

Treasury Committee

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

Monday 1 March 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 170 - 260

Witnesses

I: Charles Randell CBE, Chair, Financial Conduct Authority, and Nikhil Rathi, Chief Executive, Financial Conduct Authority.

Written evidence from witnesses:



Examination of witnesses

Witnesses: Charles Randell and Nikhil Rathi.

Q170 **Chair:** Good afternoon and welcome to this Treasury Committee inquiry session into the Financial Conduct Authority's regulation of London Capital & Finance. I am delighted to be joined by two witnesses this afternoon. I will ask them to introduce themselves briefly to the Committee, starting with Nikhil.

Nikhil Rathi: Good afternoon. My name is Nikhil Rathi, and I am chief executive of the Financial Conduct Authority.

Chair: Thanks, Nikhil, and welcome. And Charles, please.

Charles Randell: Good afternoon. I am Charles Randell. I am the chair of the Financial Conduct Authority.

Q171 **Chair:** Thank you, Charles, and welcome to the Committee.

We will come on, in some detail, to the lessons that we need to learn from what happened in respect of LCF and the FCA's regulation of it. However, what is also important is the issue of responsibility and where the buck stops for what were a series of failings, missed red flags and so on, on the part of the FCA. It might take a moment or two, but I will start by just going through the key failings, as the report by Dame Elizabeth Gloster sets them out, and saying up front where she suggests responsibility lies.

Dame Elizabeth refers to issues in relation to the perimeter, and she identifies, in para 6.4 of chapter 6, that the executive directors of supervision—that is, Megan Butler and Jonathan Davidson—exco and the then CEO, Andrew Bailey, were responsible for the "lack of operational awareness" of the perimeter "as it affected the authorisation and supervision" of LCF.

Again in relation to the perimeter, para 6.13(b) of chapter 9 of the report states: "The FCA's process for risk assessing applications for Variation of Permission focused too much on the risks posed by LCF's regulated activity, resulting in the significant issues connected with LCF's unregulated activity not being appreciated and acted upon." Dame Elizabeth also says: "Responsibility for this weakness lies with: (i) the Executive Director of SRA", which is the executive director of supervision, retail and authorisation, who was Jonathan Davidson.

The investigation found gaps in training and in policy documents. Paragraph 6.19 of chapter 9 states: "Responsibility for inadequacies in the training framework for staff within the Authorisations Division (and the relevant staff within the Supervision Division) ultimately rests with the Executive Director for SRA"—that being Jonathan Davidson.

On policy deficiencies around the financial promotion rules, para 3.13 of chapter 11 concludes: "The responsibility for the policy deficiencies...rests with Mr Davidson". On the lack of clarity of documents—the contact centre



HOUSE OF COMMONS

policy documents—the report says they lacked clarity as to when “call-handlers should refer allegations of fraud or serious irregularity regarding the non-regulated activities of FCA-regulated firms to the Supervision Division” more widely. The report says: “Responsibility also rests with management of the Supervision Division,” that being Megan Butler and Jonathan Davidson.

On training materials, the investigation found that, “Despite the concerns expressed in the Internal Audit Final Report”—the report of 2015—“Contact Centre training materials remained deficient” and “the Investigation has concluded that responsibility for the above failings rests with Mr Davidson solely by virtue that oversight of the Contact Centre falls within his remit.”

Then, paragraphs 2.22 and 2.24 of chapter 12 state: “there was no policy which required the FCA’s supervision staff to interrogate a firm’s financial information following an allegation of fraud or serious irregularity being made against a firm” and “Responsibility for these policy failings rests with the Senior Management of the Supervision Division,” Megan Butler and Jonathan Davidson.

Those are the main failings that relate to both Jonathan’s and Megan’s areas of responsibility. There will be many people out there, who perhaps lost quite a lot of money over the failings of the FCA in this area, who will be asking why it is that Megan and Jonathan are still in post—albeit that they have moved posts, but, in Megan’s case, to a very responsible post in charge of transformation. Why are they in those posts, given the large failings that occurred on their watch in the areas I have just gone through? Perhaps I could start, Nikhil, with you, please.

Nikhil Rathi: Certainly. Thank you, Chair. I am sure that Charles will be able to give you the board’s view of the assessment of responsibility of executives. Let me explain the approach I have taken since I arrived at the FCA in October. I started, obviously, during the middle of the pandemic and also with the end of the transition period and Brexit approaching in December. There was clearly significant operational work to do in the near term, between October and the period immediately afterwards.

As I indicated to the Committee when I was at the pre-commencement hearing, transformation of the FCA is and has been a priority for me, and I wanted to get moving quickly. In order to do that I chose to recruit an executive director for transformation from within the current executive team. In parallel to that, we have launched a number of campaigns for a range of other roles, including our operating roles, chief data officer and a number of other senior executive positions, which were run through global searches, internally and externally.

In doing that, I was looking to make sure that I was able—recognising that I was coming from outside the FCA—to ensure continuity during a period of considerable challenge ahead, but also that we could move as quickly as we can to bring the right external capabilities into the organisation. Megan was the best candidate for the executive director for transformation role,



HOUSE OF COMMONS

recognising the issues that you have identified. I believe she does recognise the mistakes that have been made and is committed to working to resolve them, but she also brings over three decades of very deep experience in financial regulation and policy making, as well as a lot of work to ensure that the resilience of the system was maintained during the pandemic, and also preparations for Brexit.

I informed the Committee last week of the four other appointments I made, which bring much wider experience, also, to the organisation—in particular, deep operational experience, which reflects some of the findings that you have identified. It was something I was thinking about before joining. It brings data intelligence experience to the table, brings experience from e-commerce and brings experience from investigations and enforcement.

Q172 Chair: I just want to stop you there, Nikhil. That is useful—to know about the others that you have brought in—but I just want to stick with Megan and Jonathan for a moment. Was it your assessment, when you put them in there, or agreed to them moving to their new roles—that they had knowledge of the failings around LCF, and did you feel that they took reasonable steps to address those failings where they occurred? What was your assessment, personally, of that, can I ask?

Nikhil Rathi: My assessment is that there was an understanding of the mistakes that had been made and an openness to addressing them. That was the basis on which Megan was also interviewed for the role of executive director of transformation, along with board members.

In the case of Jonathan, as you will be aware, we delivered a restructuring of the supervision divisions: we have brought together supervision, policy and competition to ensure there is much more joining up between the policy functions and supervision functions, and much more operational connection. Jonathan will be leaving the FCA next month, having supported the transition to the new team. He was also leading on a number of important pieces of work, most notably the business interruption insurance case, which was at that point going through the Supreme Court.

Q173 Chair: Can we focus on Megan for a moment? Do you believe that Megan had knowledge of the failings that were occurring within the areas for which she had responsibility? If you believe that she did have some knowledge of those failings that were occurring, do you believe that she took reasonable steps to address those when she was in her previous role?

Nikhil Rathi: Certainly, reading the report and having listened to the evidence of Dame Elizabeth before your Committee, I believe that, during the conversations around the board, there was an acknowledgement that there were mistakes made and issues to be addressed. There was an acknowledgement that there were gaps. Steps were taken, although they were clearly not adequate steps, and that is why we have said we are going to accept all the recommendations of both the Gloster review and the Parker review and implement those. I believe there is an openness to



HOUSE OF COMMONS

do that, but I also believe that there is a wider context here. As a chief executive coming in from outside the organisation, it is also important to me to make sure I maintain institutional memory, particularly during a period of quite considerable turbulence and challenge externally for the organisation.

Q174 Chair: The acknowledgement of mistakes' having been made was a positive thing, but did it not leave you, in any sense, debating in your mind whether this was therefore appropriate and whether the optics, shall we say, of the FCA's retaining Megan and putting her into a really important role in charge of transformation were right? Did you have any doubts in your mind? Was that a very easy decision to make? What went through your mind on that?

Nikhil Rathi: Certainly, it was a desire on my part to get moving quickly. You will see I have completed a number of external appointments, and they are arriving between now and June. It takes time, as you are bringing teams in from outside. I wanted to get moving quickly, and therefore an internal appointment was the right choice, recognising that more skills would be coming in around the executive table in the months ahead.

Q175 Chair: On the recruitment process, literally just moments ago I picked up a tweet from *The Times* commenting on the actual recruitment processes and concerns that some are raising, first, that it might have been internal, when there is a history here that we have been discussing, and, secondly, about whether it looked widely enough. Can you just tell us how many candidates there were for that recruitment process?

Nikhil Rathi: Absolutely. I wanted to get moving quickly, so, with the board's approval, I ran a competition across existing executive directors. Two candidates—*[Inaudible.]* Megan was the best candidate. However, as I said, in parallel, I launched competitions for a number of other positions around operations—

Q176 Chair: But in terms of the one you launched in respect of heading up the transformation programme—the position that Megan now has—how many candidates were there for that role, and were they all internal?

Nikhil Rathi: Yes, it was an internal competition. I did not want to wait until June to fill that.

Q177 Chair: May I ask how many candidates there were along with Megan?

Nikhil Rathi: Two. There were two candidates.

Q178 Chair: Two in total—Megan and one other?

Nikhil Rathi: Exactly. I did not want to wait until June to fill the role; I needed to get moving, and get moving quickly, and I believe—we will come on to this later—that we have moved very fast on a number of areas in the past few months to make progress. As I say, as a chief executive coming from outside the organisation, with three decades of institutional memory there, that is something you have to think very carefully about before making a major change. With that institutional memory and



willingness to understand where things have gone wrong in the past, but also a recognition of many of the successes that there have been as well, particularly over the past year, I think I have struck the right balance, and I have a team now who I am very confident will, as they come into post, bring real diversity of experience and depth of experience to the FCA.

Q179 **Chair:** Thank you, Nikhil. Charles, can I turn to you? What are your feelings about recruitment? Some out there might be thinking that here is someone—let's focus on Megan for a moment, because she is staying with the FCA in a critical role—who was at the wheel when a number of very serious failings occurred, which Dame Elizabeth Gloster said were in her area of responsibility. Yes, one understands that there is a need to move quickly, but does any part of you feel that maybe, in the haste to fill this position, there has been a very restricted recruitment process that has only been internal and where somebody who has really been at the heart of some of the failings in the FCA has ended up in a role to take things forward? Were there any doubts in your mind at any point that that was the right approach?

Charles Randell: Can I start, Chair, by repeating the apology I have already given on behalf of the FCA for the mistakes we made in our regulation of LCF? I am deeply conscious of the impact that the collapse of LCF has had on some people's lives, and I am profoundly sorry for that.

I agree that it is really important that we are transparent about the accountabilities of our senior leaders, and Dame Elizabeth identified—following the map of accountabilities that we publish on our website—that the CEO is accountable overall for the organisation, and the supervision directors are accountable for the performance of their divisions. Under the senior managers regime, as we apply it to ourselves, establishing who is accountable is a first step in considering their conduct. You will probably remember that when the regime was introduced, the regulators made it very clear that there is no assumption of guilt or reverse burden of proof.

So the next step for the board was to assess the reasonableness of the actions that people took. That needs to take account of everything they face, and in the case of Megan and Jonathan in 2015 and 2016, that was a very challenging environment. Dame Elizabeth herself recognises that. She says that when she names them as responsible, she is not saying that they are personally culpable.

The picture that they faced in 2015 and 2016 was an FCA that I think was still carrying the scars of the last time there had been a report—the Davis report in 2014—that resulted in the better part of a generation of leaders leaving the organisation. With that went the continuity of supervisory knowledge and experience, to a large extent. That was the picture that they inherited and had to build from.

They had huge remits and, in a lot of what they did, they did a very good job—Jonathan has done a huge amount to clean up consumer credit, and Megan has had to deal with some really complicated new wholesale regulations and with Brexit. They did identify problems in the approach of

supervising small firms, and they did put in place a programme to make it better. And it was not a small task.

So the board then had to consider what should be the consequences for individuals.

Q180 **Chair:** Can I interrupt at that point? Charles, when you say “the consequences”, is this the consequences for your assessment as a board that there was culpability for the failings on the part of those individuals? You are quite right that Dame Elizabeth Gloster did not find on culpability, but that is because that was not the remit of her inquiry. What was the board’s view on culpability?

Charles Randell: The board certainly thinks that there were mistakes that were made and that there were things that should have been done differently, and I think—

Q181 **Chair:** And could have been done differently.

Charles Randell: Things could always be done differently—

Q182 **Chair:** I know that—we all know that, Charles. But I am asking you a very specific question. In the board’s assessment of what happened and of the role of Megan Butler in her area, where there were serious failings, was it the board’s view that she would have known about those failings and had not taken reasonable steps to address them?

Charles Randell: No, the board was of the view that the mistakes that happened in Megan’s area of responsibility did not amount to serious culpability on her part that would justify our asking her to leave the organisation, but the board did consider what the consequences should be for individuals. That is why the board cancelled the performance-related pay for the executive committee for the 2019-20 year. For 20-21, there has been a discussion about performance-related pay. The executive committee, despite having performed, in my view, outstandingly in its response to covid, considered that, in light of the impact of that on the country, it would be wrong for them to be considered for performance-related pay in the current year. Finally, the board decided that, going forward, exco members should not receive performance-related pay in the future and that it should take this opportunity to reduce both higher pay packages for exco members and the average levels of exco pay.

We decided that the consequences that flow from this should be collective. It was clearly the case that the FCA wasn’t sufficiently joined up across its various activities, including its policy and supervision functions, its systems and technology. That is why we decided that it was important to take actions that were collective, because the last thing we want to come out of this LCF review is a culture where FCA executive directors try to avoid responsibility through silo working, or try to avoid high-risk responsibility, such as supervision, altogether. We want our executive directors to embrace a culture of collective delivery, working as a joined-up team, and to be motivated by public service. As Nikhil said, we have reorganised the structure of the executive committee. As a result,



HOUSE OF COMMONS

Jonathan Davidson is leaving the FCA, but the one thing we absolutely need in this current period as we transform is some continuity of our knowledge of supervision and experience of that. That is why the board agreed with Nikhil that Megan should move into this role.

Q183 Chair: Can I step in there, Charles? Do you not understand how some people would see this quest for continuity, for a quick decision and moving quickly? Despite the failings in Megan's area of responsibility, which resulted in, admittedly for the whole exco board but also for Megan in the stopping of bonuses, for example, so you recognised that sufficient failings had occurred on the part of those individuals and some sanctions, as you outlined, were necessary, Megan has now been put in charge of the transformation. Many people will ask the question, has this been rushed? Has this been properly thought through? And would not a wider search, just as Nikhil himself has been brought in from outside at a difficult time for the FCA, at the very least have been a wise approach to the recruitment for the transformation role?

Charles Randell: It was my judgment that if we did that it would put back our momentum to change the FCA by somewhere between six and 12 months. You would need to bring somebody in. There would then be a delay in their arriving. They would then need to analyse the existing challenges within supervision. It would be the better part of a year, I think, before they would be contributing to the executive team fully. We would have lost the lessons of this episode, and 30 years of other lessons about where things have not gone well in the FCA, which Megan has lived through.

Q184 Chair: Would it be a fair characterisation to say that there was a balanced decision here that had to be taken between retaining the experience and institutional knowledge and so on that Megan has and moving quickly, and the fact that in many ways, for the reasons we have discussed, it would not otherwise have been an ideal appointment? If you had had an alternative who did not have the history, as it were, of the organisation, you might have gone with somebody else.

Charles Randell: When we were having conversations about Megan at the board, I knew that it would end in a conversation like this with you, Mr Stride, and I felt that it was really important that I did what I believed was in the interests of the FCA and not what would give me an easy ride in this conversation. And it is my belief that that is what we have done. I absolutely understand that people who are extremely angry about the failure of LCF will feel the way that they do, and I am really sorry about that, but my commitment is to try to make things change as quickly as possible.

Q185 Chair: I will ask one final question, because we need to crack on and, as I said earlier, it is very important that the work of this Committee is about looking forward, as well as looking to what has happened in the past, and we will get on to that in a moment. A lot of people will just feel that there are so many instances with organisations where lots of innocent consumers get let down and the question "Where did the buck finally

stop?” really just doesn’t end up having an answer. People get moved around, put into new roles, etc. The buck never really stops anywhere. As you look back over the litany of failings, where do you think the buck has stopped on this, as things currently stand?

Charles Randell: I think the buck stops with me. I am accountable for the organisation overall; as chair, I am accountable for it. And the chief executives are accountable for it and so are the executive directors of supervision. That’s where the buck stops, but I would suggest that, as we look at the FCA, which is an organisation in which our ambition to change, to be as good as I would like us to be, in my view won’t be realised for a number of years—we will continue to improve and we are improving, but we won’t realise that ambition fully for a number of years. I think that people who move into the very high-risk frontline roles need to have their performance assessed fairly, in the light of the overall pressures that they face and their overall performance, and that is what I believe we have done.

Chair: Charles and Nikhil, thank you very much. There were certainly moments in that conversation when there was some candour. We may come back to you with further questions—not in this session; we may write to you with further questions. Could I now move on to Jonathan, please? Sorry, what am I talking about—Anthony is the person we are about to hear from.

Q186 **Anthony Browne:** That must be an imaginary member of the Treasury Committee. Thank you, Chair. Hello, Nikhil and Charles. My questions are going to be about the perimeter, the boundary between where you regulate and where you don’t regulate, which has been at the heart of many of the issues the FCA has grappled with—funeral plans, the GRG, crypto-assets—and obviously, LCF itself was regulated by the FCA, but the mini-bonds it was selling were not, and that was at the heart of the confusion. Could I first ask you, Nikhil, a consumer-oriented question? If you are a consumer out there and you see a company that is FCA regulated, but you are thinking about buying a product that is not itself FCA regulated, how do you know whether that product is FCA regulated or not? Isn’t it quite confusing for consumers?

Nikhil Rathi: I agree, Mr Browne. I think the current situation is confusing for consumers and for practitioners. Ultimately, you have to look at the disclosures that are associated with the product to understand whether it is regulated or not. One of the findings of the report is a suggestion that we could go further in making sure that when products like that are marketed—notwithstanding the fact that part of the activity of the firm may be FCA regulated—they should not in any way associate the FCA name with that product, and we are certainly looking at that. We are also looking at how we can further clarify the point on our register, too, to make sure that is well understood.

You mentioned crypto-assets. We also have to be clear that, in certain areas, firms can be FCA registered, as they are in the case of crypto, for money laundering purposes, but not authorised for consumer protection



HOUSE OF COMMONS

purposes. You will have seen, a couple of months ago, we put out a very clear warning to consumers to say, "If you invest in these products, you should only be investing money that you can afford to lose in its entirety." There is an education exercise to be done there and to be expanded upon.

Q187 Anthony Browne: Presumably when consumers are buying mini-bonds, for example—in the case of LCF—LCF would still say that it is FCA regulated. It has the blurb at the bottom to say that the company is FCA regulated. Would we not need a requirement to say that, although the company is FCA regulated, these products are not? Should the company not have to state that explicitly?

Nikhil Rathi: In many cases they do. The question, I think, is whether, when those products are being marketed, the FCA name should be associated with that at all.

Anthony Browne: Take it off the blurb.

Nikhil Rathi: Dame Elizabeth Gloster made an interesting point about that. I asked Dame Elizabeth and Raj Parker to come in to meet the senior leadership team, so that we could hear directly from them about their findings and recommendations, and this is one of the points that she made during that conversation as well.

Q188 Anthony Browne: I have two fundamental questions about the perimeter: the first is where it is at, where the boundary lies; and the second is about the powers you have beyond the perimeter, because you have various higher-level powers. That is not continuous monitoring, but you have the senior managers regime, for example, which extends beyond the perimeter, and under the Competition Act you can look beyond the perimeter. Do you think that you need different powers to look at things that are going on beyond the perimeter, or are your powers about right?

Nikhil Rathi: First of all, in the case of LCF—I have read the report, and it was sobering reading, as I said in the remarks in December when we published it—I would not want to suggest that the issues were necessarily to do with our powers, in my understanding. There were some serious operational issues, which we need to work on and fix. That is an important point, which I want to stress. That is also why I have worked hard to bring in the best operational expertise that I can to the executive team.

Anthony Browne: Do you think that the powers are right?

Nikhil Rathi: On the powers, I would draw a couple of things to the attention of the Committee. First, looking at this as a strategic issue, the one big vector for this kind of activity, which is increasing, is online. The one single thing that is not a panacea, but would help is for investment fraud to be included in the online harms Bill, to enable us to work much more enthusiastically and rapidly with the large search firms and social media, and for them to take some responsibility as well for the promotions that are put on their websites.



HOUSE OF COMMONS

This morning, we shared with you the letter from Google. We have been doing some good work, and it is constructive, but it is by negotiation, it takes time and it will be inconsistent given that voluntary approach across all the companies. At the moment, it has not yet landed in parliamentary debate whether fraud should be in the online harms Bill, but we strongly think it should be. We do not think that the other solution being mooted, around the online advertising programme, really matches the urgency of the problem that we are dealing with. That is one area on powers.

Q189 Anthony Browne: Have you formally made that recommendation? I guess the DCMS leads on the online harms Bill.

Nikhil Rathi: We have made that recommendation to the Government very clearly. I recognise—this is ultimately a decision for Parliament and Government to make—that another lobby says that that might undermine the competitiveness of the UK tech sector but, arguably, we cannot see how you can have a competitive technology sector if—

Anthony Browne: [*Inaudible*]*—*fraud.

Nikhil Rathi: Exactly. That is one clear message, but it is only part of the solution—I would not want to say that it fixes everything. It is one point. Secondly, we will need to consider some of the exemptions that exist for marketing to self-certifying, high net worth investors under the financial promotion order.

We have a very liberal regime in the United Kingdom, relative to other developed economies such as Australia, Canada or New Zealand, with a threshold of £250,000 at which you can be deemed sophisticated and can self-certify. Other comparable markets have that threshold at the equivalent of about £2.5 million, and with a much more rigorous process for certification. You cannot just go online and click a box; you have to demonstrate your sophistication before you can buy those products.

Yet, on the other side, we have a greater expectation of regulatory safety in the United Kingdom, compared with other jurisdictions. That is one area where, again, we have made our points, and I raised it in my meeting with the Economic Secretary a few weeks ago.

Other powers would be helpful—information gateway powers for the Advertising Standards Authority and a few other things—but I do not want to make this all about a perimeter point, because I am convinced that there are big operational issues we need to address as well.

Q190 Anthony Browne: I agree about the big operational issues, but I think someone else will ask about those.

The second area to touch on was the location of the perimeter. You mentioned the thresholds of £250,000 versus the £2.5 million, for example, which would obviously bring a lot of other consumers into it, but are there certain business activities that you think should be in the perimeter but are not at the moment?



HOUSE OF COMMONS

Nikhil Rathi: I think there is a whole range of proposals under discussion: “Buy now, pay later”, on which my immediate predecessor, Chris Woolard, has done a really interesting review, which the Government are looking at and have indicated that they want to take forward; funeral plans are coming in; and there is work ongoing on crypto-assets and non-transferable debt securities. The way I see the point around what activity should be in or out is that we will of course make our recommendations, but it is up to the Government and Parliament, obviously, to decide where our perimeter sits.

I see it as my job, and the collective job of the team that I am building, to make sure we have the operational capability and the integrity of excellence across our systems to be able to adjust to what is going to be a constantly changing financial services landscape in the next few years, where things are going to come in and out because of the speed with which these markets are moving. We need to have an operational platform that can scale and deal with that, and the people, culture and capabilities alongside that. I will not ask for more to come in or for things to come out. Those are ultimately your decisions.

Q191 **Anthony Browne:** You are absolutely right that the location of the perimeter is ultimately the decision of Government and of Parliament. Your primary responsibility is obviously to make sure that it works operationally, but your staff are at the frontline of the perimeter and see what is going on just beyond it, in a way that civil servants at the Treasury, and certainly parliamentarians, do not. You clearly have a view on what should and should not be in the perimeter.

You said that you have made recommendations. The Treasury Committee has, in the past, recommended that you have a formal power to recommend to the Treasury changes to the perimeter of regulation. Do you think you need a more formal power in that way, or are your informal recommendations to change the perimeter enough?

Nikhil Rathi: There has been innovation in recent years following the work of the Treasury Committee on this issue, with an annual perimeter report. I have had the first annual meeting with the Economic Secretary—the minutes of that have been published. I am not sure that a formal power, as such, would add very much, because ultimately, whether we make formal or informal recommendations, it is ultimately up to the Government and Parliament to decide whether you wish to take those recommendations forward. As I have said on online harms as well, we have made a clear recommendation; now it is really a political decision.

Q192 **Anthony Browne:** In your evidence to us when you were appointed as chief executive of the FCA, you said that you thought it was important to be “proactive in finding ways to tackle...and deal with” consumer harms—that was in reference to the perimeter. I was wondering what you have done. You mentioned that you have made recommendations on online harms, for example, and you had a meeting with the Financial Secretary to the Treasury. What else have you done to be proactive about addressing consumer harm around the perimeter, and what else could you



do in future?

Nikhil Rathi: We have taken a number of steps in recent months. For example, we set out what we describe as a “Use it or lose it” regime. One of the issues in the case of LCF was that you had a firm that perhaps did not have any regulatory income but was using the FCA badge to promote other products. We have indicated that there is a presumption that if you have had no regulatory income within 12 months, your permission will be lost. We have taken those steps immediately, in terms of sensitising the market to that. When the Financial Services Bill is passed, we will have the powers to move much more quickly to remove those firms—at the moment, it takes a bit longer. That is one example of the perimeter extension where the Government are taking that forward through legislation. We actually think that we can then use digital and machine-learning tools to become even more automated with processes such as that.

We have taken temporary product intervention powers, so we banned the mass marketing of mini-bonds to speculative securities at the end of last year. We envisage that further product intervention powers may come our way as the EU acquis is onshored into the United Kingdom. We have also taken further steps in terms of scams and digital campaigns, particularly between December and March. Those are some examples; I can go through a longer list if that would be helpful to the Committee.

Q193 **Anthony Browne:** Thank you. I am out of time, but before I go, I want to give your chairman the chance to say something on the perimeter. Does more need to be done to give more powers or protection beyond the current perimeter?

Charles Randell: There are two principles that we need to try to follow. The first is that it needs to be clear to consumers what they can expect of the FCA in relation to an activity, and whether it sits inside the perimeter, or sits outside the perimeter. We need to develop a regime in which consumers can see that what they are doing is or is not protected. The real problem is where consumers do not know, and there is great confusion and an ability for bad actors to exploit that confusion. That is the first principle I would follow.

The second principle I would follow—this was very helpfully put forward in UK Finance’s proposals in response to the Government’s consultation on the future regulatory framework—is that similar activities should be regulated in the same way. This is not the case at the moment. For example, quite a lot of stuff around debt advice is regulated by different regulators in different ways. If you have money in a payments firm, you do not get FSCS protection if that money is lost, but if you have it in a bank, you do. If you have it in a bank, you also have the reassurance of the additional capital and liquidity requirements that are applied to banks. Fundamentally, for you as a consumer, the consequences of losing your money are exactly the same, but when you look at a payments firm, it has a FCA badge on it but it is not regulated like a bank.

These areas where similar activities with the same consumer harm are subject to different systems of regulation are highly problematic. They are all technically within the perimeter, but they are differently treated, and that creates a lot of problems. Those are the two principles that I think we need to try and follow.

Anthony Browne: I certainly agree with you on that last point. It was a point I made regularly when I ran the British Bankers' Association: regulate the activities and focus on the harm, not the legal entities. That is all I have time for. Thank you both very much.

Chair: Thank you very much, Anthony. We will now go to Steve.

Q194 **Mr Baker:** Since you mentioned payments, I refer to my registered shareholding in Glint Pay.

I want to turn now to the legislative framework, since Anthony has talked about the perimeter. Do you think all the concerns about the perimeter that we have discussed suggest that there is some problem with the present legislative framework through FSMA? Perhaps I might come to Charles first.

Charles Randell: I think the two examples that Nikhil has given are, for us, the most pressing. The first is the fact that we see a huge growth in online promotion of a variety of quite risky financial propositions and outright scams, but we really are pushing water uphill to try to address that problem, and that is a huge issue. The financial promotions order is also a huge issue: I think far more harm is accruing through the financial promotions order, and the exemptions from it, than has been recognised.

I think the legislative framework is fundamentally sound, because it gives us very clear objectives in terms of consumer protection, market integrity and competition. If I may, I will just put down a marker that as legislation moves through Parliament over the course of the year, I think there is a real danger of trying to turn financial regulation and financial legislation into a lucky dip that contains something for everybody in terms of the objectives we are given. It is really important for us to keep our eye on those three absolutely paramount objectives that we have, and not to have a whole load of additional secondary objectives or "have regards" that dilute our focus on those things. What I think we do need to do, however, is articulate much more clearly how success can be measured in our pursuit of these three objectives, and that is one of the things that Nikhil is going to be doing through transformation.

Q195 **Mr Baker:** If I may, I will just pick up on something you mentioned, because given the range and scale of market activity, isn't it likely to be something of a lucky dip anyway? You cannot possibly regulate all activity in the market. This is a subject that we have picked up before with other witnesses, but are you not just institutionally facing a massive problem, that things will happen in the market that you will not have supervised? Nikhil, would you perhaps like to pick up on that?



Nikhil Rathi: You make an important point: this is a very broad market, and also the online world enables products to come very easily from outside the United Kingdom to consumers in the United Kingdom, so there are necessarily limits on what we can achieve. That is why the whole point about education and prevention is so important.

Without in any way detracting from us having to do our job at an operationally excellent level, we also need to make sure that there is education and prevention out there. For example—I am sure you will come to the point about fraud later—last year there were 822,000 reports to Action Fraud. It is the single biggest reported crime in the country, and only 1% of police are devoted to it. By any definition, you are not going to be able to use regulation to stop all that. There is also a point about consumers' awareness of some of the risk of scams and pension scams and so on, which is why we have been investing more in some of those digital campaigns.

Q196 **Mr Baker:** I think we can agree that insufficient resources are directed to prosecuting fraud. That is definitely something that I have brought up before. The FCA response to Dame Elizabeth's report states: "the LCF Review's suggestion that we should do more to avoid a 'halo' effect...is particularly challenging for us to respond adequately to within the complex current legislative framework." Could you expand a little more on why it is difficult for you to respond adequately to the halo effect?

Nikhil Rathi: The starting point is that it is obviously the Government and Parliament that determine who gets FCA-registered and authorised. You can be authorised and registered for many different things, from money laundering registration to full authorisation for consumer protection. That has enabled firms to say that they are FCA-registered or authorised in some way, and in this case use that as a marketing tool for other activities. Using our powers around promotion, we can seek to restrict that further, but that fundamental mismatch is always going to be there with the current construct.

Q197 **Mr Baker:** What view do you have of how we should legislate to deal with that halo effect? While you think about it, let's face up to it: Ministers bring forward legislation and MPs vote on it. Most Conservative MPs most of the time will vote with the Conservative Government. We always say, "Parliament intends—" and so forth, but of course Ministers bring forward legislation on advice, and I would hope that you would feed in advice. Now that I have given you a chance to think about it, how would you like us to legislate to support you in dealing with the halo effect?

Nikhil Rathi: I think there are a number of things that we can think about. First, we are looking at how we can take forward the recommendations that prevent people from using the FCA name when they are not engaged in FCA-regulated activities, although the regulation may become part of their business. We will have to test how legally feasible that is, but it is possible that some legislative ballast behind that would help.



Secondly, we would like greater protection for naming firms where we have concerns. We have gone quite far now with our warning lists. We go out and name firms where we believe there are problems, but as Andrew Bailey said in his evidence to you, there is always the risk that we can get pursued in court for sharing concerns about a firm before we have been able to fully investigate and evidence. There is an issue around the publication and naming that is important. Those are the two that I would pick up, and Charles may have more on his shopping list.

Q198 Mr Baker: I will come to Charles in just a second. You mentioned the issue of using the FCA's name, but isn't there a problem that sometimes your name will be used to create the impression of reliability and trustworthiness when actually firms might go further than their regulated status might warrant? Is there a case for requiring some short boilerplate text to indicate what FCA regulation actually means for the consumer so that firms can't overstate what consumers obtain, in terms of trustworthiness in that firm?

Nikhil Rathi: Yes. And you will see, if you look at the warning that we put out on crypto-assets, that we were very clear that being registered for money laundering purposes does not in any way suggest that the FCA has authorised these firms for the purposes of consumer protection. Therefore, if you invest, you invest recognising that you may lose all your money in a highly volatile instrument.

Q199 Mr Baker: Very good. Charles, how should we legislate? That is the key question.

Charles Randell: The suggestions that we made about trying to restrict easy access to high-risk products for retail consumers who don't have money they can afford to lose are important. We have some firms who have an FCA authorisation where no one would reasonably think that we are looking at all of their business. You may have a shop on your high street that has a credit broking licence because it will refer customers to sources of credit when they are buying things, but no one would suggest that we would look at whether the sofas they are selling are up to scratch or exactly what the owners are doing with their shareholder loans. That one, in a sense, is easy.

At the hard end, we have something like LCF where the product looks and smells financial, but it is not regulated, and consumers suffer from the halo effect. My sense is that what we need to do in those cases is fundamentally redesign the consumer journey, because high-risk financial products have become much more accessible than in the old days when, probably 40 years ago, financial products were being sold in a face-to-face meeting with a dialogue with the consumer. Now they are not. A lot of things are done on a one-click basis and a lot of huge mistakes are made on a one-click basis.

Q200 Mr Baker: I am so sorry; can you just finish that point? My time is racing on.



Charles Randell: I think what we really need to do is look at redesigning that consumer journey to be fit for the digital age, not with lots of wording and boxes, but with interactive communication with consumers, which will mean that they come away genuinely having had to understand what they are being told.

Q201 **Mr Baker:** Unless the Chair cuts me off, I am going to try one more question. You have previously made the point that some investment market problems are systemic. By systemic, do you mean that they are just a feature of investing, in the sense that the return on investments is not certain and that there is always a degree of speculation in investments, or do you mean something different? What feedback have you had on the point about the systemic nature of problems in investment? Briefly, please.

Charles Randell: To my mind, the biggest issue around investments and consumers, particularly in a low-interest rate environment, is the search for yield. It is consumers not understanding the relationship between risk and reward. I had an email over the weekend from a consumer about what was obviously a scam bond, offering an interest rate of 4.5%, asking if this was a scam. For a one-year bond, issued by a bank, yes; it's a scam. That is absolutely clear, but consumers don't have an understanding of that point, I don't think.

Therefore, we need to find a journey that means that, first, those sorts of scam ads don't get sent to them, and secondly, that for higher-risk investments that are accessible to them, they have to go through a consumer journey that confronts them with the realities of the risks.

Q202 **Mr Baker:** Nikhil, a last point on system issues.

Nikhil Rathi: I mentioned the online one. We are in a world where the low interest rate environment is going to create an incentive for people to chase after these kinds of high-risk investments. We haven't quite resolved, with this Committee or with Parliament more generally, the tension between freedom of choice for consumers, where they are to be allowed as much choice as possible, versus the amount of regulatory safety you expect coming out of those choices. Pension freedoms is one example of that, which has created some of the dynamics we have seen in the last few years.

Mr Baker: Thank you very much. It is an extraordinary world when 4.5% is a return so high that we should all know it is scam. What a terrible time we have reached.

Chair: Steve, thank you. Julie, please.

Q203 **Julie Marson:** Good afternoon, Nikhil. There may be an element of repetition, but I would like to go back to the financial promotions team. Dame Elizabeth's report mentioned that the FCA had the rules and the powers, but it didn't always have the policies to deal with the halo effect and some of the other perimeter-type issues. Pending the legislative changes that we have touched upon, what changes have you made and



how have you potentially addressed the lack of policies?

Nikhil Rathi: One very specific change we made at the end of last year was our repeat breach of policy for financial promotions. Previously, action was taken only when there were three breaches. We are now taking escalation action when there are two breaches. Someone who has breached the policy twice goes into significantly higher escalation.

Furthermore, we have expanded the work of the team that works alongside the financial promotions team—the joint supervision and enforcement taskforce. One of the things you will have seen from the report is this issue of different parts of the FCA perhaps not always working in a completely joined-up, holistic fashion, with different tools being used in different ways. Having a joint supervision and enforcement taskforce dealing with non-standard investments enables the case officers to make the judgments about what is the right combination of tools—the right calibration to use to deal with those situations. That work has been intensified as well in recent months.

Q204 Julie Marson: Have you made any changes? One of the issues that we have seen in the past was the resources of the financial promotions team. Have you made any changes, and how well resourced is the team at the moment?

Nikhil Rathi: What I would say is that we need to think about the resourcing, and a combination of teams are dealing with this. There is the financial promotions team and the joint supervision and enforcement taskforce, which have about 80 people between them.¹ We have a further 50 people in the unauthorised business division, and more people in the retail enforcement division as well. The point I would make is that, rather than focusing on the number of people in one team, it is about how those teams collectively are resourced and how they are working together. We may have moved people from one team to the joint supervision and enforcement taskforce, because we thought that was the better way of getting the decisive action that we needed to enter into.

Q205 Julie Marson: The report also suggests that even when the FCA had powers to act, it did not always use them. What can Parliament and Government do when you are given presumably pre-emptive and proactive powers? How can Government help you to ensure that they are actually used?

Nikhil Rathi: I think this is a fair point. There has been, historically, a cultural issue where—it comes out in both reports, actually—there is a degree of legal risk aversion, or a degree of concern around potentially losing a case and being challenged for doing it. We need to be ready to be more proactive and take more interventions, recognising that if we are taking balanced decisions, some of them may be challenged. In some cases, we may lose. It is certainly my intention to move the organisation in a direction where we are willing to take more risk. I certainly hope that,

¹ *Note by witness:* There are 18 people in the joint supervision and enforcement taskforce and an additional 9 people in the financial promotions team.



HOUSE OF COMMONS

when I come to this Committee, you will understand that sometimes we are making difficult judgments and dealing with some very well-resourced individuals, who will seek to challenge us in every possible way legally when we take that action.

Secondly, being able to speed up enforcement action is important. We have to make sure we get the balance right between the legitimate protections that, subject to investigations, firms need when dealing with the regulatory body that is taking enforcement action, versus our ability to act decisively and speedily to prevent consumer harm from being incurred. That balance has not always been so easy, because I think the legal system loads quite a lot of protection on those individuals, and it can take quite a lot of time to sort things out.

Q206 Julie Marson: Thank you. Perhaps I could ask Charles about that. Looking back, did you identify that as an issue at the time, and did you raise that with the Treasury?

Charles Randell: I have the benefit of about three and a half decades of perspective on this, because when I started practising as a lawyer, to get your investment advertisement, as it used to be called, approved by somebody was a very big deal, and very few institutions were able to do it. As I recall, it was members of the Accepting Houses Committee and a few others—brokers and members of the London stock exchange—who could approve an investment advertisement. Please don't write if I have got that wrong. But it was a much smaller group of people, and the standards applied were much more substantial. People would look at the promotion and ask whether it gave a really fair picture, including of the downside risks.

Once the ability to approve financial promotions was extended to everybody who had an FCA authorisation, what necessarily happened was that we moved from substance to box ticking, to some extent. Over time, expectations of what a good financial promotion looked like degraded. Then the consumer credit funds came in in 2014-15, and the number of firms was doubled, so now we had a huge universe of firms that could potentially approve financial promotions, and they could do so perhaps without having the standards, culture and governance to do the right thing.

That is why we have been talking to the Treasury about making the approval of financial promotions into an activity that requires a specific permission, so that not everyone can do it, so that we have a much smaller cohort of people who can do it, so that the purposes for which they can do it are set out, and so that we can withdraw those permissions if we see that they are not doing their job properly. That is because one of the things we see in this area is firms that appear to be just guns for hire—their sole business seems to be approving other firms' financial promotions, which troubles me a great deal.

So, with the benefit of four decades of looking at this area, I have seen a serious deterioration in standards, and it is time to turn that around.

Q207 **Julie Marson:** To continue with Charles, the FCA issued a temporary ban on the mass marketing of speculative illiquid securities, such as by LCF. You did that without consultation, and you have made it permanent now. Have you seen any results of that?

Charles Randell: We have seen that those types of securities are not being marketed in the same way, but I would be lying to you if I said I was comfortable with everything else that was being marketed. My office knows that Monday morning quite often brings an email from the Chairman with lots of lists of things he has seen on the internet that he wants to be looked into. And there is still too much going on that I am deeply uncomfortable with.

I think that, when we can move to this position of having financial promotions approval as a specific regulated activity with its own permissions and with standards that we can enforce against a much smaller number of firms, with senior managers who are specifically accountable for their performance in that area, then we will have turned the tide, but I think the tide is still out.

Nikhil Rathi: If I may add to that, Ms Marson, as a result of the ban, what we are seeing is heavier use of the exemptions that we talked about earlier: the high net worth exemption, the self-certification that you are sophisticated, and people being coached through to an online click to access those securities.

Q208 **Julie Marson:** Thank you. It is concerning to hear Charles say that there are still things coming across your desk that concern him and that might be getting through. Customers are still out there.

Charles Randell: Yes. We have our joint supervision and enforcement taskforce, who have the job of picking these cases up and following them up, and taking enforcement action if it is justified. We have a large number of firms in our enforcement division at the moment for financial promotions-related issues.

Q209 **Julie Marson:** Finally, may I ask Charles a question again? In his evidence to this Committee, Andrew Bailey said of the financial promotions regime that it was "a slightly odd adjunct to the FCA regime. It is not part of the FSMA regime proper in that sense." Would you agree with that view?

Charles Randell: Yes. That is really what I have been talking about—that approving financial promotions isn't an activity we regulate. The way that FSMA is set up, under section 21 anyone who is authorised can approve financial promotions, but it is not a regulated activity. That means that we don't get returns saying how many financial promotions have been approved, and we don't get a regular supply of information from the firms who are doing this business, whereas in other regulated activities it is very much something that we have data to look at.



HOUSE OF COMMONS

So bringing this into the regime in the way that I have suggested will be a huge help, and then just resetting the standards to where they should have been and where they were 30 years ago.

Julie Marson: Thank you. I don't know if Nikhil has anything to add, but that is my last question.

Nikhil Rathi: Charles has covered it. Thank you.

Chair: Thanks, Julie. We go now to Felicity, please.

Q210 **Felicity Buchan:** Thank you, Chair. My questions are on the culture of the FCA, and Angela will follow on after me on the same subject.

Let me turn to Nikhil first. When you came to the appointment hearing, you said that you had a perception from the outside that the FCA was risk-averse. Is that what you have found? And if so, what are you doing about it?

Nikhil Rathi: First of all, I would say—coming in from the outside, and notwithstanding the heavy criticism in the report, as we accept its recommendations—I find an organisation with colleagues who are deeply committed to our public purpose, who work incredibly hard and who have worked incredibly hard, particularly over the last year, to support the economy and support consumers. I just want to make sure that that point is registered.

We do need to make changes, though, in terms of our operational systems and our culture around risk—in particular, legal risk. There needs to be greater operational expertise around the leadership table, which is why I brought in—am bringing in—some senior operational leaders. We also need to be more willing to take legal risk, particularly in areas where we see harm occurring.

I would also say—this is again a conversation that it would be good to have with the Committee—that sometimes colleagues strike a very difficult balance when they take some of these decisions. I have seen a few of these cases. As CEO, I don't get involved in individual decisions, but, for example, you have a choice, when you have an online situation where harm has already occurred to consumers, of putting it on the warning list. If you do that, you will stop future harm from occurring, but you will probably prevent redress from being secured, because the assets will get dissipated. When we deal with potential frauds, we have the option of intervening early to stop the fraud, but in some cases it probably makes the prosecution of that fraud harder because the evidence will get destroyed. So people are making these difficult decisions every day, and we are moving to being more interventionist to prevent consumer harm, but that will have knock-on consequences, which I think it is important to share with the Committee.

Q211 **Felicity Buchan:** Thank you for that. You mentioned being more interventionist. Are you set up to be more interventionist, or is there a culture still whereby you are not prepared to really go for it on behalf of



the consumer?

Nikhil Rathi: The organisation is changing. You have seen some of the really proactive steps taken over the last number of years in respect of payday lenders and so on; in the past year, the speed at which consumer action was taken during the pandemic; and the business interruption insurance case—quite a unique case—to support small businesses to secure sizeable sums to keep them afloat. So we are an organisation that is willing to take things on, but we have further to go.

The issues that we need to address were already under way before I arrived—I talked about them, before I had seen any of the FCA report, when I was at the Committee. They have been amplified by the report, so we have to get our systems into a better place around data, information and intelligence sharing so that people can have the confidence to move quickly because they know that the systems that they have are of the quality they need. We need different capabilities in the organisation.

One of the new executive directors joining us comes with investigative experience so that we have a mindset in our supervision division that builds on the traditional supervision skills and also builds investigative skills into our organisation. We will need data scientists and prudential and financial specialists as well. All of that will help us get to the position, Ms Buchan, that you are pressing us to.

Q212 **Felicity Buchan:** Thank you. I just want to put it on the record that that insurance case was certainly very welcomed by my constituents.

If you look at Dame Elizabeth's report, there was a sense that the FCA was not taking financial crime seriously enough and that you really did not have the mentality whereby you were the first defence for consumers and retail in terms of financial crime. Do you think that you have got that focus, and does the focus on financial crime now permeate the institution?

Nikhil Rathi: We have taken immediate steps. At the end of January, we ran a training module for all frontline authorisation, supervision and enforcement colleagues on fraud and the perimeter, as well as some other modules, to make sure that there was a good understanding of the responsibilities that we have when we see evidence of financial crime linked to financially regulated firms. We are certainly moving in that direction and seeking to improve there. We have also taken steps in the money laundering space with respect to crypto-assets, where we are operating a temporary regime currently, in case of money laundering.

On this question of financial crime, we are one of many partners. That is not trying to in any way diminish the responsibility we have and the contribution we need to make, but, as I described, when you are dealing with the largest single reported crime in the country, which is now fraud, which involves the police, the Serious Fraud Office and many other agencies, there is an importance that needs to be attached to economic crime collectively across the system that historically has perhaps not been there to the extent it has needed to be, either in terms of funding or focus. We certainly want to play our part in that.



Q213 Felicity Buchan: Clearly, with crime, you do need to take a collaborative approach across multiple agencies, but do you think that you have enough powers to investigate financial crime?

Nikhil Rathi: The powers are there in the system. If we do not have them, then the police have them, or the Serious Fraud Office or others have them, so it is a question of us making sure that we have the gateways and are sharing information proactively and positively to deal with these situations. For example, in the case of fraud, where there is not a FSMA nexus, we do not have the powers to get information in the way that other agencies do. That is the way Parliament has set it up.

However, one area where I do think we can be more creative, and I think this is something that you may wish to consider as a Committee, is whether we should have greater ability to pool capabilities with some of the leading actors in the private sector—for example, banks and others. They are feeding us a lot of data, but they can actually bring quite a lot of analytical heft to bear as well, to help us interrogate that data, think about where the vulnerabilities and risks may be, and then work together to develop common strategies around financial crime and fraud. That is one area in which the gateways are not as clear as they might be.

Q214 Felicity Buchan: I want to bring Charles in, but before I leave you, if you were to sum up just in a couple of adjectives what you think the culture of the FCA was when you arrived, and then what you want it to be in a year's or two years' time once you have done the transformation programme, which adjectives would you use in both cases?

Nikhil Rathi: The FCA is a purposeful, committed organisation as I have arrived. I would like to turn it into a proactive, operationally excellent organisation during my tenure.

Q215 Felicity Buchan: Thank you.

Charles, I only have two minutes, so let me bring you in briefly. Reading Dame Elizabeth's report, it does seem as though the FCA is very heavily siloed. Do you agree with that, and what can you do as chair to correct that?

Charles Randell: I think the FCA is still not as joined up as it should be, but I have made inquiries from those who have been around over quite a long period, and they assure me that the organisation is much more joined up than it was in, say, 2015. I think it is a steady improvement in join-up, but there is still some considerable way to go.

If I could add my adjectives to Nikhil's adjectives, the FCA that I would want is one where people in the frontline are curious, impatient, agile and decisive. I think if we can drive that more broadly across the organisation, we will end up with an FCA that is quite close to being as good as it can be.

Don't get me wrong: there are colleagues at the FCA who demonstrate all of those things every day and produce amazing results, and I am very proud of many of the things that the FCA has achieved. However, it is not



HOUSE OF COMMONS

always the case, and we have seen in these reports—not just Dame Elizabeth’s report; this is particularly evident in Raj Parker’s report around Connaught—that there were periods of time where the organisation sort of turned in on itself, and could not decide what to do. That is not the way we should be. We should be reasonable and moderate in our judgments, but we should be swift, and that is something where we still have a little way to go.

However, I want to repeat that I really do think, certainly over the past year, that the efforts that colleagues in the FCA have made to support the economy, consumers and businesses through the coronavirus have gone, in many cases, well above and beyond.

Q216 Felicity Buchan: As we are talking about adjectives, I hear where you want to be, but which adjectives would you use today?

Charles Randell: I would say that there is still too much process, some of which is a bit repetitive, and there is still a risk aversion, particularly around legal risks, which conceals the true risk. It is absolutely clear in case after case that where we have been averse to acting because of our perception of risk, we have ended up with a much bigger risk than we would have had if we had acted. That is the message that we get again and again from these reports.

Felicity Buchan: Thank you, Chair.

Chair: Thanks very much, Felicity. We are going to Angela now.

Q217 Dame Angela Eagle: Thanks very much, Chair. Picking up on that last observation, Charles, the nature of the businesses that you supervise and the way that they change rapidly surely means that if a small loophole is spotted or a small scam is allowed, all of a sudden much more focus can be put on it by those who are trying to behave badly, to the detriment of consumers. Isn’t there a very powerful argument for doing a lot more prevention and being far more up front about the potential scams as they become clear and for rebalancing the risk to consumers by being much more proactive earlier than you have been in the past with potential fraudsters and scam merchants?

Charles Randell: Absolutely, and it’s not just limited to scams. If you look at the system as a whole—I include the FSCS and the Financial Ombudsman Service, as well as the FCA—and ask how many resources are devoted to prevention and how many are devoted to cleaning up the mess, actually a majority of the people in the system are dealing with problems that have already been allowed to happen. That is a crazy system, and we see, particularly with the FSCS, that the costs associated with it are enormous. And that is just the problems that attract FSCS coverage; of course, there are many scams that attract no FSCS coverage. You will be particularly aware of people who borrow unaffordably and don’t have redress to the Financial Services Compensation Scheme when the firm that mistreated them goes under.



HOUSE OF COMMONS

My view is that we have to be preventive as our absolutely first priority, to take this harm out of the system. Once a problem has happened, the resource implications of dealing with it explode. If you let a bad firm into the system, it takes up the time of the supervisors and the enforcers, and in the meantime it takes up the savings, livelihoods and health of consumers. Just one decision at the gateway—not letting them in—could prevent all that.

We have a system that currently contains far too much of what I call failure demand. From a systems point of view, we have a system in which quite a lot of the resources of the system are devoted to dealing with things that perhaps could have gone better.

Q218 Dame Angela Eagle: What is the percentage between active prevention and clearing up the mess? How much of the resources at your disposal are actually used in trying to prosecute those who have defrauded customers?

Charles Randell: A little under a quarter of our headcount is in enforcement activity. We probably have about the same again in supervision—I'm sorry if I have got these numbers not entirely right—and then we have other policy responsibilities.² We supervise markets, we are obviously the listing authority, and we have a whole load of other responsibilities too.

My point is much more about the total system. When you look at the downstream consequences of something that isn't stopped early, that then translates into enormous volumes of Financial Ombudsman Service complaints. If that firm fails, it translates into a huge job for the Financial Services Compensation Scheme. I would like to feel that we can be more preventive, but it is not just about headcount. A lot of it is about the information that you collect, the use you put it to, and, in particular, whether you can use the information that you already have within the building, and information that we collect subsequently, to identify much more swiftly outliers and people whom we should move resource to stop.

Q219 Dame Angela Eagle: Dame Elizabeth's report pointed out, for example, that fraud and protecting consumers in that way were part of the remit, but that there was a constant refrain from within the FCA that that was an issue for the police. Nikhil, perhaps you can also say something about this. What are you doing to put that culture to bed and to create a much more proactive culture where there is real commitment to increasing the risk for those defrauding consumers, rather than worrying about legal risk aversion in the organisation?

Nikhil Rathi: As I mentioned earlier, we rolled out further training by the end of January, and there will be further work in done in that regard to build our capabilities. We are bringing investigative capability into the organisation as well. We will expect the transformation programme to build a stronger surveillance mechanism. In November, we rolled out an

² *Note by witness:* Full details on FCA staff numbers, including the numbers in the supervision and enforcement teams, are set out on page 83 of the FCA's [Annual Report and Accounts](#).



enterprise-wide risk management system as well, to help log the risks and make sure that we can look at them more strategically than has been the case in the past.

Q220 Dame Angela Eagle: When will you know whether that is working? Do you have internal mechanisms reporting on it? Are you going to try to jail a few fraudsters to make the case that behaving in that manner carries downside risk for the people who have been scamming consumers?

Nikhil Rathi: Look, we will be publishing our enforcement statistics, as part of the transformation work we are doing, hopefully by July or August, when we publish our business plan and annual report. We can start sharing with you the kind of metrics against which you can hold us accountable, and we can test those with you so that you can understand whether we are making progress.

I think the point around accountability and culture, to build on the earlier questions, is important. I want us to go to a system where we are setting out for you how we can be measured for our performance. We can then translate that through the organisation in the way we evaluate and resource teams. Critically—this is one distinction that I would like to make relative to previous reviews where things have gone wrong, in FSA or other areas—what I do not want to do is load on a load more Government and decision-making processes to slow things down. We actually need a more empowered organisation where colleagues through the organisation can take sometimes difficult decisions and judgments, recognising that they will not always get them right because they are difficult. That also goes a bit to the point about responsibility that we touched on at the very start of the hearing. We have those measures that help us track that performance more systematically than we have perhaps done in the past.

Q221 Dame Angela Eagle: Do you think that making a larger use of watchlists and warning lists for dodgy behaviour, and actually publishing what you think dodgy behaviour is and maybe even being more open about the companies that you consider too close to those boundaries, or which have gone over those boundaries, might help? Might more transparency about that, in a more up-front manner, help increase the risk for people who were thinking that there might be big profits from defrauding consumers with no real risks?

Nikhil Rathi: We are using the warning list much more, particularly for unauthorised businesses. This is also an area where—to go back to my online point, given that it is such a significant vector for this fraud—if we had wider powers to make sure that online firms were taking practical steps, because a lot of it comes through there before it reaches anywhere near our domain, and it stopped at that point, that would make a big difference. It is also worth bearing in mind—

Q222 Dame Angela Eagle: Sorry to interrupt. You made a very specific point earlier. If investor fraud needs to be included in the online harms Bill, how would you be able to react to that were you to get your way, and would we then have a regime that was faster and more responsive to the way

those things grow online?

Nikhil Rathi: I believe so, because it would then become an obligation on the online platforms to take responsibility for the adverts and the promotions that are being distributed via their platforms to millions of people every day. At the moment, we have to negotiate voluntarily with every single one to see how far we can get them to move, change their policies and help us. I shared some examples of that with you this morning. I recognise that there are many other harms that you are looking to address in Parliament through the online harms Bill. There is a lot of nefarious online activity going on out there, but this is a very big crime that is taking place in the UK every day and is costing people a lot of money. We think it deserves being in there, and we think it should not wait for an untested advertising programme that may come a few years down the line.

Dame Angela Eagle: Thank you very much.

Chair: Thanks very much, Angela. Let's go to Harriett now, please.

Q223 **Harriett Baldwin:** Thanks, Chair. Can I start with Charles? You have been at the FCA a bit longer and have a bit more of the corporate history in your experience there. I am going to turn to Dame Elizabeth Gloster's recommendation 8. She wanted urgent steps to ensure that all key aspects of the delivering effective supervision programme were embedded and operating effectively. Would you say that, as of now, that has happened?

Charles Randell: In the area that Dame Elizabeth is looking at—firms that were promoting mini-bonds—we have a lot of resource focused on it. We started in the first quarter of 2019, when we brought together a dedicated team to look at the whole mini-bonds area and work out which things it should be trying to close down. That team then transitioned into what Nikhil has called the joint supervision and enforcement taskforce, which is a faster-reaction team, to target this particular type of harm.

There are aspects of the delivering effective supervision programme that have not yet been fully delivered. When you look at why they have not been delivered, to some extent the issue is the limitations, at the time, of our technology capabilities. In particular, one of the most pressing issues is to make sure that, in front of everybody who is dealing with an FCA firm, there is a really good-quality dashboard that brings together in one place all the bits of information that we have about that firm, so that the join-up happens much better. We have taken a series of short-term actions to make sure that is happening, but they are somewhat manual. In the future, we would like to feel that everyone who takes a call from an authorised firm immediately sees in front of them what they are dealing with, in terms of the history of that firm's interactions with the FCA.

Q224 **Harriett Baldwin:** What is your expectation, as chair, as to when that will be available?



Charles Randell: Could I write to you with more detail about our short-term action plan to respond to Dame Elizabeth's report? I don't want to get any of the dates absolutely wrong.

Harriett Baldwin: Nikhil may want to come in.

Nikhil Rathi: The single view of a firm is important, and that is being piloted this month for a particular segment of firms—the consumer investments population—but we clearly need to roll it out much further. By the end of 2021, we will do a risk assurance piece of work on the delivery of the delivering effective supervision programme.

Q225 **Harriett Baldwin:** By the end of 2022?

Nikhil Rathi: By the end of 2021—this year—in terms of how far we have gone in rolling things out. One big thing we are doing, which is a major focus for us on the technology front, is moving out of our data centre to a cloud platform—a much more scalable data platform. We are doing that in April. Once we are done with that, it should enable us to move more quickly to these big data platforms, which can help us then accelerate these next steps of the programme—not just in the DES programme, but in our future work on supervision.

Q226 **Harriett Baldwin:** As you go through the process of implementing all the recommendations, have you surfaced any firms that are similar to LCF as a result of the delivering effective supervision programme?

Charles Randell: There are a number of firms that are involved in the issue of mini-bonds. Either they are the approvers of financial promotions, or they have or had a business model that involves issuing mini-bonds. I think it's fair to say that we haven't come across any FCA-authorized firms of the size and type of LCF that appear to be involved in— I need to be quite careful of what I say, but where there are indications of serious misconduct of the kind that we have seen in LCF. But we do have concerns that particularly the involvement of those firms approving financial promotions gives an FCA imprimatur to what is essentially a very high-risk investment, at a time when interest rates are very low, and savers are searching for yield. We continue to be really concerned about that, and every time we see one of those promotions, we look at it very carefully and take action when it's necessary.

Q227 **Harriett Baldwin:** So are you confident that such a failure could not happen again?

Nikhil Rathi: If I may answer, in the case of mini-bonds, we have taken specific action, in terms of banning those products. We have also introduced more risk triggers to enable us to spot other portfolios of firms where there may be risk, so that we can take earlier action. Can I give you the assurance that we are not going to see significant issues? Not at this stage; I don't want to give the Committee that complete assurance. We are building the systems. We are developing the capability, but these things take time, and certainly in the online space, I can't give you the assurance we are going to catch everything early enough.

Q228 Harriett Baldwin: One of the things that really struck me about Dame Elizabeth Gloster's report was how long the whole process of transformation has taken since the FCA was given responsibility for the 50,000 consumer firms. We are now seven years on from that and we are still in the process of finally implementing the transformation. We heard from the Governor of the Bank of England, when he gave evidence to us on this particular issue recently, about how rapidly the market is evolving, particularly around the perimeter. You have mentioned crypto, Nikhil, but there is obviously GameStop and the way of using social media to pile into particular securities. It feels like the market is changing very, very quickly, and the FCA still comes across as an organisation that changes very, very slowly. How can you reassure this Committee that you can rapidly reform in areas where you are identifying failure that is causing harm to consumers?

Nikhil Rathi: As we talked about at the start of the hearing, I was keen to get moving quickly on the work that we need to do. I would say that transformation is about something much wider than simply the lessons we have learned from the LCF report and the Connaught report. It goes to precisely the point that you are making about the speed with which the market is changing. You mentioned GameStop. There's a category of consumer there that we are not used to engaging with—20 to 25-year-olds sitting at home, going on social media and trying to bet on US stocks. That is not a group that we are conventionally expecting to reach. We have done a lot of work on pensioners and we have done a lot of work on vulnerable consumers, but this was a relatively new one for us.

So, these things are changing fast, and I think that's why we need, through our programme, to invest much more heavily in our systems, our data, our technology, new techniques, artificial intelligence and machine learning. All that is under way and we are going to scale it up much more significantly. We have been much more diverse in the capability we are bringing in. You will see that there are people who have experience of big tech, and experience of artificial intelligence, coming in around the executive table, and we will make that the case throughout the organisation. Yes, we need to be willing to move more quickly—and to make mistakes, because we will sometimes move quickly and not get it completely right. We need to explain why we have done that and, hopefully, build the understanding of the Committee around those issues.

Q229 Harriett Baldwin: If I am a flexible firm and operating on the perimeter or near the perimeter, how will my experience of interacting with the FCA have changed as a result of your implementing the recommendations from the Gloster report?

Nikhil Rathi: I think you will find, if you are operating and the indicators that we are seeing are flashing risks—for example, you have no regulated income, or we are seeing very significant levels of senior management change, or—

Q230 Harriett Baldwin: Would those be flashing, Nikhil, on a dashboard you already have, or is this on the dashboard that we are going to get?



HOUSE OF COMMONS

Nikhil Rathi: Some of them are flashing on a dashboard we already have—for the regulated income one. For others, we will start building these indicators; we have started building, and we are going to industrialise it, if I can use that word. If you are flashing those risk indicators, you will find that we will be contacting you more proactively than may have been the case historically. We hope that will be more targeted, using these data techniques. We also hope that, if you cannot convince us or you are non-responsive to our request, we would seek to remove you from the system far more quickly than might have been the case historically.

At the same time, we want to support small businesses. We want there to be competition in the market. We want there to be innovation and entrepreneurs in financial services. If you are doing everything right and you are responsive to our requests, we can have a good, healthy relationship for the regulator to want to build.

Harriett Baldwin: Thanks. I am afraid I am out of time.

Chair: Thanks, Harriet. Going now to Rushanara, please.

Q231 **Rushanara Ali:** I have a couple of follow-up questions, then I will go on to consumer responsibility, and complaints and compensation.

To pick up on the Chair's question about—this is a brief point—Megan Butler's appointment, Nikhil, did you and the chair consider an interim appointment, so that you could have an open competitive process for the recruitment in order to assure everybody that you recognised the sensitivity of an appointment such as that one? It would have been good for confidence in how selections happen. You will appreciate that after the GRG scandal, certain people in that bank remained within the bank, which generated a lot of criticism, so there is a wider concern. This is not personal to an individual, but there is a culture issue about how people might respond when they see that, despite a major inquiry and the failings, things do not change in terms of individuals who bear considerable responsibility.

Nikhil Rathi: I understand the question and I am happy to expand on the thinking we had to do. It was a subject of discussion with the chair and the board—

Rushanara Ali: Whether to have an interim—

Nikhil Rathi: Absolutely. In any transformation exercise, what is really important in driving cultural change—I felt this very acutely coming from outside the organisation, and bear in mind that I was also working remotely, so I had hardly met physically any of my new colleagues, in October—is that you are able to bring your colleagues with you, that you have advocates who are driving transformation across the organisation and that you can carry the organisation with you. First, on whether we would have secured the candidates if we had gone for an interim role, I am sceptical. Secondly, whether that would have had that wider cultural impact, I am also sceptical, in all honesty.



HOUSE OF COMMONS

Transformation is a team effort. Of course, Megan is playing an important role, but transformation is something that is going to be the objective of every single executive director, every single director, across the Financial Conduct Authority. Everyone will be held to account for their contribution. I knew that, in parallel, we would be likely to bring in significantly additional—

Q232 Rushanara Ali: It was a question about whether you did. I heard you, and you have given a pretty convincing answer on the wider points, but did you consider an interim appointment? If you did not, that's fine.

Nikhil Rathi: I considered a range of options, but if I had gone for an interim appointment, what would I have done with supervision and all the other appointments? How many interims? There would have been a knock-on consequence right through the executive committee.

Rushanara Ali: Sorry, this was quite unique, quite different, because of the report that came out on LCF. That is why I asked the question.

Nikhil Rathi: Absolutely. A sub-committee of the board was evaluating the issues of executive performance on LCF before I arrived—it was constituted before. They took the judgment they did on executives, as Charles explained earlier. Broadly speaking, I had the executive team that was there when I arrived, and I had to make sure that responsibilities were allocated in the right way so that I could get on with transformation and with building a new team.

One thing I would say about Megan is that, as a CEO, you have to look at performance in the round, recognising the very significant issues with LCF, and I absolutely do. I also see that the fact that the wholesale financial markets in the United Kingdom stood up, operationally resilient, at a moment of record volatility and high activity at the start of the pandemic, was down to several years of hard work and supervisory leadership. That had a big impact on the economy of the United Kingdom, because it enabled companies to raise capital and get us through; likewise the smoothness of the preparations for Brexit. You have to try to look at performance in the round.

Q233 Rushanara Ali: Okay. I will move on. There are some wider issues that are not related to any individual but are about culture of institutions when things go wrong and how consumers receive a signal about whether anyone is accountable; however, let's move on.

You talked a fair bit about legal risk, culture change and staffing, and a lot of what you said makes sense, not least because many of us have found it very frustrating seeing how responses are often associated with having to clear things up, as Charles was saying earlier. Do you think the FCA needs more resource and more support to achieve your ambition of turning it into a much more proactive and modernised institution to deal with the challenges regulators face, especially in the face of technological challenges and risks? Do you think the FCA has enough resource, or should it be given more support, given the amount you have to do?

Nikhil Rathi: We covered this in my pre-commencement hearing. My mindset going in—maybe this is because of my genesis as a Treasury official—was not one of wanting to spend lots more money. I wanted to be sure we were using the resources we had as efficiently and effectively as possible, and I am focused on that right now. I think we can reallocate resources and do things differently and more efficiently to achieve our objectives. I know in the past the Treasury Committee and, indeed, the Treasury itself have encouraged us not to go for more resources. That is on the record from this Committee.

Saying that, if I think—I may be heading in that direction—that there are areas where we need more resources, I will be open in saying so and having a conversation with all stakeholders about it. I am conscious that we want to keep the overall combined resource demand on the system—the FCA, FSCS, FOS and everything else—as manageable as possible, although I sense that the industry in particular is quite anxious on some of these economic crime points to see investment, to reduce the costs they are having to deal with from the consequences of some of that crime.

Q234 **Rushanara Ali:** Charles, I am going to move on to consumer responsibility and a question for you. In her report, Dame Elizabeth noted that “the FCA’s failures of regulation are not excused or mitigated by the risk associated with LCF’s products.” Do you agree with that conclusion?

Charles Randell: I certainly think we need to be as good as we can be. I think we made mistakes in the LCF case. It would be inappropriate for me to engage in what might be called victim shaming by saying that people who bought LCF mini-bonds should have paid heed to the warnings they were given, which included warnings that they were not covered by the Financial Services Compensation Scheme and that they were not products that we regulated.

The fact of the matter is that, in the world in which we operate, we see consumers taking decisions that are not always calm, rational and well-informed. Some of them are very vulnerable when they take those decisions; some of them are taking them on their iPhones, and they are not getting the sort of interaction with advisers that, to some extent, the system had previously perhaps assumed would be part of any serious decision about money. We have to deal with the reality of the world we live in and try to do the best we can within a system in which consumer behaviour is what it is.

At the same time, we need to see what can be done to enable consumers to take better decisions. I don’t think the decision-making pathways that firms have to go through to comply with our rules are always pathways that really give consumers good information that they can act on. We need to be better at that. We have to assume that the long-term task of consumer education and changing consumer behaviour is a very long-term task, and that we have to deal with today.

Q235 **Rushanara Ali:** Do you think her report has a wider bearing on the interpretations of the Financial Services and Markets Act on consumer



responsibility, or do you think it is quite specific to that case?

Charles Randell: There's a debate that will need to be had as we go forward about the position of the FCA in cases where we are not the primary cause of the harm to consumers, but we say we could have done better. Our reading of the intention of Parliament is that, in those cases, we certainly should do better.

We should acknowledge the mistakes we made and we should improve, but there is a specific safety net for consumers that has been created through the Financial Services Compensation Scheme, which is levied upon the industry, and that is really Parliament's expression of the main financial compensation arrangement that exists in this area. There is a potential issue there, but, as I say, I am not in any way trying to escape our responsibility for the mistakes that we made. We made mistakes that we shouldn't have made.

Q236 **Rushanara Ali:** Nikhil, did you want to add anything in response to either of these questions?

Nikhil Rathi: I am really pleased you have raised this topic, because there is the "have regard" in FSMA around consumers taking responsibility for their own decisions. There is then a question of what is the level of regulatory safety that we should be looking to secure for different types of consumers. Coming out of the pandemic, when I look at the numbers I see on vulnerability in our society and our economy—in excess of an additional 1 million vulnerable consumers—my feeling is that that is where our focus needs to be. That is where we need to be devoting our efforts.

Whether we need to be putting the same level of effort into sophisticated consumers and very high net-worth consumers in terms of regulatory safety, or whether you as Parliament feel satisfied that they can take their own decisions, particularly when things are manifest in other areas, that is a conversation that we need to have. I separate this from the specifics of this case, where there have clearly been mistakes, but I think we need to have a conversation around where politically you, as parliamentarians, would like us to strike that balance. Then we can operationalise it in the best way possible.

Q237 **Rushanara Ali:** Certainly, your proposal to Government around the online harms Bill and some of the activity that leaves consumers susceptible would be very welcome. My answer to you would be that ideally we would like to see consumers protected, especially those who are vulnerable, who should be absolutely protected. It came up in the session with Andrew Bailey that too often the FCA can find itself between a rock and a hard place, where you have to protect the big investors, because you are talking about scale of activity, but then the attention can be missed on activity that affects ordinary people. In proportion to their income, they have invested a significant amount, like with LCF, and it has a massive effect. We would like to see both happen. What needs to be done to achieve both outcomes? I suppose I am just running it back at you.



HOUSE OF COMMONS

Nikhil Rathi: I can give you another example where we are in the middle and we are getting it from both sides. On pension freedoms, clearly there has been some concern around the speed at which they have been introduced and the consequences in terms of pension scams. We have taken action with the Pensions Regulator and others, and clearly some quite decisive action around advice for defined-benefit pension transfers. There are many out there who think we have not done enough, or moved quickly enough, and that is a legitimate debate to be had.

There is another significant constituency growing. We get mail from those who say that we have gone too far and we are taking away the right that Parliament has given them to get access to their pension by making these barriers a significant hurdle, that they can't get access to it when they want to and that they are able to take their own decision. Maybe we are striking the balance right because we are getting it from both sides right now on that specific debate. Maybe that is the test as to whether we are successful or not.

Q238 Rushanara Ali: Moving on to complaints and compensation, in the response to Dame Elizabeth's findings on LCF, the FSA's website notes that, "We recognise that this is an uncertain time for bondholders. We will determine complaints against the FCA arising from LCF as quickly as we can. In line with our Complaints Scheme, we will consider all complaints on an individual basis." Can you both quickly run through the complaints process to the Committee and can you tell us about the number of complaints you have received so far?

Charles Randell: We have received a little over 1,000 complaints, and we are in active communication with people who have complained to us; we keep them regularly updated about progress. As a result of the report, I think we are now in a position to start moving forward the assessment of individual complaints and to categorise people according to the various factors that affect how we deal with their complaints. At the end of that process, we will issue a decision to them, which will include as one of the questions that we address whether we should offer them an ex gratia compensatory payment, which is what our complaints scheme provides for.

The complication here is that, at the same time that we are doing this, we have some people in dialogue with the Financial Services Compensation Scheme to see what—if anything—they get from that. At the same time, there are also consumers who are waiting to see what the distribution in the liquidation of LCF is; and then there is a fourth factor, which is the Treasury's own compensation scheme. We need to ensure that these processes are co-ordinated, not least of all to avoid requiring consumers to give the same information again and again and again in order to get an answer, and so that they produce a coherent answer.

Q239 Rushanara Ali: Recognising the points you make about the different schemes that are available, is the co-ordination happening? How many cases have been resolved?

Charles Randell: We have not issued any final decisions on LCF-related complaints. We are continuing to work on them, and we will continue to work as the Treasury develops its own scheme. We need to think very carefully about how those situations fit together.

Our current complaints scheme, which is in essence the one that has been in place for about 20 years, since the Financial Services and Markets Act 2000 was passed, envisages that in cases where there are complaints against the regulators, obviously we will issue apologies when we fell short in what we did. In cases where we are the primary cause of the loss, we will also make compensatory payments—although we have always been clear that those compensatory payments would not attempt to reflect the totality of the financial loss that people have suffered. That is broadly the arrangement that Parliament debated back in 2012 as well.

That is the position, but obviously each complaint needs to be determined on its own merits because people will have had in each case a different interaction with the FCA. We are doing that, and that involves listening to all the recordings of the contacts that they had with our contact centre and so on.

Q240 **Rushanara Ali:** Just to clarify, in response to the Chair's letter on the complaints scheme, you noted that "Where payments are made they are on an ex gratia basis and typically modest." Does it follow that the payouts will be modest in relation to LCF complaints, or will they be higher than what is normally provided? Or should we not pre-empt what might happen?

Charles Randell: We aim to have a policy which is consistently applied, and consistently applied according to the experience of the consumer concerned rather than necessarily the profile of the case, because there are many people who have unsatisfactory experiences in cases that are not high profile. But the scheme that we have in place does envisage modest compensatory payments and always has done. Where we are the primary cause of an investor's loss, we will look at making somewhat larger payments for financial loss, but I think each case does need to be determined on its own merit.

Q241 **Rushanara Ali:** How quickly will people hear about their claims against the FCA? Looking to the future, should firms and potentially consumers have to cover the costs of the FCA not performing well, or should it be done in some other way?

Charles Randell: Do you mean by taxpayers? There is probably no one else, is there?

Q242 **Rushanara Ali:** What do you think? Who should pay? On the first point, when can people expect to hear about claims—what is the timeframe? And who should be paying?

Charles Randell: We will be updating people who have complained to us about the progress of their claim. I'm afraid I cannot give you a deadline for the resolution of any particular claim because of the factors that I have

outlined—the need to assess each claim individually—1,000 claims—and to ensure appropriate co-ordination with the other sources of redress that they are seeking. I would be happy to write to you with further detail about what might occur.

Q243 Rushanara Ali: I think it is important to have a general overall timeframe—whether it is six months or a year—just so people have some idea of what is down the track, because some of these things can go on for quite a long time.

Charles Randell: On the funding of the FCA, we are funded through fees from the industry. That is the decision that Parliament has made. We need to work within a budget that is affordable by the industry. As Nikhil said, broadly we think we can do that, and there may be some cases where the industry would welcome us diverting some more resources. I think that is a funding model that works. I would like to consider a funding model across both the FCA and the FSCS where the risk sensitivity of the funding is perhaps a bit clearer, so that the costs for firms that choose to do higher risk activities are more visible in the fee structure than is currently the case.

Q244 Rushanara Ali: That is really helpful. Nikhil, did you have anything to add to any of those questions?

Nikhil Rathi: No, I think Charles has covered the position fairly clearly. The only point I would add is that in any situation where something goes wrong, with hindsight you could have spotted something sooner or asked a question. If you go back to the banking crisis of 2008, there were similar situations. We just need to make sure we have a system that holds us to account for doing our jobs properly but also recognises, if a case goes into enforcement or a firm fails, that we don't operate a zero-failure regime.

Q245 Rushanara Ali: I don't expect you to do that, but we would expect a regulator to spot a financial crisis in the future.

Nikhil Rathi: Absolutely.

Q246 Rushanara Ali: We would hope that you could pick that up.

Charles Randell: The regulator didn't spot the financial crisis last time round. Obviously, had the regulator—

Q247 Rushanara Ali: I would have thought that you would down the line.

Charles Randell: I think the point that Nikhil is making is that, had the regulator been responsible for paying out compensation equal to the entire cost of the bailouts and consumer losses that followed 2008, that would not be a sustainable system. It is a statement of the obvious—without being rude to Nikhil—but it is still worth making.

Rushanara Ali: Absolutely. I can see that that would not be practical.

Chair: Thank you, Rushanara. I think we can all agree on that last point. Can I go to Alison, please?



Q248 Alison Thewliss: Thank you, Chair. I have some questions for Nikhil about the transformation programme. You used the word “ambitious” about the transformation programme. Could you give me a sense of the timescales you are looking at for completing the transformation programme and what you intend to prioritise in it?

Nikhil Rathi: First of all, I would like to separate out the short-term actions that we are taking and will continue to take to deal with the recommendations coming out of LCF consumer investments. I have been through a number of those, and I am happy to go into any amount of detail on them. The transformation programme goes much wider, and there are various things that we are considering.

First, we have a significant investment to make in the integrity of our databases and our technology. I would like to see a significant step change in that, which I think will deliver results in the next 12 to 18 months. That should give us a platform to roll out a more sophisticated use of data and intelligence. We do that in some domains already—for example, for market abuse and market oversight, we have fairly advanced techniques that we use—but we need to be using them much more systematically. To do that, you have to get the basics and the foundations right, and that has to be the priority.

Secondly, on our people, culture and capabilities, you are seeing the changes I am bringing in at the executive level. As they arrive in the coming months, we will be working to continue to build that shift in capabilities through the organisation; inevitably, that will take time. We are also very mindful of a broader agenda, in terms of our location and whether we can be more UK-wide-based, as it were, including in places outside London and the south-east and Scotland, where we have offices already. I would expect to be making significant progress on that as well in the next year or so.

On culture, we will be defining our objectives in a different way. Charles has already talked about how the executive performance management structure is changing; it will change for the coming year, and that will be cascaded through the organisation. Again, I would hope that in the next year, you will start to see results from the changes we are looking to bring in as well.

In terms of a deadline for the transformation programme, this is an important point, which I think is worth talking about with the Committee. We have to get used to a world in which we are constantly being disrupted by something or other. Given the way in which big tech is coming into financial services—over 40 mainstream products from big technology companies, compared with just half a dozen a few years ago—and the changing demographics we have, we need to build a model, an operational platform and a capability that is able continuously to transform and change. I know that is probably not something you want to hear, because you want a deadline, but I think that is how any modern organisation is going to have to equip itself in the years ahead.



Q249 Alison Thewliss: I have a few points to follow up from that. I suppose the first would be about the challenge that you have in regulating 60,000 firms. How does the transformation programme make that more manageable?

Nikhil Rathi: It makes it more manageable by investing more in technology and using data much more effectively than we have before, and making our systems joined up, with the single view of a firm that I talked about earlier, the risk analysis and the machine learning that we also talked about.

We are testing other ideas that are not fully mature yet, but we also want to think about having much a tougher gateway, and potentially a probation period at the gateway, so that when a firm comes in they do not get their authorisation for life, as it were. That is one of the challenges: once you get your authorisation, it is quite hard to remove, because you have to go through quite a detailed investigation process, so we are thinking about whether we can have a period of time to monitor firms, as you would if you were a new employee in a firm. Thirdly, more proactive surveillance capabilities—so, going out and looking for issues that are going wrong, as well as waiting for them to be alerted to us. Those are all the types of things we are looking at.

I would also stress, though, that this has to be done in partnership with a number of other organisations. We are one player, and we have to work with a number of partners across the regulatory system to make this work effectively. My view on this is that I am not particularly precious about what we are doing, because we are dealing with complex objectives. I want us to be working very collaboratively, whether that is with the Pensions Regulator, the PRA, or whoever it may be.

Q250 Alison Thewliss: That is useful to know. You have talked a lot about the need for data, and one of the big issues highlighted in Dame Elizabeth's report was the gaping hole at the contact centre, where data was not being collected, was not being used and was not being passed up the line. I wondered whether you could tell us a bit more about what has changed from that point to now, and what more you are going to do in terms of collecting the correct data and flagging it appropriately so that action can be taken at a much earlier stage.

Nikhil Rathi: You are right to flag this, and it was highlighted in Dame Gloster's report. I think the level of risk we carry in the authorisations function and the contact centre is quite high for our organisation, which is why I have appointed a specific executive director for authorisations with strong operational experience, and they have brought that experience to the exco table, not simply reporting into another exco member. That change will happen later this month.

We have taken further steps—so, within the database of escalation, the issue of financial crime is a specific field that then gets escalated into supervisory teams for further triage and further examination. We have changed our policies around the communication to consumers about FSCS



coverage, to make sure that consumers are not incorrectly assured when there is lack of clarity about whether something is covered or not, and also that they are not incorrectly assured about a firm that is doing unregulated activity, although it has a regulatory badge for another type of activity. Some training has been introduced as well, so those are short-term tactical things. In the more medium term, like all major customer-facing organisations, we are going to have to think about how we use more digital channels—how we can get our information out in multiple ways, as well as relying on people simply calling in.

Q251 Alison Thewliss: One of the other failings of the call centre that Andrew Bailey highlighted was in the morale of contact centre staff. I know that he also highlighted that changes had been made since that point, but he highlighted issues of staff turnover, of people who were phoning in and giving abuse to people who worked there, and a lack of training. If I was to phone up now with an issue, what confidence would I have that that complaint would be correctly addressed and escalated within the staff team? Has that culture within the contact centre changed, as well as at more senior levels within the FCA?

Nikhil Rathi: I spent several hours listening to calls in the contact centre. It was really an eye-opening experience, and I have asked that every senior leader in the organisation does that. They are dealing with such a range of issues across the whole of the FCA's responsibilities, from the vulnerable consumer worried about being incorrectly billed for something to a firm having a problem connecting to a system. There is a very wide range of issues, and very often consumers are phoning us—the majority of calls—about things that are not to do with the FCA. There are other consumer issues that they are concerned about.

I think that those staff do really valuable work. We have to invest further in training and capability. The point around abuse is a serious one. I have looked at the data and it is approximately two cases a week where we have had to ban callers from contacting our contact centre. Obviously, that is two too many. We have support there—mental health first aiders and so on—to help colleagues who have to deal with those situations.

The overwhelming majority of consumers are legitimate consumers who just want to get their issue sorted out, and I think they can generally have confidence that the systems are there to support and escalate. The question then is at the back end—how quickly we can move when these things get escalated through the supervision of the departments.

Q252 Alison Thewliss: What is the current level of vacancies and staff turnover in the contact centre?

Nikhil Rathi: I don't have that data to hand. I think these numbers right now around sickness and absenteeism are very difficult to make judgments about. We are dealing with covid; we have had a 15% to 20% productivity dip, like everybody else operating right now, because of elevated sickness, caring responsibilities and so on, so it is quite hard to give you a precise picture. I am not detecting that there is any sort of



HOUSE OF COMMONS

elevated level of staff turnover relative to the past; in fact, covid has obviously meant that staff movement has been diminished, if anything.

Q253 Alison Thewliss: The latest FCA business plan highlights the expected change to how the FCA will handle intelligence and information. Can you provide the Committee with some assurance today that intelligence such as the Neil Liversidge letter and the so-called “anonymous” letter to authorisations, and calls received in relation to LCF, would be appropriately dealt with going forward?

Nikhil Rathi: Certainly, the system has been put in place for those situations to be logged and to be escalated. There has been an expansion of the whistleblowing team as well. I mentioned earlier that we are piloting the single view of a firm in the area of consumer investments. Those are all changes that have been made; those systems are now operating.

We have also bolstered our risk team and our risk assurance team. I myself, as chief executive, want to be assured around that, and I hope that risk assurance work will give me that satisfaction, so that I can then convey that to you by the end of this year.

Q254 Alison Thewliss: Thank you. Finally, the FCA does not operate a zero-failure regime. Does it need, as part of the transformation, to be more explicit about the limitations of what regulation means and can do, and ask firms to be explicit about that as well?

Nikhil Rathi: Yes, I agree.

Chair: Thanks very much, Alison. Finally, we will go to Mike, please.

Q255 Mike Hill: I want to take a look at the independent investigation of LCF. The FCA asked HM Treasury to undertake this review. The FCA can undertake its own inquiries, under section 74 of the Financial Services and Markets Act 2000. Having now seen the results of Dame Elizabeth’s inquiry, do you still think that the Treasury’s intervention was required? Perhaps Nikhil could go first.

Nikhil Rathi: These were obviously conversations the board was having with the Treasury through Charles. In my understanding, because the issues that were covered by the review by Dame Elizabeth Gloster go beyond the FCA, there were recommendations in there around the regime more generally and around innovative finance ISAs, where we have been doing work with HMRC on the back of the recommendations. It feels as though the Treasury intervention was the appropriate course of action, but Charles is much more steeped in the detail and the history.

Q256 Mike Hill: I thought as much. Charles?

Charles Randell: It is essentially a timing issue that gave rise to this. At the time in March when discussions were taking place about an independent review, there had just been a series of raids and arrests in relation to the firm, and allegations were appearing in the media that we knew things. We were unable to verify what we knew and when we knew it. In particular, Dame Elizabeth’s report makes it clear that Mr



HOUSE OF COMMONS

Liversidge's letter to this day has not been located. So we were struggling to find the evidence of what we knew. Some of the evidence that Dame Elizabeth subsequently gathered, which took her team a number of months to gather—such as exactly what the content was of various calls into the contact centre and so forth—was all in preparation.

If we had had a couple more weeks, the board might well have been able to take a decision to commission a review under section 73, but it was clear at the point that we reached in late March, or right at the beginning of April, that this review needed to be gotten under way. There were serious issues of public confidence involved, but, as Nikhil also indicated, there were some issues that went much wider than the financial regulatory system and included the incentives that people have to buy very high-risk products under the innovative finance ISA policy, for example. That was why the board decided that we should without delay write to the Treasury in the form that I did. I spoke to senior Treasury officials and said, "This seems to us the best way forward", and they agreed it was the best way forward, so that's what we did. I wrote to Nicky Morgan, now Baroness Morgan, on 2 April 2019 setting out the precise reasoning for the course of action that we adopted.

Q257 Mike Hill: Given the circumstances, that is understandable to people. Do you think, Charles, it would be of benefit if section 73 could be reformed to allow the FCA board greater scope to undertake these types of investigations in the future?

Charles Randell: We have a variety of ways that we can investigate the actions of the FCA. We do a variety of internal reviews in some cases. In other cases, we appoint reviewers outside the statutory framework, and sometimes we find ourselves within the statutory framework. I don't believe we need more powers to appoint reviewers than we currently have. I think it was important that the LCF case should be a statutory review, given its significance and its scope, but in cases where it would be of benefit to the system to appoint an independent review, we are able to do so, I think. LCF was an unusual case in that the issues that the SFO was looking at really could be looked at quite separately from the issues that Dame Elizabeth needed to look at. What was interesting about Dame Elizabeth's case was the fact that she was able—when she was first appointed, I was very concerned that there might be a clash with the criminal investigation, but in the event that proved not to be the case.

Q258 Mike Hill: Earlier, Nikhil talked about how operational improvements are being made and the need for that. Charles, in her investigation, Dame Elizabeth faced a number of challenges with the FCA, to be polite—for example, providing information late or suddenly finding additional material. Why was this?

Charles Randell: Bluntly, I think over a very long period of time there had been an under-investment in the FCA's processes and systems, and Andrew Bailey recognised that when he arrived in 2016. The programme to remediate that is continuing and, as Nikhil says, we have a critical moment in the next few months, when we finally exit a data centre that



HOUSE OF COMMONS

has acted as a constraint on our ability to make technology change, to move into the cloud and to have a fit-for-purpose set of technology resources going forward.

It was really disappointing to me to have to inform Dame Elizabeth of our finding additional documents. We did a very large audit to ensure that we had given her everything that she should expect to have, and there were some additional documents that were found. Now, that is not acceptable, but, in my experience of having practised as a commercial lawyer in private practice, I would say it is not entirely unusual in large organisations, as you reach the final stage of an investigation and do a data audit, to find that there are some more documents. However, it is still disappointing to me, and the thing that is more disappointing is the delays in the provision of information that we should have been able to provide more swiftly.

I regularly encountered the team that were working on this around the building at 12 Endeavour Square at 10 o'clock or 11 o'clock at night, so it was not any lack of effort on their part, but we did fall short. That is why I apologised to her, and I am grateful to her for the fact that she worked with us as best she could to complete her review as quickly as she could, given our performance.

Q259 Mike Hill: I am grateful for what you have just said there, because that comprehensively covered what I was going to ask about data retrieval and IT. Nikhil, is that something you have picked up on and moved forward with?

Nikhil Rathi: Yes. Our systems need to get better and our record-keeping needs to get better. As we move out of our data centre into a newer platform, we will have the ability to operate at scale in a way that we did not before. That has been a significant project running for many years before my arrival, so I think that will lead to a decisive shift.

Q260 Mike Hill: Thank you very much. Finally, one last question: the FCA is conducting its own investigation to determine whether LCF's collapse was caused by serious misconduct by individuals and third parties linked to the firm. What kind of timescales do you have for completion, and what are the next steps in that?

Nikhil Rathi: We put out an update on our website at the end of last week, 26 February, for LCF investors. We are very grateful to those investors who have shared with us information and questions. You will be aware that the SFO has an investigation under way as well. It is important that we do not prejudge the outcome of those, so I am afraid I cannot give you a definitive deadline, but you can be assured that this is being given really serious focus and that the appropriate lines of inquiry are being pursued proactively and vigorously.

Mike Hill: Understood. Thank you very much, gentlemen, and thank you, Chair.

Chair: Thank you, Mike. That brings us to the end of this session. May I



HOUSE OF COMMONS

thank you both, Nikhil and Charles, very much indeed for appearing before us this afternoon? I think it is fair to say that you have faced some very uncomfortable questions, but none the less we are grateful for the helpful and open answers that I think you have given us to those questions. I wanted to let you know that, while we are of course interested in the history of what has happened and particularly in establishing the lessons that need to be, and indeed in many cases probably have been, learned as a consequence, we are equally interested in considering the future and in doing whatever we can as a Committee to ensure that, with yourselves, we arrive at as positive an outcome and learning exercise as we all possibly can from what has happened. We are here to challenge, but as a Committee, ultimately, we are here willing you to succeed, because that matters for many, many people up and down the country. Thank you once again for appearing before us. That concludes this session.