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Rt Hon Mel Stride MP
Chair
Treasury Select Committee
House of Commons
London
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BY EMAIL (treascom@parliament.uk)

8 February 2021

Dear Mr Stride,

Re: Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc

In order to assist the Committee's ongoing evidence gathering in connection with the collapse of London Capital & Finance plc ("**LCF**"), I wish to raise two points arising from Mr Bailey's evidence before the Treasury Select Committee (the "**Committee**") this afternoon.

The representations made by Mr Bailey

During the course of Mr Bailey's evidence, you asked him about the Maxwellisation process and whether he regretted representations he made that there should be no findings of individual responsibility within my report. In response, Mr Bailey stated that there had been a "*fundamental misunderstanding*" and then appeared to suggest that his representations were limited to the need to clarify any perceived ambiguity in my draft report regarding personal culpability and responsibility.

To ensure the Committee has the full background on this point, I have enclosed with this letter the relevant extract from Mr Bailey's representations (as Mr Bailey noted, such representations being made on his behalf by Andrew Green QC). As you will see, Mr Bailey's primary assertion was that my report should "*delete the reference to 'responsibility' resting with specific identified/identifiable individuals, whether the Executive Directors of Supervision or Mr Bailey*" (part of this quote appeared at paragraph 11.1 of Chapter 1 of my final report).

Mr Bailey's representations then go on to list various reasons in support of the request to remove references in my draft report to responsibility resting with specific individuals. In summary, these reasons were (in the order set out in the representations):

- The Direction setting out the scope of my investigation did not require attribution of responsibility. As you will see, Mr Bailey's representations on this point stated: "*While it is accepted that para 3(2) of the Treasury Direction permits the Investigation to "also consider any other matters which they may deem relevant to the question of whether the FCA discharged its functions", no benefit arises (and the draft report's findings and conclusions are not strengthened) by the attribution of responsibility to particular individuals – whether Mr Bailey or the Executive Directors of Supervision. This is a freestanding reason for the removal of the references to Mr Bailey's responsibility.*"
- There was an inherent ambiguity in the use of the word "*responsibility*" and that, on the basis of the draft report, it was not clear whether I was suggesting that Mr Bailey was personally culpable for particular issues.

- The wording of the draft report could suggest that there was a causal link between Mr Bailey’s actions or inaction and the subsequent losses suffered by LCF bondholders.

Mr Bailey’s representations on this issue separately invited the investigation to “*bear in mind that the attribution of responsibility to [Mr Bailey] is likely to have the consequence of his being singled out for blame once the final report is published.*” The final paragraph on this point in the representations requested that, in the event that the investigation disagreed with Mr Bailey’s primary position that references to individual responsibility should be deleted, the final report should make clear that the investigation “*is not making findings that acts or omissions of Mr Bailey caused the regulatory failings*”.

To the extent that Mr Bailey’s evidence was that his representations to me were limited to requesting a distinction between personal culpability and responsibility (which was my understanding of his evidence today), I must disagree. I also reject his suggestion that there has been a “*fundamental misunderstanding*” on this issue. As will be clear from the extract from Mr Bailey’s representations enclosed with this letter, Mr Bailey’s primary position in those representations was that references to him (or any other individual) having personal responsibility for the FCA’s regulation of LCF should be deleted. The distinction between personal culpability and responsibility was merely one argument in support of that position.

“Broken machine”

During the course of Mr Bailey’s evidence this afternoon, I think he may have inadvertently suggested that it was I who referred to the FCA as a “*broken machine*”. My report does use the term “*broken machine*” in paragraph 4.1 of Chapter 8. However, as the relevant footnote explains, this was a comment made by Mr Bailey in an interview on 28 August 2020 to describe the state of the FCA when he joined in 2016.

References to fraud

There were various discussions regarding fraud during my appearance before the Committee last week. I wish to make clear that any references to fraud were general in nature. Given the ongoing criminal and regulatory proceedings, I want to be clear there have been no findings of fraud (or other wrongdoing) in the LCF case. At this stage, only allegations of fraud and wrongdoing have been made in connection with LCF. In the circumstances, I would ask you to consider adding appropriate disclaimers to the video and transcript of my appearance before the Committee.

I hope the above information is of assistance to the Committee. I do not consider that the contents of this letter or its enclosure contain any confidential information and, as such, I do not object if the Committee determines that it would be appropriate to publish this letter (as the Committee did with my earlier correspondence with the Committee).

Yours sincerely,

Elizabeth Gloster

Rt Hon Dame Elizabeth Gloster

Encl.

RELEVANT EXTRACTS FROM THE REPRESENTATIONS ON BEHALF OF MR BAILEY

SPECIFIC CRITICISMS OF MR BAILEY

(1) 'Responsibility' of the CEO

20. The draft report states, in various places, that “*responsibility*” for the failure to implement operational change to address Perimeter issues rests with “*the CEO*”. In particular (emphasis added):

20.1. Chapter 5, para 1.7(d) states: “*Section 6 explains that, despite the awareness of the issues described in paragraph 1.5 above, the FCA’s senior management failed to implement operational change at lower levels of the organisation. The FCA’s failures of regulation in respect of LCF, which were associated with its approach to the Perimeter, accordingly occurred nonetheless. Responsibility for this failure rests with the CEO and ExCo.*” Footnote 237 states: “*In this context, the Investigation is referring to Mr Bailey.*”

20.2. Chapter 5, para 6.3 states: “*The Investigation has concluded that responsibility for the lack of operational change described above rests, in the first instance with the Executive Directors of Supervision, but ultimately with ExCo and the CEO. As the papers described above demonstrate, ExCo was the body before whom issues connected with the FCA’s approach to the Perimeter repeatedly came. However, as also described above, despite the repeated attention and navel gazing by ExCo over the years about Perimeter problems, this failed to result in a practical operational change sufficient to prevent failures in respect of LCF associated with the FCA’s approach to the Perimeter described above.*” Footnote 279 states: “*The FCA’s description of the CEO’s responsibilities include: “The Chief Executive Officer is responsible for implementing the strategy agreed by the Board in the formulation of which they will have played a major part” and “communicating throughout the FCA the strategic objectives and the values of the FCA agreed with the Board, and ensuring that these are achieved in practice”* (emphasis added).”

20.3. Chapter 5, para 8.2 states: “*However, despite the above awareness, there was a lack of operational or practical change at lower levels of the organisation. Accordingly, the failures in respect of the FCA’s regulation of LCF arising out of the FCA’s approach to the Perimeter occurred nonetheless. Responsibility for the lack of operational change rests with ExCo and Mr Bailey.*”

20.4. Chapter 11, para 2.12 stated: “*Responsibility for the failure in respect of the FCA’s approach to its Perimeter rests with ExCo and Mr Bailey.*”

21. The Investigation is respectfully requested to delete the reference to “*responsibility*” resting with specific identified/identifiable individuals, whether the Executive Directors of Supervision or Mr Bailey. This is for the reasons set out below.

22. First, the scope of the Investigation, as set out in para 3 of the Treasury Direction, does not require the attribution of “*responsibility*” to particular individuals within the FCA, but rather is directed at whether the FCA (as an organisation) “*discharged its functions*”. Given that investigations of this type are generally directed at identifying “*lessons learned*” following a

high-profile financial failure, it is normal for such investigations to focus on identifying institutional rather than individual failures. It is for this reason that the terms of reference of such investigations do not generally invite the investigator to make findings of individual blame. While it is accepted that para 3(2) of the Treasury Direction permits the Investigation to “*also consider any other matters which they may deem relevant to the question of whether the FCA discharged its functions*”, no benefit arises (and the draft report’s findings and conclusions are not strengthened) by the attribution of responsibility to particular individuals – whether Mr Bailey or the Executive Directors of Supervision. This is a freestanding reason for the removal of the references to Mr Bailey’s responsibility.

23. Secondly, there is an inherent ambiguity in the use of the word “*responsibility*”. In particular, it is unclear from the passages quoted above whether the draft report is using the word “*responsibility*” as meaning that: (1) responsibility in an organisation rests “*ultimately*” with its CEO (cf Chapter 5, para 6.3), and that Mr Bailey bears responsibility in that sense; or (2) Mr Bailey is personally culpable because of his particular knowledge of particular problems at particular points in time and his failure to address those problems - and so bears responsibility in that (very different) sense.

23.1. Insofar as the draft report is making the point in (1) above, Mr Bailey freely accepted in interview, “*As the Chief Executive I had responsibility for everything*”.¹ If the Investigation wishes to make a finding of that more limited nature, it is respectfully invited to make that clear by the wording it uses e.g. “*As the CEO of the FCA in the period from June 2016 to March 2020, Mr Bailey bears ultimate responsibility for this failure.*” (in the draft report, although the word “*ultimately*” does appear in Chapter 5 para 6.3, it is absent from the other paragraphs quoted above). Otherwise, there is the very real possibility that those reading the final report will seek to attribute responsibility to Mr Bailey in a sense that is not intended by the Investigation i.e. that of personal culpability.

23.2. Insofar as the draft report is making the point in (2) above (i.e. “*responsibility*” in the sense of personal culpability), then the foundational basis for any such finding is not clear from the draft report – and has not been properly formulated and put to Mr Bailey for his response.² In particular:

23.2.1. The draft report makes only limited findings about what Mr Bailey knew at particular times, and does not set out detailed findings about what he personally did or tried to do at particular times, or what specific acts or omissions of his are worthy of criticism and why. Nor is there consideration of what other issues were competing for his time and attention at particular times; see General Points of Context above.

23.2.2. No particularised allegation of personal culpability has ever been put to Mr Bailey by the Investigation, and the draft report does not set out sufficient detail of the “case against him” to allow him to address it.

¹ Mr Bailey’s interview, 28 August 2020, p.31, line 4.

² As to the legal duty to properly formulate and put criticisms to a person before publishing a report, see ‘A Review of Maxwellisation’, commissioned and published by the Treasury Select Committee in November 2016, and particularly paras 52-56 and the cases cited therein.

23.2.3. If the Investigation does intend to make a finding of personal culpability on the part of Mr Bailey, fairness requires the factual basis for that finding to be put to him in detail and for him to be given a further opportunity to comment.

23.2.4. It is also important to note that the draft report, when considering the extent to which “*responsibility*” for certain failings should be attributed to one of the Executive Directors, observes that (Chapter 11, footnote 734) “*in reality someone with the broad portfolio and seniority of [the Executive Director in question] is unlikely to have been aware of the points of detail described above... This in practice limits the extent to which [the Executive Director] is responsible for the above failings.*” The same point applies (with even greater force) to Mr Bailey who was head of an organisation which was beset with problems and was himself enormously stretched. Any attribution of personal culpability could not fairly be made without a detailed consideration of the various matters being dealt with by the CEO over the relevant period.

23.2.5. A specific example of the unfairness of attributing personal culpability to Mr Bailey without properly formulating or putting to him particular criticisms appears in the context of Chapter 11, para 2.12, which states: “*The unclear Contact Centre policy documents described above are an example of this broader deficiency in the FCA’s approach to its Perimeter and of the failure to ensure appropriate operational change at lower levels of the organisation (in this instance the Contact Centre). Responsibility for the failure in respect of the FCA’s approach to its Perimeter rests with ExCo and Mr Bailey*”. It was never put to Mr Bailey in interview that he was aware of the lack of clarity with these documents (which he was not), or that he was somehow responsible for this lack of clarity (a point which would be surprising given the Investigation’s acknowledgement that a member of senior management is “*unlikely to have been aware of the points of detail*”); but yet the paragraph ends attributing responsibility to him.

24. Thirdly, certain wording in Chapter 5 suggests (or might be taken to suggest) that there was a causal link between what Mr Bailey did (or failed to do) and the specific failures of regulation in relation to LCF, with the consequent loss suffered by the Bondholders. However: (1) the draft report does not contain the underlying causation analysis which would be necessary to justify such a finding; and, furthermore, it follows that the analysis necessary to support such a finding has not been formulated and put to Mr Bailey for his response; and (2) to attribute “*responsibility*” to Mr Bailey in these circumstances carries with it the real possibility that the report will be represented as finding that Mr Bailey caused the losses suffered by LCF bondholders (which would plainly be unfair). In particular:

24.1. The relevant wordings are as follows: (1) in Chapter 5, para 1.7(d) (emphasis added): “... *senior management failed to implement operational change at lower levels of the organisation. The FCA’s failures of regulation in respect of LCF, which were associated with its approach to the Perimeter, accordingly occurred nonetheless. Responsibility for this failure rests with the CEO and ExCo*”; (2) in Chapter 5, para 6.3: “... *this failed to result in practical operational changes sufficient to prevent the failures in respect of LCF associated with the FCA’s approach to its Perimeter*”; and (3) in Chapter 5, para 8.2: “... *there was a lack of operational or practical change at lower levels of the organisation. Accordingly, the failures in respect of the FCA’s regulation of LCF arising out of the FCA’s approach to the Perimeter occurred nonetheless*”. *Responsibility for the lack of operational change rests with ExCo and Mr Bailey.*”

24.2. The failures of regulation of LCF which the draft report finds to be “*attributable to the FCA’s approach to the Perimeter*”, and which there were insufficient operational changes “*to prevent*”, are identified in Section 3 of Chapter 5 (paras 6.1 & 6.3). They include the failure to pursue allegations of fraud or serious irregularity; the failure to pursue red flags in LCF’s financial information; and the failure to respond to LCF’s repeated breaches of financial promotions rules by considering LCF’s business as a whole.

24.3. It is one thing to find that senior management ought to have done something about Perimeter problems, but another to specify what they should have done, given the knowledge they had. In order to establish causation, it would be necessary to analyse (1) what specific operational changes they should have brought about; (2) when those changes should have been in place; and (3) what (if any) effect those changes would have had on the LCF case.

24.4. The draft report does not make detailed findings about what specific steps should have been taken at senior management level. It therefore cannot, and does not, analyse by when those operational changes should have been in place, or what (if any) difference those changes would have made to the various decisions made by front-line staff in relation to LCF.

24.5. The timing issue is particularly relevant to Mr Bailey. For example, the First VOP Application was submitted on 14 October 2016 (just 3 months after Mr Bailey became CEO) and approved on 13 June 2017 (less than a year after he became CEO).³ Any Perimeter-related failings in relation to that application undoubtedly took place on Mr Bailey’s “watch”, but it cannot fairly be said that those failings resulted from a lack of operational change for which he was “responsible” without identifying changes that he can be criticised for not having put in place before the relevant decisions on the First VOP Application were made, and which would have made a difference to those decisions.

25. The Investigation, in considering the request to remove the reference to Mr Bailey’s “*responsibility*”, is respectfully invited to bear in mind that the attribution of responsibility to him is likely to have the consequence of his being singled out for blame once the final report is published.

26. If, notwithstanding the above, the Investigation intends to retain the word “*responsibility*”, it is respectfully requested that the final report makes clear that the Investigation is not making findings that acts or omissions of Mr Bailey caused the regulatory failings (or, *a fortiori*, caused the bondholders’ losses), and to modify the wording quoted above which suggests, or might be taken to suggest, the contrary.

³ Chapter 8, para 6.1.