where the team and I heard from about 100, 150 or 200 bondholders. They came along, and we were there all afternoon. They articulated what led them to invest. There were all kinds of different reasons, but what really came over was that they felt that, because LCF was an authorised firm, irrespective of whether that gave them compensation scheme protection—some knew it did, and some knew it did not because it was not a regulated product—they thought that regulation was going on at the FCA in relation to LCF.

There was the halo effect. If you look at some of the promotional materials or some of the contracts, sometimes it is clear and sometimes it is not clear that the actual bonds being sold are not regulated products. Sometimes LCF says so, but it is in the small print or over the page. Usually—this was the real pull-in for investors—the statement is, “LC&F is regulated by the Financial Conduct Authority.” Whatever their individual circumstances, the investors were all assuming that some sort of regulation was going on in relation to LCF, irrespective of whether the product itself was regulated.

Of course, that leads on to the next point. It was sold as an ISA or an IFISA product. That, of course, gave false comfort to some bondholders. I cannot quite remember where we were with the question. I am sorry; it is my fault. The real halo effect was the understanding that, because it was a regulated or authorised firm, there was going to be some regulation there. If you will allow me, that takes me on to the next point.

There was no doubt so far as the FCA’s powers were concerned: they were entitled to regulate LCF on a general basis, irrespective of the fact that this particular product, in our view—people’s views may differ about this—was not a regulated product. The FCA clearly recognised that it had powers to regulate an authorised firm in respect of its unregulated activities, and it had power to do so under the “fit and proper person” provisions and also in relation to the requirements that it was conducting its affairs in a “sound and prudent manner.” It also had power to do so in order to minimise the extent to which its business might be used for a purpose connected with financial crime.

There was an appreciation at the FCA of the fact that it did have the powers to regulate this activity outside the perimeter, in the sense that it had the power to regulate LCF and to look at LCF and say, “Hang on a moment. This is not appropriate.” That is the halo effect. There are lots of other ways of describing it, but it is the imprimatur of respectability that regulation gives a firm, albeit that it is flogging non-transferable bonds, which in this case was not, or probably was not, a regulated activity.

Q30 Julie Marson: Why was the FCA so slow in using its powers? It is really interesting. You identify that the FCA had rules but not policies. It had powers. Why did it take so long to appreciate and use those powers?



Dame Elizabeth Gloster: This is really set out in chapter 6 of our report. The FCA had an approach to the perimeter, a really cultural approach to the perimeter, that meant it really was not enthused or enquiring. The operational people on the ground were not motivated to look at activity outside the perimeter. They looked at financial promotions, yes, but there did not seem to be any appetite or enthusiasm for looking at the non-regulated business, even just to see whether LCF was a fit and proper person to be authorised at all.

James Petkovic: There were quite stark instances where the FCA was warned about potential improprieties in respect of LCF's non-regulated bond business. For example, you have an anonymous letter sent to the FCA while LCF is going through an authorisations process. You also have the examples, of course, given to the contact centre where there are allegations, again, of impropriety. There are quite stark allegations.

What seems to occur is either, as in the case of this anonymous letter, FCA staff members conclude that it is primarily a matter for the police and do not follow up to investigate whether there might be improprieties going on as alleged, or it seems that contact centre staff often do not refer the allegations on or, if they do refer on the call, they refer on the issue about whether or not LCF's products are within the perimeter. It is the perimeter issue they refer on; they do not refer on the allegations of fraud. It may well be that they thought, "Those allegations are outside our perimeter," and so they do not note that and refer it on up to their supervisors.

Q31 **Julie Marson:** I would just like to touch on what you would like to see coming out of the Treasury consultation on financial promotions. What would you like to see happening in the future?

Dame Elizabeth Gloster: There is a real problem, and a lot of IFAs and trade organisations communicated this to us. There are a lot of problems around what I might call cowboys, who are not authorised at all, operating on websites and comparison websites. If you go on one, they are not necessarily obviously in breach of the financial promotions regulations, but when you get sucked into it you are asked to provide your details and then certify you are sophisticated and all these sorts of things. There are cowboys out there on the websites. It is all now done on the net somewhere.

The issue is really about how the FCA, with its general obligations to maintain an honest and good UK market, deals with what are either probably breaches of the existing financial promotions regulations or the offering of what are, in truth, regulated investments for sale and conducting a regulated activity. That is the wider problem.

I am not just looking at authorised firms now. In relation to authorised firms, we have made our recommendations: appreciate the halo effect, and appreciate that you have to go and regulate activities in appropriate circumstances. I am not saying that the FCA should go and regulate



Sainsbury's grocery business, which was one of the examples given to us, but where you have an authorised firm that is not using its authorisation for corporate finance advice but is running this unregulated mini-bond business, that is a situation where you should go and check up on a holistic basis.

Leaving that aside, where, for the future, should attention be directed? There are a lot of problems for retail and consumer protection as a result of offerings that are being made on the net and on comparison websites.

Richard Frase: If I can just follow up on that quickly, you actually have an example here of one of the problems with the focus on the regulated industry, because a lot of attention is now going on to the regulated firms and adjusting how they approve financial promotions, which is absolutely right. As Dame Liz says, there is a lot of unregulated activity going on out there, and that is potentially more concerning than what the regulated firms that are firmly within the net are doing.

If you were to look at the rules on cold calling, they seem to pre-date the modern internet in how they operate. They are really for someone knocking on the door. We did mention, in the recommendations, the Online Harms Bill, which may be on the ambitious side, but certainly there is a real problem for the FCA, or any investigator, trying to find out what is going on when all you have is a website that is fairly inconclusive, and, in order to get into it, you have to register with your personal details. Should a regulator really be pretending to be someone else in order to get the information?

In so far as it is possible legally, we need some method for gathering information from internet service providers, or access to what cannot be got simply publicly online, and some progress in that direction. A duty of care has been talked about, but maybe even expand the nature of the advertising regime so that it is not purely limited to things that are obviously financial promotions.

Q32 **Dame Angela Eagle:** Dame Elizabeth, protecting the users of financial services from fraud is clearly within the FCA's remit; Parliament gave it that job. Why does it not do it more effectively, do you think, after your investigation into this particular instance?

Dame Elizabeth Gloster: As I said earlier, it was a cultural feeling that the FCA was not really there to be a policeman, discovering and prosecuting fraud. To be fair to Mr Bailey, he thought that was a wrong cultural approach, and he said that was one of the things he really wanted to change, but it took a long time. My view is that that is such an important point, as you have just said. I grew up with this when I was junior counsel for the DTI, doing just and equitable petitions for the DTI, winding up and putting in provisional liquidators in an afternoon's work after some DTI inspectors had been in to look at something. That is in the olden days, and it absolutely seems to me to be the role of a regulator.



Of course, it cannot regulate fraud across the world, but what it can do within its jurisdiction is protect the retail consumer, whether it is from phoenix companies, Ponzi schemes or whatever it is. That should be the role of a regulator, and to say we are only looking at people we have certified as behaving properly, or the big banks, seems to be a misconception.

- Q33 **Dame Angela Eagle:** Do you think it is a thing that has come along because enforcement is so much harder? Maybe people are worried about people having expensive lawyers to protect them, and they do not want the faff, the bother or the stress of prosecuting? Does the FCA actually need to have a much more hands-on, operational, prosecutorial structure? It seems to me, from reading your report, that people in the FCA have said, "Oh, fraud—that is the police," and that actually doing the job became a hot potato that you just threw off to the next group of people. We have just had the police in. They prosecute 1% to 3% of economic crime. It is falling between every stool, and the fraudsters are getting away with it, are they not?

Dame Elizabeth Gloster: I agree with you that it is the role of a financial regulator to protect the retail investor, so far as appropriate and proportionate, from fraudulent companies. That is one of the important functions of a financial regulator, and that is done by the exercise of intervention powers and protective powers.

Although they do have powers to do this, I am not saying that one is looking at prosecution necessarily. We have the Serious Fraud Office. It is important that the FCA should appreciate that it has a remit and a job, under its existing powers, as you rightly say, to be the first level of protection for retail investors.

- Q34 **Dame Angela Eagle:** How can the incentives for those people who work in the FCA be changed to try to encourage them to use that first level of enforcement much more regularly and routinely? It sounds, from what you have said, that you had that at the DTI when you were a lawyer there.

Dame Elizabeth Gloster: I was not a lawyer there, sorry. I was a barrister. I was briefed by the DTI on occasions, as junior counsel.

Dame Angela Eagle: What can be done to incentivise that muscle to be used more regularly to discourage people—

Chair: Angela, unfortunately you have frozen. We might have to come back to Angela.

- Q35 **Mr Baker:** I want to thank you all for doing this report. Dame Elizabeth, thank you in particular. It is a magisterial piece of work, and I am very grateful for this opportunity. Mr Frase, when the question was first asked by Dame Angela, I hope you will not mind my saying that I noticed a wry smile when the question was put about why they do not prosecute fraud. Can I put that to you, Mr Frase? Why did you smile? Why do they not



prosecute fraud at the FCA?

Richard Frase: There was some discussion about resources in some of the interviews, and I know it was a matter of concern to at least one of the senior interviewees that the police do not have the resources to prosecute fraud. There was a recent City of London report I recall from 2020 that seemed to come to a similar conclusion. There was a concern that this would all become yet another job for the FCA. While they are capable of doing it, the amount of resources that it would mop up would be enormous.

This actually goes to what Dame Angela was saying about it falling between stools. It is not just the FCA; it is the other organisations that cover the same area, where you actually need a coherent plan for all this to come together. Whether that is more policemen doing fraud or more resources for the FCA, that is the next stage after you get to that.

Q36 **Mr Baker:** I well remember the conversations I have had with our police and crime commissioner, Anthony Stansfeld, who personally saw to it that the HBOS Reading fraud was prosecuted. We have come, therefore, immediately to the main point I wanted to get out of this, which is the question of who has the resources to prosecute fraud when it is this complicated and requires this level of expertise? Dame Elizabeth, I am extremely interested to know what you think about that.

Dame Elizabeth Gloster: The first point I would make is that, in the first instance, within the FCA there needs to be an appreciation of not just fraud but circumstances suggesting fraud, so calls suggesting impropriety. Those need to be flagged and dealt with. As we found in our report, they were not. You can see, from all the calls to the call centre and our analysis, that suspicious circumstances were not being flagged, escalated and dealt with where necessary. Whereas we had good things to say about the actual enforcement division, suspect situations, if I can call them that, did not get to enforcement because there was not this cohesive approach to the allegations that were being made. That was partly because of the culture, partly because of the training and partly because of the lack of enthusiasm: "That is fraud. That does not happen to us."

In the first instance, there is more that can be done in the FCA to protect the consumer. Your question goes on to prosecution of fraud. I am not really in a position to give you any useful information on the police prosecution of fraud, or anything like that. I can say that there is a real issue as to who should provide the resources for that. Should it be the Government providing it, or should it be the financial services industry, which is the funder of the FCA at the moment, where the effect is that the costs of doing all that fall back on, in the first instance, the people who are behaving well in the financial community, and, in the second instance, the consumers of financial services? Should it be funded by the taxpayer in the way that the police force is?



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There is a real resource issue. Do we want to have something equivalent to other countries' regulators, where they might be more enthusiastic to prosecute fraud? Just because I have read the papers, I know it is difficult to get the police to prosecute fraud.

Q37 Mr Baker: This is the absolute heart of the matter. We are potentially talking about some extremely large frauds. Thinking about the £1 billion fraud at HBOS Reading, and the costs to investigate that approached £10 million. It is hardly a surprise that it is difficult to obtain resources on such a scale, but what are the poor FCA to do when the cost of investigating these things is so enormous? You have said some very interesting things. I am just trying to unpick the causes behind them and this lack of enthusiasm for getting into it.

Dame Elizabeth Gloster: Our investigation did not do a cost analysis of the cost of regulating and discovering what had happened at LCF. What I can say is that, from our point of view, the investigation's conclusion was that the limited resources issue was not a reason why the red flags at LCF went undetected. It was nothing to do with that, or very little to do with that. It was because of the various reasons we set out in our report, namely failure to look at the matter holistically, lack of enthusiasm to look beyond the perimeter, not joining up the dots between the information, not having the adequate technology to put all the things together and not having adequate policies in place.

The work is being done, but it is not being done in the right way. In terms of whether discovering LCF a year or two earlier would have had any cost implications, I do not actually think so. That is not an informed answer.

Q38 Mr Baker: I just wonder if one of the reasons why there is a lack of enthusiasm for looking outside of the perimeter in the ways that you have suggested, Dame Elizabeth, might be because the FCA is just so overwhelmed with the scale of the regulatory task within the perimeter. I wonder if we are just asking the impossible of the FCA, to look outside the perimeter in the ways you have suggested.

Dame Elizabeth Gloster: I do not think so. The report makes it clear that I have not done a feasibility study or analysis of all the work done by the FCA. Although one of my recommendations is that the Treasury should look at the optimal scope of the FCA's activities, I have not actually done the work that would be necessary to work out whether they are overloaded or not.

In relation to the regulation of LCF and other flexible companies of its type, the inadequacies were not attributable to a lack of resources, save, perhaps, for the lack of people in the financial promotions department, which is one of the criticisms that we make. The authorisations department, the supervision department, the financial promotions department and the call centres were there doing their job, but, in my view, they were not doing it well enough. I do not think it is asking the



FCA too much to go outside the perimeter, certainly to look at the activities of authorised firms of the type of LCF. It would be wrong to approach it on that basis.

Q39 Mr Baker: Earlier in your evidence you mentioned the imprimatur of respectability given by being a regulated firm, and this reminded me of something we have heard in relation to tax evasion: that sometimes firms will say this is a DOTAS-registered tax avoidance scheme, and that seems to persuade people who perhaps ought to know better that it is somehow a respectable scheme. Is there more that could be done to put boilerplate text before the consumer so that they understand what being regulated actually means and where the boundaries are drawn, and that actually they might be about to buy a product that does not have that imprimatur of respectability?

Dame Elizabeth Gloster: We say in our report that it needs to be made clearer. In June 2019, the FCA published its first perimeter statement. That goes some way, but it needs to be much clearer. An authorised firm that is selling an unregulated product has to be much clearer about what it says, about not having the protection. How that is implemented is another question, and that is for the FCA.

Q40 Dame Angela Eagle: I hope my internet holds out until the end of my questions. I was just exploring the culture around the seeming reluctance to deal with fraud, and I wondered, given that the FCA is a statutory supervisor for anti-money laundering, how concerned you are, Dame Elizabeth, about the culture around financial crime.

Dame Elizabeth Gloster: I did not look at the anti-money laundering department, and I did not, as it were, run my scope over any of that. I do not know whether the systems they have for assessing money-laundering operations, identifying them and doing anything about them have any parallel with the regulation of flexible firms in the period I was looking at. I would hope that the culture in any anti-money laundering department would be more focused and that the people would have a more inquiring mind and an enthusiasm for at least sniffing something that does not look right. Otherwise, as you suggest, one would be concerned about the ability to identify an offensive operation for money laundering.

Q41 Dame Angela Eagle: This culture of saying, "That is the police. We are doing regulation. We are not going to look at red flags that flag up LCF as a potential danger," certainly extended over more than one department, did it not? It might actually extend across the whole of the FCA rather than just the bits you looked at.

Dame Elizabeth Gloster: It could do, but it would be speculation if I were to make any comment about that department.

Q42 Dame Angela Eagle: Did you find any best practice there that you would like to see spread, which would actually make it more likely in the future that the FCA would be more active in the prevention area and the enforcement area?



Dame Elizabeth Gloster: We say in our report that, when the thing finally came to the investigations department, they did a pretty good job.

Dame Angela Eagle: The horse had bolted by then.

Dame Elizabeth Gloster: Pretty much, yes.

James Petkovic: From some of the materials I have seen, there were materials saying that the FCA has responsibility for scams, where those scams are to do with regulated activity. For example, the training centre and contact centre documents would say "If an alleged scam is about regulated activity, refer it up." The problem in LCF's case was that the products where there were alleged improprieties were concerned with unregulated activity. That is primarily why, although there were allegations of fraud, those ended up not being pursued.

Q43 **Dame Angela Eagle:** How might be good to put that right? If you are in a regulator, it is clearly wrong to find out that there is fraud, or potential fraud, and not refer it anywhere. It clearly has implications for the ethics and functioning of a company if it is madly defrauding somebody outside of the perimeter while trying to stay within the law in its regulated activities. That would strike me as a bit of a red flag to be pursued.

James Petkovic: I agree. Our recommendations put forward essentially two kinds of changes to deal with this issue. One is quite a targeted change. For example, recommendation 2, which we have already discussed, talks about improving contact centre training materials to ensure that, where there are allegations of fraud concerned with unregulated activity, those allegations are appropriately referred on. Similarly, once those allegations are referred on to the supervision department, one must have appropriate policies to deal with them, to know how to follow them up, looking at investigating, even in a preliminary way, the company's financials, to determine whether there is something potentially wrong.

There are those low-level operational changes that we recommend and that have been accepted by the FCA. At a higher level, we recommend a cultural and mindset change, to the effect that FCA staff, including junior staff, have to realise that there is a need to be concerned about fraud of an FCA-authorized firm, even when the alleged fraud is outside the perimeter.

Q44 **Rushanara Ali:** Good afternoon. My questions are focused on authorisation. Others have talked quite extensively about red flags, so I am going to move on. In light of your findings on the inadequacies in the supervision of LCF, how concerned are you, Dame Elizabeth, with the FCA's overall supervisory model?

Dame Elizabeth Gloster: When you say the overall supervisory model, what do you mean?

Rushanara Ali: What does this case signal, in terms of the wider



supervisory model of the FCA? Is it fit for purpose? Is this an exception to the rule, or should we expect to see further problems going forward?

Dame Elizabeth Gloster: I am repeating what I have said already. This is not being defensive, and I will tell you why in a moment. Of course, I only looked at, and was only tasked to look at, the FCA's regulation of LCF. Is it, therefore, appropriate, fair or justifiable to draw wider inferences for the whole business model of the FCA, for example about the manner in which it regulates banks, huge financial institutions or insurance companies? I would not have thought one would be able to deduce lessons from my report, other than to say there were clearly a lack of fit-for-purpose information systems within the FCA, from what I and my investigation saw. There were inadequate technical analytics and inadequate systems. That was demonstrated not least by the fact that it seemed to be so difficult for the FCA to collate all the relevant documentation and supply it to the investigation within an appropriate timeframe. I can say that there is clearly a systems inadequacy, and information in silos and not joined up.

Can I answer the question you put to me about whether the overall supervisory model is okay? I took the view that, in relation to flexible firms such as LCF conducting business of the type that it was, what I saw would demonstrate that its model in relation to the regulation of those types of what you might call oddballs, but which were none the less oddballs taking in an awful lot of retail investors' money, was not appropriate and was inadequate. That is my conclusion.

Q45 **Rushanara Ali:** Your report has only recently come in. What about the FCA under its previous head and the management team that is still there—the two people who were named in your report and others—since 2019, since this happened? You referenced the internal report, which pointed to some of the things that could have been done and might have mitigated this scandal from taking place. Do you feel that, in light of your recommendations and what they already knew about the need for improvement in training and the contact centre that you mentioned, enough work has been done to rectify the problems so that we do not see another LCF-type case coming down the track?

Dame Elizabeth Gloster: It had not been done at the time I delivered my report. I have not gone in and done a management consultant audit of the steps they have put in place since 30 January 2019. From the response of the FCA to my report, it would seem that it is still putting those steps in place. The various programmes are not yet in place. That is clear from its response. I would hope that new management of the FCA, the new CEO, this Committee, the Treasury or whoever is appropriate will want to ensure that the recommendations have indeed been implemented, and that the FCA has accepted them and says it is going to. There needs to be some sort of audit process to check those have been put in place. I cannot really answer the question.

Q46 **Rushanara Ali:** You will appreciate some of the frustration, certainly for



those of us who have been on this Committee for a while. When this scandal happened, whenever we had hearings in this Committee, the then head of the FCA often made this point about the regulatory perimeter.

Dame Elizabeth Gloster: Yes, absolutely.

Rushanara Ali: Action could have been taken, and the FCA perhaps should have taken a different approach, which is to approach it in the way you are suggesting and were suggesting in your report. Until it does, should we expect further problems to continue, like this one? We have had the TSB scandal; we have the Global Restructuring Group. You mention other areas—banking, technology failures. In recent years, the FCA has presided over a huge number of these problems, albeit different, but they are affecting millions of consumers. It does not seem to be fit for purpose. Do you have a view on what else needs to be done systemically to sort this out so that our constituents do not continue to be harmed by the failures of the FCA?

Dame Elizabeth Gloster: What I tried to get over in our recommendations is that there do not need to be wholesale change programmes. The FCA has been in a state of flux for a number of years now apparently, as we were told. The changes that can be made are actually operational-focused fixes. That may be optimistic, and I may be coming in as a lawyer rather than as a director of an institution, but they are meant to be practical changes that can be done, that can be put in there by way of policies, training, data collection and cultural change, which should bring about a better regulation of these sorts of companies that are, or certainly might well be, a danger to the retail market.

This is probably an issue for the Treasury, but, from my perspective, it is a focus and a concentration on relatively small operational changes and communication within the FCA that ought to be able to fix things. That may be wildly optimistic, but it seems to me to be really obvious what needs to be done. That may be arrogant.

Q47 **Rushanara Ali:** If it is so obvious, why do you think it took four years? The report came out in 2015, setting out some of the things you pointed out that they could have done. Earlier, we talked about culture, responsibility and leadership. Given it is so obvious, what is it about this institution that means it cannot get these basics sorted out? Is it groupthink? Is it that there is too much dislocation between those on the delivery side and the contact centre-type side on the ground, having contact with consumers, and those at the top? Is there somehow a big disjuncture and dislocation between these different elements? You are saying that is not that difficult to solve, but it seems to be beyond the wit of the people involved to get it right. Why is it that they are getting this so badly wrong?

Dame Elizabeth Gloster: You are right that there is a disconnect between quite grand statements of policy at the top, board level, and



getting that message to be picked up and run with operationally in the various divisions and on the ground. I am not a management consultant; I am a lawyer and somebody who can analyse fact. Lawyers, although you may not think it, are actually quite practical people, because they come up with solutions for problems, or at least they are meant to, not just grand ideas. Maybe I am stepping outside of my remit here, but it seems to me that that disconnect should be something that is capable of being fixed. I know Dorothy has some views on this.

Q48 Rushanara Ali: If I can just dig in on this point, Dame Elizabeth, the supervisory approach that the FCA set out publicly was not reflective, as your report highlights, of the way the FCA approached the LCF. Would you say that the FCA therefore misled consumers? There was a clear expectation, and indeed you even mentioned that in the contact centre the wrong information was provided to people by staff in some cases. Were they misleading consumers, our constituents? I have a number of constituents who lost their life savings in this scandal.

Dame Elizabeth Gloster: The message that came over from a lot of the investors is that a lot of people have suffered, financially as well as physically and mentally in their health. I am not an advocate for the bondholders, but that is something we all need to recognise as being at the top of all this: that a lot of people have suffered. I am not saying everybody, but a lot of people have suffered real hardship, and not just financially.

Leaving that aside for a moment, I would not characterise it as misleading consumers. As a lawyer, I would not say consumers were being misled. What I would say, and I have said in my report, is that whatever category of bondholder, or potential bondholder, they were, even though regulation went beyond the perimeter, or should have gone beyond the perimeter, they were entitled to expect a better level of regulation than what they got. If there is going to be a regulator at all of these sorts of companies, which there is at the moment, there has to be effective regulation, not just pretend regulation. That is probably the best way I can answer your question.

Dorothy Cory-Wright: On the question of what can be done to improve the overall culture, I have two observations. The rate of change that this organisation has gone through since its inception, or since it replaced the FSA, is really quite astronomical in terms of its structure and management. That is set out in chapter 8, paragraph 1.5 of our report. There was a slight concern among this group. It was not for us to comment on, but when the FCA's response to Dame Elizabeth's report came in, a whole lot of further operational and structural changes were envisaged. That is all good, and I am sure they will all take place, but at some time the change has to stop and the functioning organ has to appear. We noted that there was not an end date suggested for the programmes in the FCA's response. That is the first observation.



The second observation is there were some pretty good people in the FCA. A lot of the people we interviewed, who are not named, by agreement, in the report, were interested and enthusiastic. With different policies, with a different culture—we all know how difficult cultural change is in an organisation—there is a real opportunity to have them address issues like alleged fraud, issues that you have been identifying.

Lastly, Dick Frase, one of our team, was a great benefit to us, because he has actually worked in a regulator. One of the things he kept telling us is that you do not want this to become an over-hierarchical structure for the people on the frontline. You do not want them to have to go up three levels to get permission to do things. With training, encouragement and good people, we think it would be possible to have a cultural change to address the issues that have been described.

Q49 Anthony Browne: I should declare at the outset, as per the register of Members' interests, I have been a director or adviser to various firms that have been FCA approved, or have gone through the FCA approval process, both for firms operating inside and outside the perimeter.

I want to focus on the perimeter and the regulations around that. You have talked a lot about the need for better internal communication and management within the FCA. In terms of its powers outside the perimeter, the FCA has said it accepts it does have powers outside the perimeter in terms of implementing its general principles and the senior managers and certification regime, for example. Are you saying that it did not use its powers outside the perimeter, or that its powers outside the perimeter were not enough?

Dame Elizabeth Gloster: I am not saying the latter. I took the view that it had adequate powers. The report says, at page 103, chapter 6, section 4, "The FCA was entitled, and recognised it was entitled, to look and act beyond the perimeter." We set out the various powers there, which you have just referred to. It clearly did have adequate powers and recognised that it had adequate powers, but, because of the various defects that I have tried to highlight today, it just did not go there, when it should have done.

Q50 Anthony Browne: The corollary of that is you do not think it actually needs greater powers beyond the perimeter. Is that right? Do you think the regulatory regime outside the perimeter—that light-touch, non-direct, supervisory regime—is enough?

Dame Elizabeth Gloster: Yes, with one exception, which we were talking about earlier, in relation to comparison websites and stopping cowboys, if I can call them that, who are not authorised and who are not complying with the financial promotion provisions. There may be a need there, but there are real difficulties, as Dick referred to and indeed as the FCA told us, which are summarised in our recommendations bit, about giving them powers to stop these kinds of cowboys promoting financial



products, which should really, if they were operating lawfully, be within some sort of regulated framework.

Q51 Anthony Browne: You are talking about the position of the perimeter. Presumably, you are not saying that the perimeter should have been moved to include the mini-bonds that LCF was selling.

Dame Elizabeth Gloster: At the moment, the FCA, under its intervention provisions last year, prevented the sale of these types of mini-bonds by companies such as LCF. It did that under its product intervention powers and it has now continued that. It was a temporary intervention on the marketing of speculative mini-bonds to retail investors. It had power to do that because it is enabled to prohibit authorised firms from entering into those sorts of agreements.

I do not think there is a power to intervene against unauthorised persons. There may be a question mark as to whether there should be a power to intervene against unauthorised persons, prohibiting them from selling this sort of stuff. They should actually be controlled, perhaps, by the financial promotion regulations or others, but we were told, as I said earlier, by various industry participants, regulated IFAs or trade organisations, that the problem is that there are lots of unauthorised promoters and intermediaries out there who sell, or try to sell, these sorts of mini-bonds to retail investors. They operate on the fringes, probably in breach of the financial promotion rules. Because they are unauthorised, it is harder for the FCA to identify them and take action against them.

That comes back to what Dick and I were saying a moment ago, about these promotions, sales or inquiries—a little bit of fishing on the internet—from these websites. That is difficult, but the FCA probably has powers in its general powers to protect markets and consumers against financial fraud, et cetera, to do something about it, but there is a real problem in actually identifying them.

Q52 Anthony Browne: When I was chief executive of the British Bankers' Association, I spent five years negotiating regulations with the FCA. We always made the case that they should focus more on regulating activities rather than entities. As Parliament passes the laws, as a regulator it is far easier to try to regulate an entity rather than an activity.

Dame Elizabeth Gloster: I might agree with you on that. That is just me speaking as Liz Gloster.

Q53 Anthony Browne: As a consumer, if you are sold a dodgy mini-bond, it does not matter whether it is sold by a company that has got an FCA authorisation or a company that does not have an FCA authorisation; your experience is exactly the same. It follows from that, in terms of the regulation outside the perimeter, that actually the regulation of mini-bonds, in the example we are talking about now, should be the same if it



is sold by an entity that is regulated, like LCF, or an entity that is not regulated, like some of the promoters you are talking about.

Dame Elizabeth Gloster: This intervention was very specific. It would not have prevented the issuing of debentures, or the raising of capital by genuine companies that wanted to use it for their own business, such as companies like Hotel Chocolat or John Lewis. It would not have had any effect on that. I do not think the intervention restricts the ability of issuers to raise money for their own businesses, but there is a question as to whether, in circumstances where unauthorised cowboy operators are not prevented, authorised people are being treated unfairly. That is an issue that has been raised with us.

Q54 **Anthony Browne:** You mean being treated unfairly because it is not a level playing field between them all?

Dame Elizabeth Gloster: Yes. It is going back to your point: do you go after the product or after the firm? It is difficult, for the reasons we know, for the regulator, however enthusiastic, to go after these chimeras, these Cheshire cats, who are there one minute and not there the next.

Q55 **Anthony Browne:** It is easier to go after the firms that it knows because they are on this list of the 50,000-odd firms that it regulates. Can I just come to one other thing? You have talked variously throughout this session about the lack of curiosity the FCA has for suspected fraud, that it is not its job to investigate fraud and so on, and about what should be done about that. Could you not have a scheme where the regulator has a duty to report suspected fraud to the Serious Fraud Office or the police if they see that going on? You have been talking about internal communication within the organisation, but in other sectors, like in the legal profession, you have a certain duty to report things.

Dame Elizabeth Gloster: Yes. That might be a good idea; I have not thought about it. Certainly, when I was at the Bar, we had obligations to report in certain circumstances. They have tightened up quite considerably in the last 20 years.

Q56 **Anthony Browne:** You could have a similar system operating for the financial regulator.

Dame Elizabeth Gloster: The problem with LCF was before one got there, if you see what I mean. By the time you get to the possibility of a case, it can be handed over to the SFO or whatever the appropriate prosecuting authority is. There are prosecuting authorities out there.

Q57 **Anthony Browne:** They may not know what is going on. There are people in the regulator who know what is going on but are not telling the prosecuting authorities.

Dame Elizabeth Gloster: I am not sure that a duty would improve that. It might keep people alive to the problem a bit more.

Q58 **Anthony Browne:** If they had internal discussions within the FCA about



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this and they consulted their own internal lawyers, they would say, "Actually, we have a duty to report this." In your review, you noted that for a period of time the senior management of the FCA knew there were risks around the perimeter, but that had not filtered down to the rank and file. Do you know why that was? Was it just internal communication, which you talked about earlier, or was there a more structural reason for it?

Dame Elizabeth Gloster: There was an appreciation of the problem at a higher level, and there were policy statements and internal documents, but the message had not got over; it had not got there. Andrew Bailey and others spoke about the difficulty in changing culture, and how it takes a long time. I do not quite get that. I do not quite understand why you cannot sit everybody down and give them the summary of the lecture by way of training and what is in my report by way of recommendation. I would have thought that could be done. As we say in our report, I am not quite sure why this cultural change took so long to effect.

Anthony Browne: I would love to ask you more questions, but unfortunately I am out of time. Thank you very much for your report and your time.

Q59 **Mike Hill:** Thank you, Dame Elizabeth, for an interesting and very forthright report. Just quickly, on the scope of the investigation, was the direction set out by the Treasury sufficient in allowing you to capture the failings in the FCA's regulation and supervision of LCF?

Dame Elizabeth Gloster: Yes, I thought so. Did you have any particular concerns? I did not feel it was limited, because I had a catch-out phrase that allowed me to address anything else I considered relevant. I did not feel it was for me to address issues that involved political considerations or economic considerations, such as restrictions on the raising of capital, because I thought that would have involved consultation and the kind of economic investigation that was not appropriate for me and my team to do.

Q60 **Mike Hill:** It is just a question to see if there were any other areas that you felt could have or should have been allowed to be considered.

Dame Elizabeth Gloster: No. If you are pulling me back to the question of personal culpability, if that is where you are going, it would not have been appropriate to have specified that as part of my remit unless there could have been a clear articulation of what particular legal liability, from what particular circumstances, I was being asked to give a view on. Again, I am speaking as a lawyer here in the sense that, if you are going to find somebody liable for something, you have to identify what the duty is, what the breach of it is and whether the breach of the duty caused the loss. They could have framed it differently and more flexibly than that if they had wanted to, but I did not feel constrained by that. In fact, that would have been an unnecessary component on the plate.



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Q61 **Mike Hill:** In terms of constraints, earlier you mentioned one or two pushbacks, or attempts at pushbacks. Did you feel constrained by the FCA's protocol at any point during the investigation?

Dame Elizabeth Gloster: No, I did not. One point I would make is that it took quite a long time for the inquiry to get under way, because the direction, the protocol and my terms of appointment had to be agreed. I did that before I had the support team onside. That was an appointment process that happened later. In retrospect, I had to do some negotiation on the FCA's protocol prior to the appointment of my support team. I was doing it on my own. That is fine, but because I had not had the experience of a prior investigation, I might have been assisted by lawyers who had done a previous one so that I could have perhaps insisted on more draconian measures for securing information.

Q62 **Mike Hill:** On the broader front, because you have answered a lot of the things that I wanted to ask you, in terms of the directions from the Treasury, it requested consideration of any other matters you might deem relevant to the investigation. Do you think that was too broad, or do you think it was about right and gave you the scope that you needed?

Dame Elizabeth Gloster: I thought it was just right, actually, because it enabled me to identify for myself what I thought I needed to decide as to whether the FCA had discharged its functions in a manner, and enabled me not to address issues that people might like me to have looked at. There were a lot of other things that some people would have liked me to look at, but it would have been disproportionate.

Q63 **Mike Hill:** You focused on what you needed to focus on.

Dame Elizabeth Gloster: Yes.

Mike Hill: Thanks again for your report.

Chair: That brings us to the end of this session. Could I thank all four of our witnesses very much indeed for appearing before us, and in particular, Elizabeth, yourself, not just for the insights that you have given this Committee during this session but for the excellent work that you carried out in putting your report together? I think I speak for the whole Committee when I say it really was a first-class piece of work and much appreciated by all of us.

We have a lot of issues that we are going to be considering over the coming weeks, not least the policy issues that we have touched on, as well as those matters of process, or the practicalities, as you might term them, and of course the recommendations that you have made, for both the FCA and the Treasury. We will also be interested, albeit it has been outside the remit of your report, in the issue of responsibility and what consequences there may or may not be for those who have fallen short, perhaps, in some serious ways in respect of the oversight of LCF.

Once again, Elizabeth, thank you very much indeed for the insights you have given us in this meeting and for your first-class report.



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Dame Elizabeth Gloster: Can I also say thank you very much? If there is any further information, of a technical nature or whatever, that you require from me or my team, if you want us to supply something in writing, I am not inviting you to do it but please feel free to ask if you want it.

Chair: That is extremely kind and noted and appreciated. Thank you very much indeed.