

## Treasury Committee

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

Monday 8 February 2021

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

Questions 64 - 169

Witness

I: Andrew Bailey, Governor of the Bank of England and former Chief Executive of the Financial Conduct Authority.



## Examination of witness

Witness: Andrew Bailey.

Q64 **Chair:** Good afternoon and welcome to the Treasury Select Committee evidence session on the Financial Conduct Authority and its regulation of London Capital & Finance. I am very pleased to be joined by Andrew Bailey this afternoon. Andrew, could you very briefly introduce yourself to the Committee for the public record please?

**Andrew Bailey:** I am Andrew Bailey, Governor of the Bank of England and former CEO of the FCA.

Q65 **Chair:** The Gloster report was very damning of the FCA. It contained a large number of very specific failings on the part of the FCA when it came to the regulation and supervision of LCF. Could you set out for the Committee which of those specific failings you feel you take personal responsibility for?

**Andrew Bailey:** As I said to Dame Elizabeth, I take responsibility for the entirety of the FCA. As CEO, there is no question about that. We had that discussion in one of the sessions and it is recorded in one of the transcripts. I do not want to, in any sense, suggest I am not responsible for everything that happened at the FCA. I am.

Q66 **Chair:** You are of course, in that sense, because you were the CEO, and that goes for all CEOs of all organisations of any size. However, the key word in my question was "specific". Dame Elizabeth set out a number of specific failings. She named you in connection with some of those. Which of those specific failings do you personally feel responsible for?

**Andrew Bailey:** Can I make something clear? I am sure we will come on to this, but there was an element of ambiguity in the original draft of the report about the difference between culpability and responsibility. To be clear, I did not know about LCF as a firm until pretty much the point at which it was closed down by the FCA, so my personal involvement did not begin until then. Reiterating what I said earlier about the operations of the FCA and how I was seeking to change them—and I think was changing them, and no doubt we will come on to that—I do not want to differentiate my responsibility across the organisation, because I was CEO.

Q67 **Chair:** I do not think Dame Elizabeth was suggesting that you necessarily had a personal involvement or would have had some involvement with that specific business. However, for example, she highlights the failing in terms of, despite the risks, staff not being sufficiently encouraged to look beyond the perimeter, which seems to be more of a policy issue that you, presumably, would have been involved with, or not, as the case may be. The FCA's process of risk assessment, in terms of the variations in the permissions regime, in her opinion, seems to focus too much on the risk posed by regulated activities rather than unregulated activities, with unregulated activities being the bulk of the business in the case of LCF.



## HOUSE OF COMMONS

On those two points, do you not feel that, at your level in the organisation—albeit that we are not talking specifically about you intervening in LCF but about the broader policy, which in turn led to some of the problems here—you have responsibility for not having got those two specific failings right?

**Andrew Bailey:** Can I talk about the perimeter? That is a very good example of a policy. I know we have discussed this before at the Committee. The approach of the FCA up until I arrived in the middle of 2016—and you can see this in the 2014 strategy document—was that the FCA did not look beyond the perimeter, in effect. You can also, by the way, see the same point made in the Connaught report that was published on the same day as the LCF report. That struck me as a problem and it is one that I set about tackling.

Let me refer you to the mission statement that I produced, in a sense to reset the FCA's approach and strategy. We finalised that in the spring of 2017. The mission statement stated very clearly that, where we saw the case to do so, we would go beyond the perimeter. To be clear, the FCA had not done that. There was no mechanism for doing that. There was no machinery for doing that and it had not been something the FCA had done. We had to work to put that into effect alongside the other very major changes that we had to make. That process took two years, from middle of 2016 to late summer 2018. In making those changes, we had to do a lot of prioritisation as to what we were doing and not doing, in terms of the case load and how we managed a huge change programme alongside it.

Let me give you two examples of how we made those prioritisation decisions. Under the mission, the prioritisation decisions directly had to relate to the harm consumers were suffering. We prioritised two things as substantial and big issues that we had to tackle early on. The first one, which the FCA was already engaged on, was high-cost credit. The background to this is, as I think the Committee knows, that, in 2014, the FCA had taken on, by the end of the day, about 35,000 extra firms. Bear in mind it started with about 25,000 firms and ended up with just under 60,000. Nearly all of those are quite small firms.

Q68 **Chair:** Can I stop you there just for a minute? We appreciate that there was a process of change that was being embarked upon by the FCA at the time. To pick up the pace a little, let me turn to the public apology you made—that brings us neatly on to this particular point—and Dame Elizabeth's reaction to it, which I would like to run by you. In your apology you say of the FCA's decision, "We took immediate steps to change the approach", which you are referring to. "The required changes in culture, mindset and systems was a major programme of work across the organisation, which took some time to put into effect. I am sorry these changes did not come in time for LC&F bondholders." Dame Elizabeth said, and I put this to her on the Committee last week, that this response was inadequate. She told us last week, in response to your



public apology, that the problems that were at the FCA during the relevant period “were not so fundamental that they could not have been fixed by specific, focused changes. It is not an adequate reason or excuse to say: ‘If only it had been later, the changes we are putting in place would have prevented it happening’”. Do you agree with her on that?

**Andrew Bailey:** I do not agree with the substance of that point. Let me explain why. In the report, Dame Elizabeth described the FCA that I inherited as “a broken machine”. Those were her words. Let me say the second thing. She also made it clear in the report, and I think she said it last week, that it was not her remit to look across the FCA at the work we were doing to change the FCA. She did not look at that work. She did not look at the scale of it and she did not look at the prioritisation of it. She said she did not, although I think she saw some of it, but she did not assess and analyse it. I have to be honest with you that I fundamentally disagree. It is the main fundamental point of disagreement between us on this question of the substance of the change that was needed, because, as she said, the machine was broken.

Q69 **Chair:** You can reach down into the machine, can you not? If you are at the top of something that is going wrong, you can set up institutional and cultural change programmes or whatever. At the same time, and she made this point at the last meeting, she did not see, and I am also struggling to see, why you could not have just reached in and pulled some levers to put some of these things right, rather than go through a long programme.

Can I quickly bring you on to one other point, because I am aware of time? The change programmes in 2016 focusing on supervision and authorisation ran behind schedule. I think that two of these programmes were five months overdue when completed. Dame Elizabeth’s view is that the board exco was unjustifiably relaxed about the fact that these programmes were not moving forward with appropriate speed. Do you accept that?

**Andrew Bailey:** No. There are two reasons why the delivering effective supervision programme took longer than we expected. One is because it was a very big programme. It started with 20 workstreams and as we were doing it we identified three other workstreams we had to add to it. We had to give more time to do those, one of which was a major data cleansing exercise because, as we got into the work, we found that the inherited stock of management information was not adequate and it was inaccurate. That took some time.

The second one, which I think Dame Elizabeth also pointed to, and I have discussed it with her, is the work done on the risk model. Let me be clear: the FCA has to have a risk-based model of supervision, because it cannot tackle everything. That is very clear. The work done on the risk model, when it came to exco, was not of the standard that would have been effective. I said, “No, I am sorry, this work has to be redone in



important parts". It would have been a mistake to have accepted it in that form. That is the answer on that question.

On exco and the board, exco considered and, frankly, was looking at these programmes pretty much continuously. The board and the two committees of the board, which are very important, the risk committee and the audit committee, received the quarterly performance report on the organisation, which covered these programmes in some detail. They received a monthly report from me as chief executive. I counted up the number of occasions separate to those that they discussed the delivering effective supervision programme across the board and its two sub-committees; it was nine times in those two years. I know Dame Elizabeth has talked to two board members. If you talk to board members, I think you will find that they do not feel that way at all.

**Q70 Chair:** You do not feel that anybody looking in from the outside who feels there was a lack of grip as this was emerging, and you did not take immediate or quick and prompt actions—

**Andrew Bailey:** I was going to give you an example, which is highly relevant, and that is the contact centre. Dame Elizabeth is right to point to two things, and I agree with her on this. I am not hiding things that went wrong. There are two things with the contact centre. First, there were calls coming into the contact centre that pointed to what of course was eventually the suspected fraud in LCF. I say "suspected", as you will understand, because it is still under investigation, but we know what we are talking about here. Obviously, there should have been a mechanism to alert supervision and, if necessary, enforcement to those calls.

**Q71 Chair:** On that specific point, when did you first become aware of that particular issue with the contact centre, the non-referral point you are making?

**Andrew Bailey:** In the very end stages of my time at the FCA, when the material was being prepared for Dame Elizabeth. That is the first issue. She refers to the second issue in one of the footnotes. There are about 611 calls that come in from consumers about LCF, questioning the firm's status. In some proportion of those calls—I think she says it is not very large; I do not know the precise number—the wrong information was given. Again, that is wrong. Can I put this problem into perspective? We had no system. We inherited no system for extracting information out of the contact centre calls.

In many ways, the key third-party piece of evidence here is the PA Consulting report that was produced about a month after I started as CEO. I would strongly recommend that you get hold of a copy of it; you would have to ask the FCA for it. It is probably the most insightful description of the problems of the FCA at that point. It points very clearly to the problem of the contact centre in this respect, that it was effectively not possible to extract information. Can I put that into perspective with one number? The contact centre in my time was receiving 200,000 calls a



## HOUSE OF COMMONS

year and there was no system for extracting information from those 200,000 calls. To be fair to Dame Elizabeth, she benefited from the fact that the LCF calls were extracted for her team, because that is what the FCA had to do and did do. Contemporaneously, the red flags were buried in the 200,000 calls and there was not a system for extracting them. I wish there was and we set to work. One of the big deliverables in this programme of work was to do just that.

- Q72 **Chair:** If you look at the red flags, you have the point you raised about the lack of response to suggestions of fraud. You also have suggestions of some people phoning in about products that were covered by the FSCS compensation when they were not. Indeed, points were being made on some of these phone calls that, because LCF was an authorised business, that conferred—*[Inaudible]*—related to the unregulated activity of the mini-bond et cetera. It seems that there is a sort of pattern of misinformation.

This dovetails into some of the criticisms of the training at the FCA. If you look at the contact centre, and you have raised it, Jonathan Davidson had the responsibility for this area. We have just discussed some very serious failings here. Did you at all times have confidence in what he was doing and his ability to carry out this role? Do you look back now and think, “Maybe he was not as on top of all this stuff as he should have been”? What is your opinion?

**Andrew Bailey:** Jonathan Davidson and Megan Butler commissioned the PA report before I arrived, but it was delivered just after I arrived. That was based on their idea. They arrived at the FCA about eight or nine months before I did. They identified the problem, or the problems, because they were big problems, and commissioned the report, which would essentially give us a baseline on them. Jonathan in particular led both of the big programmes that we had to do to reform supervision and authorisation, so delivering effective supervision and delivering effective authorisations. Jonathan was a key part of delivering the change and the change has delivered, in that sense, I believe. I have not been in the FCA for a year now, but there is always going to be more to do. You have to have an effective system, going back to the contact centre, which was in Jonathan’s area, to extract information from 200,000 calls a year. It does not just happen.

- Q73 **Chair:** If you are responsible for an area, you have other managers feeding into you and you have this call centre operating, you would surely be able to pick up, from time to time, the kinds of red flags that Dame Elizabeth has identified. You would be connected enough to know there were some of these issues floating around, would you not?

**Andrew Bailey:** I come back to the point that the PA report identified that there was no effective means of doing that when we took over in the FCA.

- Q74 **Chair:** Would your view be that there are no lessons for Megan and



## HOUSE OF COMMONS

Jonathan personally in any of this?

**Andrew Bailey:** There are a lot of lessons for all of us. I am sure of that. I do not want you to think there are no lessons. To be clear, I was disturbed at the suggestion that the nature of my apology would be taken to suggest that there were no lessons or that I was not genuine in my apology to the bondholders, which I certainly am. They should not suffer as a consequence of this.

Throughout this report, we have had this struggle by those of us who have been saying, "Please can we explain to you the situation that we inherited and what it took to solve it?" I have to be honest with you. This is important. I agree with Dame Elizabeth on a lot of things, but I do not agree on this point. She sort of suggested to you that, if only we had told the staff to pull their socks up, the problem would have gone away. At one point in the report, she even suggested that maybe it was a mistake to do the programmes of change, which I fundamentally disagree with.

Q75 **Chair:** I do not think she was quite as glib as saying, "Pull your socks up and the problem would have gone away".

**Andrew Bailey:** She was saying, "You could have sat the staff down and told them to"—

Q76 **Chair:** She made the point, which felt like a not unreasonable point, about the suggestion that nothing could be done other than the change programme, which unfortunately took some time and what happened in the meantime happened. I think she was saying that more could have been done in some of these areas by—this is my phraseology—reaching into the machinery and making some changes.

There is this issue of the Maxwellisation process and the ability for the FCA to comment on reports. There is the issue of not wanting there to be any findings of individual responsibility within the report. Dame Elizabeth is clearly disappointed that those representations were made and feels that, in your own case, they showed a lack of judgment. On reflection, having heard her arguments and gone through that process, do you regret having made those requests?

**Andrew Bailey:** I am sorry about what I am going to have to say now, but there is a fundamental misunderstanding of this. Can I set it out because it is very important? It is not correct to present the point I made in my representations as in any sense an unconditional statement that I did not want my name mentioned and particularly mentioned in the context of responsibility. That is not the case. The representations were a response to the draft report, not the report that has been published.

The draft report was written very differently in this respect to the published report. It contained what I would describe as an important ambiguity between personal culpability and responsibility. It did not separate the two. My representation on the naming issue was a response to that. It was not a generalised point about my name, which I will come



## HOUSE OF COMMONS

back to in a moment. It set out that, if a point relating to personal culpability was going to be made, no evidence had been presented to me and nor was there any evidence in the draft report, and yet the point was made. If it relates to personal responsibility, I will say again what I said in one of the sessions I had with Dame Elizabeth, which I said earlier. There is a transcript of this. As CEO, I was responsible for everything.

The representation set out two approaches, or two points really. One was to point out the nature of the ambiguity and what needed dealing with. The other was to say that, if dealing with that point on culpability was not what Dame Elizabeth wished to do, in respect of this point of the culpability, and it was described in the representation as a freestanding approach to deal with this culpability ambiguity, the names ought to be taken out, because it was misleading.

**Chair:** Are you saying that—

**Andrew Bailey:** Can I finish, because it is a very important point? I am nearly finished, if you do not mind. In the event, Dame Elizabeth revised the text to focus on responsibility. I think she covered the culpability point at the hearing last week and explained why she did not make a finding on culpability in the end.

Can I be clear? The point I was making was not about responsibility. Hypothetically, if you had asked me, "Would you make the same point on the final report?", I would say no, because I am perfectly happy with the point on responsibility, since I am responsible. I am probably sounding quite angry now, and I am. Maybe this is just a misunderstanding, but it is a very serious issue to raise. The representation was never made in that context. It was never made. I had assistance from a QC to do this. I have talked to the QC and he said, "No, that was never the context in which it was made".

Q77 **Chair:** Did you have the opportunity, during the Maxwellisation process and before the final report was drafted, to make that point to Dame Elizabeth?

**Andrew Bailey:** No.

Q78 **Chair:** Why did that not happen, just because it was not part of the process?

**Andrew Bailey:** That is an interesting point. That was not part of the process. Perhaps I should come on to that and say two things. First, one or two members of the Committee may remember that I was responsible for the production of the HBOS report some years ago. We re-Maxwellised on a limited number of points. The reason was that our legal advice was that, because the people we Maxwellised had provided new evidence during the first Maxwellisation process, and that evidence had actually led us to criticise them in ways we had not criticised them in the draft, we had to allow them to comment on that evidence. We did that.



## HOUSE OF COMMONS

There was some interaction with this Committee and I well remember a hearing on this. This Committee, as you may remember, commissioned a report from Andrew Green QC on the Maxwellisation process. To your point, we allowed people to comment on the HBOS report, but that did not happen. I should now declare for the record—I do not think you will mind me doing this—that Andrew Green was the QC who wrote the representation with me. He was my QC in this respect. That is a coincidence in some ways. Well, it is not, because he is an expert on the subject.

I am angry about this because, frankly, you, quite reasonably, have raised this issue. You have quite reasonably regarded it as a criticism. It was never intended in that respect.

Q79 **Chair:** That is interesting. Is the logical extension of your line of arguing here that one of your disappointments with the report is that the context within which you made your representations to exclude findings of individual responsibility was not featured?

**Andrew Bailey:** It was not.

Q80 **Chair:** If the report had said, “Andrew Bailey was very concerned about an apparent ambiguity around responsibility and culpability, and therefore made representations to have names removed; however, having sorted that problem out, he does not feel there is any further requirement to have those names removed from the report”, would that be, broadly speaking, where you are on it?

**Andrew Bailey:** That would be absolutely fine—no problem at all. You can probably see I am pretty angry about this. It is just not right.

**Chair:** You have been very clear in putting your side on that one. Thank you for answering it.

Q81 **Alison Thewliss:** I have some further questions about the operation of the contact centre. That is a particularly worrying aspect of this case. I understand that, in the FCA handbook, one of the supervisory principles is to identify emerging risks of harm and ensure the FCA’s supervisory activity mitigates the risks identified. Dame Elizabeth describes a failure to react appropriately to 15 calls from a single individual between 15 July 2016 and 22 February 2018. They were voicing detailed concerns about LCF. Did the FCA fail to adhere to those supervisory principles?

**Andrew Bailey:** Quite straightforwardly, it should not have happened. Let me say two things about it. One I think I said before. It was hampered by the lack of an ability to extract information. Secondly, and I am going to be quite open about this, one of the challenges we inherited with the contact centre was very high staff turnover and quite high staff sickness rates, so continuity of staff was a challenge. Over my time, we had to make some key changes to the way it operated, to try to address these problems.



## HOUSE OF COMMONS

One thing became clear as my time went on, and we had a particular session on this. It is very disturbing. The management of the contact centre came to me and other senior managers, and we went to the board on it. They said that one of the reasons they were struggling with staff continuity, staff training and keeping an experienced thread through the staff was the abuse that staff were taking. They put together a tape for us and calculated the frequency with which these abusive calls were going on, which was growing. That tape is highly disturbing and it was happening with some frequency. The tape had racial abuse, antisemitic abuse and homophobic abuse in it, so we had to step in.

In many ways, I have to hold my hand up. I wish I had known about it sooner. I have to be honest with you. Yes, I wish I had known about it sooner. I would have jumped in and got on it sooner. It was very disturbing and it contributed to the fact that we were struggling to maintain continuity of staffing in the contact centre.

**Q82 Alison Thewliss:** Were staff themselves empowered to raise these concerns or concerns about being put in a position where perhaps they felt they had to give advice they were not qualified to hand out.

**Andrew Bailey:** I never heard the concern that staff were being required to hand out advice that they did not feel qualified to give out. We introduced training materials, certainly during my time as part of the change we did. We introduced more training materials. I never heard that comment.

**Q83 Alison Thewliss:** It is very concerning to me that staff were getting that kind of abuse but nobody at the top of the tree knew about it.

**Andrew Bailey:** It came to light eventually. To be clear, I am told that the trend increased over time. It was concerning to me that we were having this happen and I did not know. It was very disturbing because our staff should never be put in that place.

**Q84 Alison Thewliss:** It feels as though there is a bit of a missing link here. If staff perhaps were dealing with an issue and thought, "I have heard of that before", or, "The person sitting next to me has heard something like that before", was there no means of them raising and flagging that information to somebody further up? It feels as though there is a real missing link here in the chain from answering these calls.

**Andrew Bailey:** If you see the PA report, that is what the PA report says was missing.

**Q85 Alison Thewliss:** It also feels as though the internal audit report in 2015 identified lots of these issues about contact centre policy documents being unclear, and what the role of the members of staff working there would be to refer allegations of fraud or irregularity. Is there much more that could have been done on the back of that audit report to have dealt with this issue as well?



## HOUSE OF COMMONS

**Andrew Bailey:** My memory is that, in the middle of 2016, literally around the time I arrived, new documents were issued, certainly in the area of high-risk investments. I am not in the FCA any more, but I think there is work still going on on this. I think Dame Elizabeth identified that there were 600-odd calls on LCF over the period. The number I have heard, according to the assessment that was done more or less as I was leaving, was that about 4% were not answered accurately. To be fair, there may well be more work going on on that front. I think that 4% was the number that Dame Elizabeth had, because she had that documentation. It is wise not to regard that as the definitive number.

Q86 **Alison Thewliss:** Should we be worried that internal audit findings such as the one in 2015 have not been addressed? Are there other areas where we should be looking at internal audits?

**Andrew Bailey:** Sorry, I said that there was new documentation issued in 2016.

Q87 **Alison Thewliss:** Did that fix the problem?

**Andrew Bailey:** If it is indeed 4%, we cannot have 4% of calls not being answered accurately. To be honest with you, I do not know what the percentage would have been before that, so I cannot tell you what that amounted to. Clearly, there was still an issue. I can tell you that.

Q88 **Alison Thewliss:** Do you accept the possibility that, had the contact centre policies been clearer and had there been adequate escalation procedures for staff for dealing with intelligence and third-party correspondence, the level of detriment to customers would have been less, had those procedures been properly in place?

**Andrew Bailey:** I hope it would. Yes, because that must be the right outcome.

Q89 **Alison Thewliss:** You said that changes were being made to the procedures at the contact centre. Would you have confidence now that, if you or I had a concern about something, if we phoned up and spoke to somebody at the contact centre, we would get accurate advice from the people we spoke to? If we had concerns, would those concerns have a clear trail where they would be addressed?

**Andrew Bailey:** I have not been in the FCA for pretty much a year now, so I think Nikhil is much better placed to answer that question today than I am. I know that, by the time I left, the processes in the contact centre had been changed. This is a cultural point, but it is an important one. One thing that Jonathan Davidson and I were very clear on, and Jonathan identified this, was that the contact centre was too remote, in terms of its operation and general location and fitting, from the rest of the FCA. It is worth noting that, until not long before my time, it had been outsourced to a third-party provider, so it was not even part of the FCA. It had been brought in house, but it was not adequately part of it.



## HOUSE OF COMMONS

Jonathan took the lead in saying, “We have to make it part of supervision”. It is actually now called the supervision hub. It is not called the contact centre. It may sound like nothing, but it is quite important as a message to the people there that they are part of supervision. Jonathan did a great deal of work to integrate it. I spent quite a bit of time with the staff and they said, “Yes, it is very different”. The answer to your question is that I hope so, but Nikhil is in a much better place to answer that question today. I am not in a position to answer that question.

**Q90 Julie Marson:** Good afternoon, Andrew. I would like to turn to what Dame Elizabeth has referred to as the halo effect, by which consumers took what turned out to be false comfort from LCF’s authorisation. The halo effect was well known. It was a known problem to the FCA. How serious and fundamental a problem did you see it as and what did you do about it?

**Andrew Bailey:** It was part of the overall programme under delivering effective supervision. We said that, to deliver effective supervision for this 35,000 population of firms that had come our way, we had to understand their business models. That includes both inside and outside the perimeter. The aim there was to get to understand what they were doing. That would have revealed in much greater detail and much more starkly that halo effect, because you would have firms like LCF that were not doing business inside the perimeter. It is questionable whether LCF ever did any business inside the perimeter.

That was what we were doing and that was the sensible thing to do. The FCA has now taken another step further and is doing the “use it or lose it” principle on the permissions. If you do not use them, you lose them. The reason that was not done in the past was that there was a view, and it happened, that firms had permissions for precautionary reasons, because they could find themselves suddenly in a position where their business model required them to do some business inside the perimeter. If they did not have the permission, they would be committing an offence.

**Q91 Julie Marson:** Dame Elizabeth refers to one of the real wickednesses about LCF frequently breaching, for instance, the financial promotions rule, but that nothing was done about it. How do you respond to that specifically?

**Andrew Bailey:** I partly agree with her and partly do not. It is not true that nothing was done. The promotions team followed up pretty diligently. I think they followed up all the alerts they got. They got LCF to change its promotions, but the problem is that LCF did not stick to it, so we got this repeat cycle. What did not happen that should have happened was this breaking down of what tended to get called—again, PA referred to it in its report—the silos within the FCA, which we had to do. That is not something where you just go on plugging away, saying to the firm, “You have to change. You have to change. You have to change”. That had to be brought into the overall supervision of the firm. We had a programme of work that brought this whole-firm supervision model in.



## HOUSE OF COMMONS

Bear in mind that I inherited a situation where these firms were not supervised, as I said to Dame Elizabeth. That did not exist.

Q92 **Julie Marson:** One issue that has been raised is the number of staff. As you say, there were big issues. There was a delay in some of the change programmes. In 2004, when the financial promotions team was set up, it had something like 30 staff. During the relevant period it had already gone down from 10 to eight. Would it have been an easy win to get some more staff? If you knew there was a problem there, would it have been better to resource that particular team better, for example?

**Andrew Bailey:** The answer is obviously yes, in one sense, but it is always the problem we have to tackle with this that hindsight is a great thing. If you do not mind me saying so, taking hindsight into account, the answer is yes.

Q93 **Julie Marson:** It is not just hindsight, though, is it? If the problem is a known problem, for example, resourcing is quite a fundamental issue to solving that, as well as all the other changes you want to bring in, in terms of the regulation.

**Andrew Bailey:** Except that it is not entirely clear that the problem was overwork as much as joining up the whole-firm supervision. There is a difference between saying that the promotions team was so overworked that they could not do what they had to do and the real issue, which was joining up the various strands of work so you could see LCF as a whole.

Q94 **Julie Marson:** Dame Elizabeth says the financial promotions team had the right rules and powers, but in the middle of that line there is the link of having the right policies to translate one through to three. Would you agree that that is a failing?

**Andrew Bailey:** Can we stop on the question of Dame Elizabeth's comments on the powers? She made recommendations on, in a sense, the way in which the financial promotions regime operates at the overall legislative level. It is a slightly odd adjunct to the FCA regime. It is not part of the FSMA regime proper in that sense. She made recommendations on that front, which I agree with and which the Treasury is currently consulting on.

Q95 **Julie Marson:** If she says you had the right rules and powers, but did not have the right policies, would you agree with that?

**Andrew Bailey:** I agree with her. I agree with one of her central points. We were doing this, but this is back to the time it takes to change the place. This joining up of the pieces to get the whole-firm view was what was not happening. To repeat the point, these firms were not being supervised.

Q96 **Julie Marson:** Back to the powers, when we spoke to Dame Elizabeth last week, she made the comment that there was no doubt that, as far as the FCA's powers were concerned, it was entitled to regulate LCF on a



## HOUSE OF COMMONS

general basis, on the basis of it being a fit and proper person and so on.

**Andrew Bailey:** Yes, I agree with that.

Q97 **Julie Marson:** What would you suggest the Treasury and the Government do to make this more effective when it comes to the FCA using its powers?

**Andrew Bailey:** There are a number of recommendations that Dame Elizabeth made. There are a few she made in respect of the powers at the Treasury level. As I said, the Treasury are already consulting on the promotions regime. That is the right thing to do. The next level down is how the FCA puts them into effect, which is not an issue for the powers. We just talked about quite a lot of that, but I would agree with her.

I know we have talked about the second thing in past hearings, but it is important in respect of promotions. This has not happened. I remember talking about it probably in 2019 with the Committee. It is the online harm legislation. In my time in the FCA, I argued with DCMS that the online harm legislation should include financial harm, and it has not. That is a very real issue. The FCA is better placed than I am to talk about it now because it has had a year more dealing with it. The fact of the matter is that the legislation, protections and requirements for online advertising are very different and, frankly, very much less than for traditional print media advertising, where there is a responsibility of the publisher in respect of the advertising it publishes. That is not true and this is the problem we have had with the likes of Google. I possibly described it in one of these hearing in the past as like playing Whac-A-Mole with the whole thing.

Q98 **Chair:** Can I come back to this issue of the finding of individual responsibility? Your point about ambiguity between responsibility and culpability was resolved, as I understand it, to your satisfaction in the report, inasmuch as Dame Elizabeth made the point that there is a distinction and stated what the remit of the report was. Did you at any point before the report was published, or subsequent to the report being published, make any representations to Dame Elizabeth that, if the ambiguity was removed, as indeed it was, you did not have any problems with having findings of individual responsibility?

**Andrew Bailey:** That was the thrust of the representations I made on the draft. I could possibly just read out the last part of the representation, if you do not mind. It said this: "If the investigation intends to retain the word 'responsibility', it is respectfully requested to make clear that it has not made findings of personal culpability that I caused the failings and modify the wording which could be taken to suggest the contrary". I have no criticism of Dame Elizabeth. That is what she did and I am fine with that. I do not understand why we had to have this paragraph.

Q99 **Chair:** I accept it is just one paragraph in a larger submission, but that does not quite say that, in the event that she makes the distinction



## HOUSE OF COMMONS

between responsibility and culpability, you are therefore perfectly happy for findings of individual responsibility to be made in the report.

**Andrew Bailey:** I am not sure how you would otherwise read it; put it that way.

Q100 **Chair:** You had that representation. Dame Elizabeth then went off and wrote her report, which is not the report you presumably would have expected or liked. When were you first aware that the report was going to be imminently published?

**Andrew Bailey:** When I saw the final version. I talked to my QC about it and he said, "You cannot do anything at this point. There is nothing you can do about it".

Q101 **Chair:** Was that before or after it was published and made public?

**Andrew Bailey:** It was a few days before it was published.

Q102 **Chair:** Why did your QC therefore just say, "There is nothing you can do"? You described in your earlier answers in this session that you are really quite angry about this situation. Why would you not therefore have gone back to Dame Elizabeth and said, "Hold on a minute; you have put this in the report"?

**Andrew Bailey:** He said to me, "She has the right to publish the report. You cannot stop her publishing the report. You would have to take out an injunction". I am not going to do that, clearly. That is way out of line.

Q103 **Chair:** To be clear, I am really not referring to you in any way making an attempt to stop the report or anything of that nature. You arrived at a point before its publication where you saw what was going to be published. It met your requirement that there should be a distinction between responsibility and culpability. You had made earlier representations to make it clear that, in that event, you were perfectly happy for findings of individual responsibility to appear in the report. Why did you not at that point go to Dame Elizabeth and say, "Hold on; my earlier representation made it very clear that I was happy to have the names within the report on that basis? Why have you not done it that way?"?

**Andrew Bailey:** Having got this quite unexpected reaction, feeling that she had been unreasonably lobbied to make a point that had not been made, I felt that there was a real risk that lobbying again would make it worse. I would much rather just explain it. I cannot tell you that it is anything other than disturbing to me that this matter has had some public attention. If I had tried to, in some sense, resile from being named unconditionally, that would have been deservedly brought down upon me. I am sorry about this, but it has been a difficult point in this process.

Q104 **Chair:** Yes, and it is an important point for us to look at, because it is a clear point of division between you and Dame Elizabeth, as to what your representations were really about. You are suggesting that she has not



taken them in the way in which they were intended.

**Andrew Bailey:** I can honestly say, even as late as Saturday evening, I asked my QC, because I was expecting this discussion, “For the avoidance of doubt again, do you think we got it wrong in the way we wrote it?” You might say, “He would say this, wouldn’t he?”, but he said, “No, I do not think we did”.

Q105 **Felicity Buchan:** Good afternoon, Andrew. My questions are on the culture of the FCA. We have touched upon some of these issues already, but let me dig down a little more. When you arrived at the FCA in mid-2016, you were aware that a wholesale change to the culture was needed. We have talked about how that took a few years and there was delay. Do you not think that there could have been changes made to the culture earlier?

**Andrew Bailey:** One of the big decisions I had at the outset was whether to change the structure of the organisation and arguably, with that, the culture, or to focus on fixing the approach to supervision, fixing the systems and fixing staff training, which is what we did. You may know the history. The FCA had gone through some very painful experiences. It was said to me at my own appointment hearing for the FCA job by members of this Committee in 2016 that I was inheriting a very troubled legacy.

The management structure and the organisation of the institution had been changed several times in the three years since it had come into existence and my decision was not to do that. It was a very finely balanced decision. In many ways, you might say that the argument is: “Why not tear the place up and start again?” My judgment was that, because of the scale of the problems we had to deal with, that would have added more time to doing it. I was conscious of this time factor.

Can I do a comparison here quickly? I introduced the PRA’s supervision model. I was responsible for that. It took me nearly three years to do that. Don’t get me wrong; the PRA is very important, but it has a much smaller span of activity in terms of financial services. That was a very deliberate decision, to focus on fixing the approach to supervision and the approach to authorisation—so, the systems. In my time, I spent something like £230 million on IT systems changes. If you asked me the question, “Looking back from today, was that the right decision?”, I still think probably yes, but it is an open question. It has always been an open question in my mind. It was done for good reason at the time. Would we have seen differences if we had done it differently? I don’t know, to be honest.

Q106 **Felicity Buchan:** What do you feel were the biggest issues that went wrong? There were many things highlighted in the Gloster report. There was the fact that there were too many silos and not enough of a holistic approach, that the FCA was overly reactive and not proactive enough, and that there was a sense that financial crime was for the police, not for



the FCA. What do you think was the real core issue?

**Andrew Bailey:** You could say “all of the above”. I said before that 35,000 firms came in. It broke the model of supervision. The FCA had established a model of supervision in 2013, but it was large-firm-focused, because that is where the problems of the day were. The 35,000 firms came in and broke it. As you say, there was not proactive supervision. It was an enforcement model, essentially. The problem with enforcement models is that you wait for the problem to occur and then deal with it.

The financial crime issue has become more of an issue in a sense. I remember saying before to a hearing, probably back again in 2019, that one of my concerns with the FCA was because of the lack of law enforcement support below the SFO. The SFO was very engaged. The FCA was increasingly having to take these cases on as a law enforcement body, but it does not have the full powers.

Q107 **Felicity Buchan:** If we focus in on financial crime, do you think staff at the time should have had a mindset in relation to fraud that they had to be the first line of defence for retail investors, not the ultimate prosecuting body but the first line?

**Andrew Bailey:** Yes is the answer to that. The FCA is a complex organisation in that respect, because it is more than one organisation in many ways. There is a very strong consumer protection part to it. There is a very strong competition part to it, which takes a different approach towards these issues, not because they tolerate crime but because their way into these questions is different. At the time, the supervision/law enforcement side was underdeveloped. It was weak.

Q108 **Felicity Buchan:** We have talked about the red flags and in particular on the contact centre. Why do you think multiple red flags, apart from the contact centre, were not picked up? Is that because of the siloed approach?

**Andrew Bailey:** It was two things. First, there was the lack of systems. As I said earlier, in my time the contact centre received 200,000 calls a year. There is a problem and the Connaught report is very good on this. The author of the Connaught report makes the point that you have to be very careful about hindsight judgments. Quite rightly, the FCA picked out the LCF calls for Dame Elizabeth and said, “Here they are”. Dame Elizabeth said, “They are red flags”, and she is right. The problem is that, at the time, they were in 200,000 calls and, as PA pointed out, there was no proper system for extracting that information.

Q109 **Felicity Buchan:** As you sit here today, and obviously you have now left the FCA, if there is one thing you could have done differently, what would that be?

**Andrew Bailey:** Straightforwardly, I would wish that we could have saved the bondholders the suffering they have had. There is no question about that. That is why I structured my apology as I did.



## HOUSE OF COMMONS

**Q110 Dame Angela Eagle:** Governor, fraud and protecting against it clearly is in the remit of the FCA. From what you have said and from the Gloster report, it does not seem that, when you arrived in 2016, it was really on top of that, because it was reeling from this injection of far more smaller companies to regulate. Is that an accurate assessment?

**Andrew Bailey:** Certainly in my time the number of enforcement investigations went up. I think it went up from a stock of about 230 to over 600. Not all of those are fraud by any means, but that gives you some, in a sense, calibration of the change. Because there was no system for supervising these firms, it was very hard to extract the information at that point. That no doubt had an influence on the number of enforcement investigations that were being taken on. Another thing we did in my time was to do a comprehensive review of enforcement under Mark Stewart, who joined a few months before I did. Mark has led major reforms to the way in which the FCA's enforcement side works. That was another part of what we did.

**Q111 Dame Angela Eagle:** I do not think it is only in the FCA. It is across the board that enforcement has suffered. Certainly in the years of austerity, it seemed to be the first thing that went. One of the things that struck me reading the report was how there was this view among people that enforcement was a police matter rather than an FCA matter. It is almost like it was too difficult to contemplate doing it properly. Is that fair?

**Andrew Bailey:** It is another aspect of the perimeter issue. If at that time you had asked FCA, "Do you regard yourself as responsible for fraud within the perimeter?", it would have said yes. That shaped a number of prioritisation decisions that were taken. If you go outside the perimeter, the answer was "not really", with a great reluctance to take on cases outside the perimeter. That was part of a view of the FCA's role and remit. It was often said to me in those days, "Parliament put the perimeter there for a reason". I am not saying you are responsible for this, but it was interpreted as being there for a reason, which was that you should focus on the things inside the perimeter before you get to the things outside the perimeter.

**Q112 Dame Angela Eagle:** There were these companies, such as LCF, that straddle the perimeter. They were not using the permissions they had been given within the perimeter, but were using the imprimatur of being regulation-worthy by the FCA to give—let us put it this way—false assurance to the people they were marketing their mini-bonds and whatever else they sold to.

**Andrew Bailey:** Yes, and that is why we said in the mission statement in 2017—I think these are the words we used—that, if we believe an issue is serious but the relevant activity falls outside the perimeter, we may still be able to act. I say the word "may" because the legal powers are still relevant. Sometimes you can and sometimes you cannot, because the FCA does not have full legal powers, but the point was that, if we can get to it, we will get to it.



Q113 **Dame Angela Eagle:** Would you have thought that, if the FCA did have full legal powers, it would have been gung-ho and far more on to this, or was it just overwhelmed by the admission of nearly 60,000 new firms?

**Andrew Bailey:** It was overwhelmed. There is no question about that. If I go back to 2016-17, in my first year, the FCA does an annual business plan. It produces something called a sector strategy for the various sectors. Out of that comes the prioritisation. In the area of high-risk investment, we had to make a choice at that point. The prioritisation we came to was that we prioritised the problem of high-risk and unsuitable investments in the so-called SIPP pension world.

**Dame Angela Eagle:** We know all about those.

**Andrew Bailey:** Let me say two things. That is inside the perimeter and we scaled the size of these inappropriate investments at about £1.3 billion. That is a big number. I know we have discussed this quite a few times before the Committee. The FCA cannot do everything that is within its perimeter. It has to make prioritisation decisions. I have to be honest with you: if Government and Parliament do not like that, the FCA is going to be a very different organisation. That is the prioritisation decision that was taken.

Megan Butler and I were very involved in that because it was Megan's area. We had to get to grips with the SIPP issue, because it was big, it was inside the perimeter and it had not been dealt with. We had to put a lot of resource on to it and probably eight or 10 enforcement investigations came out of that.

Q114 **Dame Angela Eagle:** The call centre, which was the way that you got information in a non-proactive way, had originally been undervalued by being outsourced and separated off. It had been brought into the organisation itself, but without really any structure. Should the FCA have been doing that or should it perhaps have made more representations to Government that it did not have the funds, the staffing or the money to do the job that Parliament was expecting it to do sensibly?

**Andrew Bailey:** Can I say two things on that? One was a question of prioritisation in my first year or two. We did not introduce delivering effective supervision in a single big bang; we delivered it in phases. We prioritised tackling whistleblowing. The reason for that is that, if you read the Connaught review, the Connaught review was very critical of the FSA—well, the FCA, but really the FSA—on whistleblowing. There was a major problem on whistleblowing and the number of whistle-blowers was going up. It was about 1,000 a year by the time I left. We prioritised whistleblowing and that was the right thing to do. The Connaught review supports that.

It just so happened that LCF did not have a whistle-blower, but that is not a reason for not prioritising whistleblowing. It is true that, given the choice between going first with delivering whistleblowing or going first



## HOUSE OF COMMONS

with delivering change to the contact centre, given the resources we had, we made that call.

On the budget and the cost, this goes back well before my time, but there were some pretty heated discussions with this Committee about the cost of the FCA and how it was too high. It is all before my time. I am not going into the rights and wrongs of it, but I can tell you it left the FCA with a feeling that it had to run at a lower cost. I am not sure we achieved that, but we certainly put a cap on the costs.

**Q115 Dame Angela Eagle:** You will agree, because you have apologised, that the FCA did not protect retail customers in this case, and you have expressed your apologies for that.

**Andrew Bailey:** I do agree.

**Q116 Dame Angela Eagle:** There was the anonymous letter. There were allegations of fraud and odd conduct. There were these patterns of them having permissions that they did not use and selling mini-bonds, which are known to be high risk, and even then selling them in an unusual way. Why on earth did this not raise any suspicions, and what could have been put in place to ensure that, in future, if a company starts behaving like this, the red flags will be picked up and suspicions will be investigated?

**Andrew Bailey:** Going back to before Martin Wheatley's time, in 2014, the FCA put in place the so-called NRRS rules and these extended outside the perimeter. These are the non-readily realisable securities rules. These rules said that, when selling these products to an investor, there must be a process by which the investor signs to say that they have been given a risk warning, where it says that these are high-risk investments and there is a risk of losing their money.

Then the investor must classify themselves as either a sophisticated investor or a high-net-worth investor, and there is a test of what those are. High net worth is annual income over £100,000 and, I think I am right in saying, net financial assets over £250,000. If they are not in those two categories, they must sign to say that they are not investing more than 10% of their net investable assets, and that does not include the value of their house or their pension. That is what the FCA put in place as a guardrail to protect investors. It was not the wrong thing to do. We have to conclude in the case of LCF that it did not work. That is why I support the fact that a temporary ban was introduced in my time and it has now been made permanent. I support that, but that regime was in place.

One of the things I have always been worried about—and it is still under investigation, so we do not know—was whether the investors were in some sense forced to sign these things. I do not know what went on. From what I can tell, not many, if any, of the calls coming to the contact centre highlighted that point. Dame Elizabeth refers to one call, but it is not really that they were being forced.



The FCA did that, but, to your question, we have to conclude that the ban is the right thing. The rules were designed to try to, in a sense, separate out sophisticated and unsophisticated investors. They were designed to be applied in a risk-based fashion and, therefore, to say some people will be better equipped to take this sort of risk, which might make sense as part of a diversified portfolio, although not when it is a fraud, clearly, and others will not. It was not the wrong thing to do, but we have to conclude that it did not do the job it was supposed to do.

**Q117 Rushanara Ali:** I have a few follow-ups, and also I wanted to concentrate my questions on supervision and authorisation. Governor, I was on the Committee under Nicky Morgan when all of this happened, as were a couple of other colleagues. Nicky Morgan and this Committee called for the investigation and it was back in 2019, if I recall. Can you just talk us through what you did when the stories started to break and it became a big problem, in terms of immediate action to prevent you and your senior colleagues from having sleepless nights worrying about what happened?

What are the steps you took in relation to the contact centre and safeguards to make sure that there are not other things like that buried in the patchwork of issues and regulations you oversee? At that point, did you know about the 4% of answered calls that were inaccurate, just to get the chronology right?

**Andrew Bailey:** LCF broke in December 2018. By that stage we were really at the end of the implementation phase of the delivering effective supervision and delivering effective authorisations programmes, so we had reached pretty much the end of that phase of the work. There is still quite a large phase of transformation. There is a big phase of IT investment going on.

**Q118 Rushanara Ali:** I just wanted to know what you and your colleagues did. I am sure you did lots of things as soon as this scandal was uncovered. What specifically did you do and, at that point, did you know there were 4% of calls that were not answered accurately?

**Andrew Bailey:** The 4% number is a first cut. It may change; let us be clear. I cannot speak for the FCA. It has no doubt done more work. That number really only became clear about a year ago, actually, so we did not know that at the time.

**Q119 Rushanara Ali:** You had a sense that there was a problem in the contact centre, in that supervision and authorisation, and the connection between the two, might have been an issue, I imagine.

**Andrew Bailey:** We knew that. We had already known that because the PA report had pointed to it.

**Q120 Rushanara Ali:** What did you do before the investigation? I know, once you get into investigations, reports and so on, it becomes more complicated, but what did the organisation do when you uncovered this



problem?

**Andrew Bailey:** The key thing was which of these issues the reforms that we had already done had tackled and which they had not tackled. That was the immediate concern, other than dealing with LCF itself as an issue. The question was to map what we had done by then on to the problems that we identified. You are right. In the supervision hub, or the contact centre as it was then called, where had we got to with that series of changes? Where had we got to with the IT systems changes that were causing problems with management information? Where had we got to in terms of integrating supervision and bringing financial promotions into that? Yes, all of these things were highly relevant, in my view.

Q121 **Rushanara Ali:** But there was a process that allowed you to assess whether there were other LCF-type cases around the corner.

**Andrew Bailey:** We had a lot of work on mini-bonds going on. Yes, there was a very large amount of work on mini-bonds. Mini-bonds is a bit of a catch-all phrase for a lot of things.

Q122 **Rushanara Ali:** The investigation found that the FCA's supervisory approach on firms such as LCF was not necessarily reflective of the public statements during the relevant period. Were your public statements therefore misleading customers? In my own experience of some constituents who came to me when they found themselves victims of this LCF scandal, they were under the impression that there were safeguards. There is this issue around supervised activity and unsupervised activity that comes up quite frequently. Did the FCA mislead the public with those public statements?

**Andrew Bailey:** We can go back to the question of the 4% of calls or whatever that percentage is. Let us call it 4% for the moment. It is very relevant to that question, because we fear that in there are some people who were led to believe there was FSCS cover when there was not.

Q123 **Rushanara Ali:** To quote the FCA handbook, it says, "The FCA will adopt a pre-emptive approach which will be based on making forward-looking judgments about firms' business models, product strategy and how they run their businesses, to enable the FCA to identify and intervene earlier". That is exactly what we would want for our constituents.

**Andrew Bailey:** That was a very big part of the change we were putting in.

Q124 **Rushanara Ali:** But it had not actually taken effect.

**Andrew Bailey:** The point is that the programme came in. Much of the implementation happened from the fourth quarter of 2017 through to about the third quarter of 2018. LCF was identified early autumn 2018.

Q125 **Rushanara Ali:** Having done all this work, by the time you were leaving the FCA, did you feel confident that with those reforms, along with some of the immediate internal changes and looks at the mini-bond issues



## HOUSE OF COMMONS

more widely, you left the organisation in a shape where this is less likely or hopefully not likely to happen?

**Andrew Bailey:** I am of the view, though others must judge it, that the FCA was a very changed organisation. I am pretty proud of what I have observed the FCA doing over the last year. It has done some very good things in the covid crisis. I have not led it, but I am proud of what it has been doing. It is a changed organisation, but it is for others to judge, not for me.

Q126 **Rushanara Ali:** I have two more quick questions. You have made perfectly legitimate points about the scale of activity that the organisation inherited and the tens of thousands of those smaller companies you were required to supervise. There is an inherent tension, which is about this point about prioritisation. From that, one can draw a conclusion that, given the breadth of activity, the inherent tension that leads to less oversight of mini-bond-type scandals or emerging issues, and the requirement to focus on the bigger problems so that you do not get hundreds of millions of pounds' worth of scandals, that does not serve the ordinary member of the public, who might have invested £20,000, as in my constituent's case, compared to something that is worth a larger amount.

You are making a judgment call, but some people will suffer as a result, because you are going to have to put more energy on the bigger problems and bigger prizes. As a result, should the FCA not be responsible for this area of activity? If it has to continue to be responsible, how do we avoid your successor having to make these choices? It sounds like you made a judgment call: "We are going to focus our effort on the bigger issues and put the others further down the priority list". It has cost £230 million to ordinary people and that is a worrying problem.

I was struck by a headline, which came at the back of this particular report, in *The Times*, which you might want to comment on. It was about whether the FCA is gun-shy and whether you use your powers. This came up in the past as well. Does the head of the FCA, whether it is you or your successor, have enough of the powers or is it about willingness to use the powers?

**Andrew Bailey:** I lost the sound in the middle of the question. I think I have got it, but please come back to me if I have not. Shoot me at the end if I do not cover everything.

**Rushanara Ali:** The *Times* headline was, "How the gun-shy regulator was left shooting blanks", so the shooting analogy is well made. Keep going.

**Andrew Bailey:** I wrote three things down. The first one is the point you rightly make about the case of what I might call monetary thresholds. The original 2013 FCA model had in it a monetary threshold that, if a harm was below a certain number, the FCA did not follow it up. This was



probably accentuated by small firms coming in, but the problem with that was that, clearly, your constituents would have a good case here. It is unfair for people who have smaller amounts of resources, but for whom the loss of those resources is equally, if not more, devastating, to be told, “I am sorry; you are not big enough to matter”. We changed that and a lot of the work on high-cost credit came out of that, but it is a challenge, because in a sense it puts more stuff on to the landscape to prioritise.

The second thing is a suggestion, and Nikhil may have to say differently here, because he may have changed the way they do it. I would advise, if they are still doing it as I did it and the board did it in my time, that the Committee can say to the FCA, “When you do your annual business plan do not just tell us what you have prioritised; tell the Treasury Committee what fell below the line and why”. There is quite a big prioritisation exercise done every autumn. It was an exhaustive process, and certainly in my day you could have had that. There would be no problem in having that and you may have views on it.

There are issues around the perimeter on powers. I am not sure how many issues there are inside the perimeter on powers these days, but Charles and Nikhil are much better placed to judge that than I am.

Q127 **Rushanara Ali:** We should expect the FCA not to fire so many blanks in the future, to protect our constituents.

**Andrew Bailey:** Your first question is hugely relevant here. There is always a prioritisation exercise, unless the FCA is going to be a vastly bigger organisation than it is today, and it is wise to know what that prioritisation is.

Q128 **Anthony Browne:** I want to drill down on some aspects of the supervision of flexible firms. You have touched on some of it earlier, but I have some more specific questions. There are three pillars to your supervision. Pillar 1 is proactive and preventive for bigger firms. Pillar 2 is when you have alarm bells ringing and particular incidents that you look at. Pillar 3 is for flexible firms, such as LCF, which is sector-wide and reactive supervision. How much was the failure of the supervision of flexible firms, like LCF, to do with the internal procedures of the FCA—you have talked about training, internal communication and so on—and how much was it the actual structure of that pillar 3 supervision?

**Andrew Bailey:** When I arrived, a model had been adopted. Tracey McDermott had adopted it out of necessity, and I do not criticise Tracey for this at all, because in what she inherited the policy was to have a so-called touchpoint with these firms every four years. I said this to Dame Elizabeth. That is not supervision. The challenge was how to do it in a way that gets more contact, engagement and insight, and enables more proactive supervision to be done. That is basically what we sought to fix in the delivering effective supervision programme.

Q129 **Anthony Browne:** The delivering effective supervision programme was



## HOUSE OF COMMONS

delayed and there are red flags about that, which are detailed in the report. Was the board of the FCA rather too relaxed about the delivering effective supervision programme being delayed? Should it have challenged a bit more?

**Andrew Bailey:** You would have to ask them, but I do not think they were, not at all. The programme was covered at the board in every quarterly performance report that the board had. I do not have them, so I cannot count them, but it was covered in most of the monthly reports they got from me as CEO. It was on the agenda.

Dame Elizabeth looked at the board, but you have to include the risk committee and the audit committee, because they were important. I counted nine times in that two-year period. That includes the point at which we had to extend the programme, partly because we took on three extra workstreams and partly because the risk model got delayed. You would have to ask the board, but that is not the feedback I got from the board. When I became CEO, I made sure the board was much closer to being in touch with what was going on in the place.

Q130 **Anthony Browne:** Given the delay to the DES programme, were interim measures introduced to try to make sure that those 50,000 companies had more effective supervision? The report suggests that those 50,000 companies had virtually no proactive supervision for four years.

**Andrew Bailey:** The DES programme was introduced in phases and many phases were not delayed at all. The introduction of the DES programme ran from about the fourth quarter of 2017 to the third quarter of 2018, and quite a lot of the streams were not delayed. It was a progressive pick-up in the application of the new regime to firms.

I do not think this has really been opened up to argument. You can argue whether the fact that LCF was finally identified in September 2018 was a product of DES having been implemented or a product of something else. It is an open question. I am not sure it is hugely important to argue it, but there was no question that the FCA was becoming more effective at identifying these issues and dealing with them. It was too late, clearly, in that case.

Q131 **Anthony Browne:** Do you accept that it meant that the 50,000 firms were effectively given no proactive supervision for four years?

**Andrew Bailey:** That is the model I inherited. They transferred from the OFT in 2014. The OFT was a licensing regime and not a supervision regime.

Q132 **Anthony Browne:** They never had supervision before that. Given the problems with the DES programme, do you think that is something intrinsic about the FCA? Should we as a Committee that oversees the FCA be worried about the FCA's ability to introduce major change programmes?



## HOUSE OF COMMONS

**Andrew Bailey:** Just to reiterate, there were two things going on with the DES programme. As we went along, we introduced three new workstreams, because it was a huge programme. One of the things we learned, which was probably the major one, was that we had to do a lot more data cleansing on the historical data than we had imagined we would have to do. We just had to do it. It is not a problem.

The one thing that, to my mind, was difficult was the risk model. There is some history of this in the FSA and the FCA. It had been a very difficult area in the FSA and the FCA. The FCA had had a couple of goes at it. The FSA had had a number of goes at it and had not worked it out. I hold my hand up here. When we hit the problem with the design of the model, and it was clear that it was not working and supervision was rejecting it, my reaction was, "We cannot just implement this and call it done if it is not actually working".

That was the reason we had to delay it by about three months. That is a call you have to make as chief executive. I had to say, "Do not think you can go off, implement this and call it done. At some point in the future, we will find that it is not doing its job".

Q133 **Anthony Browne:** When the LCF issue emerged and you were trying to amend the supervision of those 50,000 firms, did you try to identify whether there were any other vandals, if that is the right word, that caused the harm? What did you try to do to identify that?

**Andrew Bailey:** Yes, the drains were fairly rigorously pulled up on that.

Q134 **Anthony Browne:** How do you actually go about that?

**Andrew Bailey:** You work out which the relevant firms are and then start going over them.

Q135 **Anthony Browne:** Is it just firms that do mini-bonds? There are lots of other sectors within the flexible supervised firms, such as foreign exchange, primary FX and so on.

**Andrew Bailey:** Yes, I know. There are a number of problematic sectors. It was not just mini-bonds.

Q136 **Anthony Browne:** You identified the sectors first and then the firms within those sectors. Did you find anything else?

**Andrew Bailey:** We had a number of problem areas at that time. High-risk investments is a better way of putting it, because it actually covers more than just mini-bonds. There were well-known issues around pension advice. Mis-selling pension advice was another big area. I cannot comment on where these have all got to because they are the subject of investigations. I am a year out of date now, so it is not for me to comment, but that is another example of an area where we can see substantial problems in the small firm landscape.

Q137 **Anthony Browne:** Finally, with the full benefit of hindsight, what advice



## HOUSE OF COMMONS

would you give to the new FCA leadership, Nikhil Rathi and his team, when they are thinking about the supervision of flexible firms in particular? Have we got it perfectly right now?

**Andrew Bailey:** Honestly, a year out of date, I cannot describe the current state of it. I know the main one, because Nikhil and I do talk. This is really important. It can be misconstrued, but it is important. The work to develop, transform and keep the FCA up to date will never finish, because the world out there changes. You look at the things that are on the perimeter these days. You look at things like crypto. Look at the whole GameStop issue. People will lose money in that, because it is basically like musical chairs, pass the parcel or something. This world never stops evolving in that sense.

**Anthony Browne:** The market keeps evolving as well.

Q138 **Harriett Baldwin:** I want to pick up on Anthony's point, Governor, about what we have learned from this whole painful process that will prevent these kinds of things from happening in the future, specifically focusing on the perimeter, because there is always going to be a perimeter between regulated and unregulated markets. When you were CEO, what did you and the executive team suggest to Treasury at that point, in terms of what changes ought to happen in the perimeter?

**Andrew Bailey:** We were, to be honest with you, pretty sparing during that time about formal changes to the perimeter, because, while it is not heavy duty, there is a legislative process to change the perimeter. We had no capacity to do much in that field because, as you may remember, we were putting so much Brexit-related secondary legislation through at that time. I can see one member of the Committee does not look pleased by me saying that, but I am afraid it is true. It was like an iceberg. There was a piece above the waterline that was very visible, but the FCA, Treasury and Bank of England had to put a huge amount of statutory instrument material through and that constrained it. There was a view that the bar is set pretty high.

We have discussed one or two things in the past in the Committee. The mortgage prisoners issue is a very big issue around the operation of the perimeter. It is still an issue, for instance. I welcome the fact that, two or three years ago now, this Committee got much more involved in being part of the assessment of perimeter issues. That has been a very positive thing, in my view. It helped with some of the work on crypto assets, for instance, which has been going on and there are now proposals on that.

There is a question about how fast that process can be, because these things do move very quickly. Look at the whole GameStop thing again. It is not necessarily a perimeter issue; I do not know. I have not looked at it in that context, but look at how quickly that issue has blown up. It is since Christmas.

Q139 **Harriett Baldwin:** Given that one of the recommendations from Dame



## HOUSE OF COMMONS

Elizabeth is that the Treasury should consider the optimal scope of the FCA's remit, do you think the current CEO ought to be in the process of drawing up a list of requests, now that all the Brexit legislation has gone through, to address this issue?

**Andrew Bailey:** Dame Elizabeth and I talked about this and she may have been coming at it from a slightly different angle. It is important that the perimeter work continues and the Committee gives due consideration to what are considered to be problematic issues at the perimeter. I know the FCA is working on the whole question of bringing funeral plans in now, which is an important one and a problematic one in the past. Crypto is in train now as well.

It is important in terms of issues that come in and how quickly they come in, but Dame Elizabeth had another point in mind, which she and I discussed and on which there was quite a strong meeting of minds between us, at least as to what the issue is. At what point does the FCA become overloaded or how big can it be in terms of scope? The FCA continues to take things on and be asked to take things on. It took some more things on in my time. I know funeral plans are coming in. It took on claims management and oversight of self-regulating bodies for money-laundering purposes during my time. Dame Elizabeth rightly raised with me, and I discussed with her, the need to take stock of the bandwidth of the FCA.

Q140 **Harriett Baldwin:** It is quite noticeable that her report talks about this distinction between remit and powers. To a very great extent you had the opportunity, should you have chosen to use it, to address some of these things that were happening outside your perimeter. As you say in the 2018-19 report and in the 2017 mission statement, the FCA has the powers to act when the unregulated activity is illegal or fraudulent, has the potential to undermine confidence in the UK financial system and is closely linked to or may affect a regulated activity. On all of those, LCF would seem to check the boxes.

**Andrew Bailey:** No, it does. I am going to pose a point. There is an unresolved question. In the FCA's prioritisation process, which it does every year, if it has a choice, because of its limited resources, between doing something inside the perimeter and doing something outside the perimeter, how does it make that choice? Historically, it would have said, "Inside the perimeter comes first". It did make that call. How it makes that call and what the impact of the perimeter is in that sense are important.

I agree with Dame Elizabeth. She has rightly pointed to that, but I would not go the full distance that she goes, at least as the FCA currently is, in saying it is equal whether something is inside or outside the perimeter, because you have to ask, "Where does the perimeter then come into it?"

Q141 **Harriett Baldwin:** Senior management when you were in charge knew that there were risks around this perimeter question.



**Andrew Bailey:** Yes.

Q142 **Harriett Baldwin:** Within the organisation, if that awareness had filtered down more to the rank and file on the front line, it might have been escalated more quickly, even within the existing perimeters.

**Andrew Bailey:** Yes, that goes back to the point about changing the mindset of the organisation from the traditional view that it did not look beyond the perimeter.

Q143 **Harriett Baldwin:** When you left, were you confident that that mindset had changed sufficiently that we could feel confident as a Committee that these kinds of issues around the perimeter are not going to cause problems for our constituents again?

**Andrew Bailey:** On that question, honestly, you have to ask Charles and Nikhil because I cannot speak for the FCA today.

Q144 **Harriett Baldwin:** I said “when you left”.

**Andrew Bailey:** There was a lot more focus on outside the perimeter, but, going back to what I was saying a few moments ago, it is important to have a very clear line of sight about how the FCA prioritises, what it prioritises, what it does not prioritise and why.

Q145 **Harriett Baldwin:** Based on this report, as a Committee, what should we be urging your successor to do to prevent these kinds of things from happening in the future? What would be your top three?

**Andrew Bailey:** Continue to build the capabilities of the FCA. That is both staff and systems, which I know he is focusing on. That is right, because it does not stop. Have a very clear prioritisation process; be transparent about it; be open to challenge on it and keep developing the tools for intelligence and proactive supervision that go with that.

Q146 **Harriett Baldwin:** There is nothing around making recommendations to the Treasury about the perimeter in legislation.

**Andrew Bailey:** There are issues around the perimeter, but as you said, which I agree with, there has to be a perimeter. It is there for a reason. I have to be honest with you; I do not have a ready solution to this problem. It is fiendishly complicated. A senior colleague at the FCA once said to me—I may have said it at this Committee before—“It is like the coast of Norway. It looks perfectly smooth from 30,000 feet up, but when you get down to the ground level it is anything but. It is very complicated”.

Let me give you an example. Why is there still litigation going on about the FSCS coverage of the LCF bondholders and the perimeter? It is actually a different point about the complexity of interpreting when something is an advised sale and when it is not.

**Harriett Baldwin:** We cannot get dragged into sub judice things.



**Andrew Bailey:** It is just a description. I offer no view on it.

Q147 **Mr Baker:** Andrew, thanks for being here. I should say that, when Brexit legislation came up, I was just engaging in a certain amount of guilty reflection on how grateful I am for all your hard work. I was the Minister responsible for Brexit legislation for a while, so I know you had a lot of work to do and I am very grateful.

To reflect on what Harriett was just asking you about, on this Committee, we have often talked about fraud and financial fraud, but is it not the case, if we chose to amend the law, that we could make fraud in the financial system always the responsibility of the FCA? In a sense, on that crucial issue of criminal conduct, we could make it always the FCA's problem. Would that not deal with some of these problems?

**Andrew Bailey:** You could, but can I enter a plea? Please consider what the effect would be on the operation of the FCA as an organisation. How big can it get? How broad can its responsibilities get? It would be a different organisation at that point. Yes, you could. It is a real issue.

We have discussed this before in the Committee. There was a report a couple of years ago by the inspectorate of constabulary, which said that the capacity for taking fraud cases in police forces, so this is below the SFO, has declined dramatically over the years. That reflects on the priorities of the police. I am not criticising the police in this respect, but the amount of capacity to take fraud cases around the country has now declined dramatically.

Q148 **Mr Baker:** That is the essence of the point I am making. We have heard evidence time and again that amounts to an inadequate capacity to prosecute fraud in the UK. Would you agree that there is an inadequate capacity to prosecute fraud?

**Andrew Bailey:** I would agree with you.

**Mr Baker:** Let us just draw stumps on that subject.

**Andrew Bailey:** If you say the answer is the FCA, please consider the impact on the FCA as an organisation in terms of the size and the scope.

Q149 **Mr Baker:** I will leave that there, because I want to return to the matter at hand of LCF and talk about consumer responsibility. As you will know better than I do, the Financial Services and Markets Act notes that when the regulator considers its work to protect consumers, it should be guided by the general principle that consumers should take responsibility for their decisions. As the chief executive of the FCA, how did you interpret that requirement and how did it influence your work and the FCA's?

**Andrew Bailey:** It was a very important thing. You are right; it is there. It does not always get that much attention. I mentioned earlier the so-called NRRS rules. The NRRS rules are exactly, in a sense, in line with that, which is to say investors should say whether they are sophisticated or high net worth. The intention behind those rules was to say, "If you



are sophisticated or high net worth, you should have more freedom and be trusted to exercise more responsibility. If you are not and you are below that level, you should impose a cap on the proportion of high-risk investments you take”.

Those rules were done before my time. Martin did them, but they were entirely consistent with that principle. They were putting it into effect in many ways. We have to ask the question, “Why did it apparently not work?” We have to wait for the criminal investigations there, because Dame Elizabeth rightly, because of the ongoing investigations, steered off that question.

Q150 **Mr Baker:** Tell me a bit more about why she was right to do so. Is it not at the heart of the matter? When it comes to questions about the perimeter and what people are spending their own money on, is personal responsibility not at the absolute heart of the matter?

**Andrew Bailey:** I am not a lawyer, so I am going to be careful here, but Dame Elizabeth was very cognisant of not producing a report that crossed over into what are continuing criminal investigations.

Q151 **Mr Baker:** Do you think that the interpretation of personal responsibility of investors has changed over time?

**Andrew Bailey:** It probably has. It has probably moved towards a broader expectation of protection. Without wishing to drag up another old case, so I will touch on it only for a moment, if you do not mind, I always felt—we talked about this at the Treasury Select Committee in the summer of 2019—that it was particularly an issue in the Neil Woodford case. Woodford was not very good at what he did, but he was transparent about what he was doing and he was investing in start-ups in biotech. We quite like biotech start-ups these days and you can get very good ones. That is a risk issue.

Q152 **Mr Baker:** Earlier we were discussing risk. I would not like to put words in your mouth, but I understood from it that you talked about the impossibility of the FCA dealing with everything that is within its scope and the need to take a risk-based approach to what the FCA does. I cannot help wondering, when we are talking about the perimeter, that issue and consumer responsibility, whether we are asking the FCA to undertake an impossible task. Do consumers need to know that it is impossible for the FCA to protect them from every risk? We maybe need to reinterpret personal responsibility of consumers to place a greater emphasis on it. Do you think that is the case?

**Andrew Bailey:** There is an important issue there. Let us go back to GameStop for a moment, a current case. As I said, people will lose money. The reason they will lose money is that, as far as I can tell—it is an American company—nothing has fundamentally changed about the value of that company. Everybody says its business model is past its sell-by date. The market value of the company has changed way in excess of anything that has gone on with its fundamental economic



## HOUSE OF COMMONS

value, so at some point I am afraid the music is going to stop and somebody is going to get caught holding the thing. What their losses or profits are depends on what they have bought in at, but I fear that we will get retail losses and people will ask, "Where is the protection?"

Let me tell you about the experience I had. I had an issue with bitcoin, and I still have, to a degree. I have said a number of times, "Only buy bitcoin if you are prepared to lose all your money". It does not mean you will lose all your money. It does not mean the value will go to nothing, but it has no intrinsic value. People may want to collect it, but it does not have an intrinsic value at all.

Here is the challenge for the FCA. You can say that about bitcoin because nobody owns the rights to bitcoin. If the CEO of the FCA gets up on television, as I did, and says, "You could lose all your money", the crypto press get terribly worked up and do not like me, but nobody sues me. If you get up and say, without the evidence, "LCF is a fraud", you get sued, so the lawyers say, "You cannot do that". The question is what standard of investigation you have to employ to get to a point when you can take action. That is a very difficult issue.

Q153 **Mr Baker:** You have tempted me over some deep waters here, because I am sure I have held in my hand pieces of paper with your signature on them that promised redemptions. I am not sure what the intrinsic value of those pieces of paper is.

**Andrew Bailey:** I am not sure that is a question for this afternoon. I am not the Chair of this session, so I cannot say that.

Q154 **Mr Baker:** I am conscious that I do not have long, so I just want to ask you this. Do you think Dame Elizabeth's report materially affects people's conception of the consumer's responsibility for their own risk? It seems to me that, if we are going to complain about the perimeter and where people are in unregulated spaces, and if the plea is that the perimeter should be interpreted fuzzily in order to further protect people, that potentially has a material implication for how the FCA behaves.

**Andrew Bailey:** Yes, it does in that sense, because it potentially expands that, which is not a criticism of it. It is a perfectly legitimate position to hold.

Q155 **Mr Baker:** Where does this leave us with personal responsibility of consumers and the direction of travel on it?

**Andrew Bailey:** It is an issue that we need to tackle. I fear, going back to my online analogies of GameStop and so on, that the FCA is always going to be fighting a battle here, because the means of marketing products is evolving all around it. The FCA in my time banned the marketing of binary options because it was so dangerous online. I come back to my Whac-A-Mole point. It is hard.



## HOUSE OF COMMONS

I used to get people saying to me, "The FCA is very slow to do these things". You can look at it like that, but the FCA lawyers will say, and I do not blame them for this, "You have to have a burden of proof before you start wading in here and there". You are highlighting a broader issue, which is public responsibility. I agree with you that it is a very important issue.

**Mr Baker:** It has been very interesting to speak with you, as always. Thank you very much.

Q156 **Siobhain McDonagh:** Thank you, Governor. I would like to look at changes to the FCA register and the reasons for the delay in updating. Dame Elizabeth Gloster found that the FCA register failed to present information in a manner intelligible to the public and that it failed to warn consumers of the risk of unregulated products sold by FCA-authorized firms. Why did such a key piece of the FCA's consumer-facing apparatus take so long to reform?

**Andrew Bailey:** It is a good point. I have said before to the Committee that, when I became CEO, I had a mental list of things that were in need of tackling and fixing at the FCA, and the register was not on it. I was wrong; it should have been on it. The reason the register was not on it is that it was a backwater. There is a requirement to have one; I think it is a legislative requirement, actually. It is big. It has something like 750,000 combinations of firm and people entries and permissions on it.

I cannot remember exactly how long it was. After probably six months or a year, it became clear to me that the register really was a problem. This was a big part of the delivering effective authorisations programme, which was the sister of the delivering effective supervision programme. It was not the only part at all, because more effective authorisations processes went along with more effective supervision, but a big part of it was fixing the register.

The register is a very big thing, so I have to give you the pushback I had to give Dame Elizabeth. You cannot just say, "Let's fix it in a week or a month". It is a very big thing. There were various fixes done in my time, but it was still a work programme going on. I am sorry; I just do not know where it has got to now.

Q157 **Siobhain McDonagh:** You made the point that you did not think the FCA register was an issue when you first took charge of the organisation. In 2018, you wrote to the Committee, "One of my concerns after becoming CEO has been that we overhaul the register and make it fit for the now larger remit of the FCA". At what point did you realise it was a problem and why?

**Andrew Bailey:** I have to be honest; I cannot answer that question precisely, but it is within a year certainly, so by summer of 2017. There were a number of reasons. This came out of things like the ScamSmart campaign, which was very successful, but it was telling people to look at



## HOUSE OF COMMONS

the register. The problem was that, when people looked at the register, it was very hard for anybody to, frankly, interrogate it. That arose before the second line of evidence. I cannot remember off the top of my head when the second line of evidence started emerging that there were actual problems with the accuracy of it, which there were.

**Q158 Siobhain McDonagh:** After you realised it was a problem and it became an important thing to change, the new register did not come online until 27 July 2020. Why was there a delay?

**Andrew Bailey:** From memory, we put in a number of upgrades to the previous one ahead of bringing a new one in. It is so big; it has something like 750,000 entries. It also has to have very high security around it, because it has a lot of personal information in it. It would take time to do that, so we put a number of what I might call upgrades into the previous one, to try to make it more user-friendly. We also did a lot of data cleansing on it.

**Q159 Siobhain McDonagh:** Given the problems that existed with it, should the FCA have been pushing people towards it, given the possibility of misunderstanding and error, especially around the perimeter?

**Andrew Bailey:** It is the journal of record, and there is not anything else, but the problem is that it needed fixing. Yes, it should have been identified earlier and got on with. I have to tell you that it was not on my list when I got there, but it was after not too long.

**Q160 Mike Hill:** I am just going to ask a couple of questions about resources within the FCA. The report notes that in 2014 the FCA assumed responsibility for over 50,000 firms. That followed the Government's decision to transfer consumer credit regulation from the Office of Fair Trading to the FCA back in 2012, but it appears from the report that some senior FCA staff were not pleased with that. In fact, one of the interviewees told Dame Elizabeth that the UK Government had put pressure on the FCA by dumping additional areas of responsibility on it, which was a challenge to the organisation that the FCA had no power to resist. To what extent might the failure of LCF and the FCA's approach to supervision be attributed to the Government?

**Andrew Bailey:** I would not go there. Once the decision was taken, it was incumbent on the FCA to get on with it. If the FCA had felt that it could not do it, it should have said so. I do not think it said to the Government, "We cannot do this".

**Q161 Mike Hill:** Do you think then that the FCA was spread too thinly, in a way that would have made adequate oversight of all these firms too difficult?

**Andrew Bailey:** There is no question about that at all. This goes back to the problem I identified at the point when I became CEO. I know that the FCA designed a model of supervision for day one in 2013. It was far more focused on big firms because there were a lot of big firm problems around at that time.



## HOUSE OF COMMONS

By the way, you quoted 50,000, and that is correct in terms of the number of firms that came in. About 35,000 of them actually stayed in. Quite a thinning out process went on, as I understand it. The fact is that it just swamped the FCA's capacity to supervise, particularly to supervise small firms. That was the big problem.

Q162 **Mike Hill:** In terms of red flags that are mentioned in the report, Dame Elizabeth again suggests that the red flags in the case of LCF were so strong that the FCA could not use finite resources as a defence of poor supervision. Do you disagree with that?

**Andrew Bailey:** I do disagree on that one, because it comes back to this point about the challenge that we faced. This challenge is laid out in some detail in the PA report that was produced literally two or three weeks after I became CEO.

The point that Dame Elizabeth and I disagree on here is the hindsight point. It is fine to say they are red flags when you see them. I agree with her that they are red flags. As I said before, and it is most apposite with the contact centre, there are 200,000 calls a year coming into the contact centre.

Q163 **Mike Hill:** Do you feel that the FCA had sufficient resources to fulfil the scope of its remit at the time?

**Andrew Bailey:** We have not touched much on it, but training is a very important part of the delivering effective supervision programme. It was really incumbent upon us not just to have the people, but to give them the tools or the training that they needed to do the job. It was a huge undertaking to get there.

Q164 **Mike Hill:** You mentioned numbers and training. I take it that you feel that the FCA had enough staff in the relevant departments to cope with the remit. How did the FCA allocate staff to its supervision of flexible portfolio firms?

**Andrew Bailey:** It is a mixture. We had what I might call a standing number of supervisors. One of the things that delivering effective supervision introduced was splitting the flexible firms into portfolios, in other words firms with common business models and common products. I think I am right in saying we came up with 43 portfolios. In 60,000 firms, there are only about 100 fixed portfolio firms and 59,900 are flexible.

We split them up into 43 portfolios. Some of the staff were then allocated permanently to those portfolios. The rest of the staff we would allocate on the basis of the business plan prioritisation process that we were discussing earlier. Once we had decided with the board on what the priorities were going forwards, which we did once a year—although some of the priorities would last longer than a year—we would then allocate those staff according to the priorities.

Q165 **Mike Hill:** I take it from that answer that you believe staff allocation was



sufficient.

**Andrew Bailey:** It is a bit circular at this point, if you do not mind me saying so, because the business plan had to be formed based on the resources and the budget that we had. You can make the point that if we had more resources, we could have done a bigger business plan. That is certainly true. We could.

**Mike Hill:** Yes, it is the point made in the report.

Q166 **Chair:** We are almost there, Andrew. I just wanted to come back on one point. In your apology, you mentioned the change programme being put into effect. Just to confirm, when did that start? When was that actually kicked off?

**Andrew Bailey:** We got the PA report in July 2016, if I remember rightly. We started the first stage of work on the change programme in October, if I remember rightly. We were not doing nothing in between, but we were doing a certain amount of digesting the PA report.

**Chair:** That leads me to my question. You come on board in July 2016, albeit that, as the head of the PRA prior to that, you have been a non-exec director of the FCA as well.

**Andrew Bailey:** Yes, but with a limited role. The PRA has a limited role.

Q167 **Chair:** That is totally accepted. You said in the session now that you really inherited an institution that, in your own words, seemed to be in severe trouble. You noted a lack of supervision of flexible firms, a contact centre not working effectively, a black hole of intelligence, et cetera.

I come back to a bit of what I was pushing at earlier. The button gets pressed on this change programme, which starts to pick up by the October, but you were in place from July. Hindsight is a wonderful thing. Could you and should you have taken some immediate action around the time that you stepped into the role, or at least between then and the autumn, when this change programme commenced?

Given what you discovered, would most people as the CEO not think, "Wow, there are some terrible things going on here. Yes, we will have this change programme, but I am not going to just sit in my chair and let that take its course over a period of months and years. I am going to step in and do what I can to firefight some of these problems immediately"? What actions did you take in that regard?

**Andrew Bailey:** If you read the PA report, you see it is a very long saga of problems. You cannot take from the PA report, "If you did one thing, this would be it". Honestly, you cannot do that. I thought that we had to do what I might call the root-and-branch approach towards the FCA.

Dame Elizabeth and I debated this quite a bit, and I accept her argument in a sense, but it has something of the hindsight about it. Viewed from now, would you do it differently? At that point in time, I knew we had to



## HOUSE OF COMMONS

do some fundamental things, but the PA report illustrated that they had to be even more fundamental and that we had to go about, in a sense, rebuilding the place.

**Q168 Chair:** There are two parts to this. There is the long-term work, which we all agree is essential to get the institutional and cultural systems, and all the kind of stuff that you have been mentioning today. None the less, you did come into a situation where you knew there were a lot of problems going on. It just seems surprising that there was not, along with that other longer-term work, attempts at immediate fixes and immediate investigations.

**Andrew Bailey:** The slight challenge is that it can easily look as if LCF was the only thing on the agenda, so can I go back to the Connaught report? Connaught happened before my time, but we were left with the legacy of it. Whistleblowing was a serious problem, including, by the way, from this Committee. This Committee was criticising the FCA very heavily on whistleblowing, so it was a priority of mine. I was getting a lot of lobbying on whistleblowing—rightly so. I admit that we prioritised whistleblowing. That was not the wrong thing to do, though I recognise it did not help LCF because it did not have a whistle-blower. There is this hindsight problem, which the Connaught review points to.

**Q169 Chair:** It just seems very odd, if you zoom in on something like the contact centre, where we have discussed all these different things that were going on, that nobody really tried to get a grip of that. There is a reliance now on saying, “We had this change programme going on, which would ultimately have ironed all that stuff out”. There just does not seem to have been a sense of an immediate requirement to roll one’s sleeves up and get stuck in.

**Andrew Bailey:** Hang on a minute. In June and July 2016, the contact centre was issued with new materials, in response to an audit report. The idea that we were doing nothing is wrong in that respect.

**Chair:** Thank you very much. That brings us to the end of this session. Andrew, could I thank you for appearing this afternoon? We look forward to seeing you again in your capacity as Governor of the Bank of England.

**Andrew Bailey:** Very soon, actually. I will get back to the day job.

**Chair:** We have covered a lot of ground and there is quite a lot for the Committee to reflect upon. We may wish to write to you with some follow-ups. I hope that is okay.

**Andrew Bailey:** That is okay.

**Chair:** For those who may be tuned in and are clearly interested in LCF, on Monday 1 March, we have a public session at 3.30 pm with Nikhil Rathi, the current chair and chief executive of the FCA. On 24 March at 2.30 pm, we have a public session with Megan Butler and Jonathan Davidson, senior FCA executives who were identified in the Gloster



# HOUSE OF COMMONS

report. Could I thank you again, Andrew, for appearing?