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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)

25 March 2021

Dear Mr Stride,

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

Thank you for providing a copy of Mr Bailey's letter to you of 22 March 2021. This letter addresses certain points made in the note enclosed with Mr Bailey's letter under the headings: "*The use of the term 'responsibility'*" and "*Broken Machine.*"¹ For ease of reference I use these headings below.

The use of the term 'responsibility'

1. There are two points I wish to address which arise from this section of Mr Bailey's note:
 - (a) Mr Bailey's explanation of what he had intended by his representations; and
 - (b) Mr Bailey's apparent suggestion that he was not given a fair opportunity to respond to an alleged "*criticism*" that was only in the final report and not in the draft report.

Mr Bailey's explanation of his representations

2. The note enclosed with Mr Bailey's letter states:

"In my view, it was therefore wrong to name individuals in the draft report as it then stood because this would inevitably result in misinterpretation, leading to unjustified accusations of personal culpability. As you have seen from the extract of my representations provided by Dame Elizabeth, I did include the point that naming individuals was not a requirement of the terms of reference, and that this was a free-standing point – in other words, its validity was not specific to my representations about clarity on responsibility. However, I would not have been compelled to make this point if the draft report had been clearer. I would also note that in Paragraph 23.1 of my representations I suggested language that could capture my responsibility as CEO which involved naming me, so I find it hard to understand how my use of the free-standing point on naming could be interpreted as unconditional."

3. For sake of completeness, the "*free-standing*" representation made by Mr Bailey was at paragraph 22 of his representations and read as follows (I have included paragraph 21 of Mr Bailey's representations below as it provides the necessary context and, for ease of

¹ I do not make any comments in relation to the other points in Mr Bailey's note other than to emphasise that the figures for calls to the Contact Centre that are included in Section 3 of Chapter 5 of my report were provided to the Investigation by the FCA and the Investigation did not attempt independently to verify those figures.

reference, I have attached again the full extract of Mr Bailey’s representations on the issue of responsibility):

“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.” (Emphasis added.)

4. Mr Bailey’s point appears to be that, if my draft report had not contained the ambiguity suggested by him in relation to use of the word “responsibility”, he would not have been “compelled” to make the representation that my report should delete references to individual responsibility and should, instead, focus solely on institutional failures (i.e. the failures of the FCA as a whole). I disagree with Mr Bailey for two reasons:
 - (a) First, although I was prepared to address Mr Bailey’s concern, I did not consider that my draft report was in fact ambiguous in the use of the word “responsibility”. When read in context, I believe the draft made it clear that responsibility did not mean personal culpability. At no point did the draft report in my view suggest that any of the named individuals were personally culpable. For example, the draft expressly noted that the Investigation considered the ExCo and the CEO had ultimate responsibility for the lack of operational change in the FCA in relation to the Perimeter and a corresponding footnote highlighted the description of the CEO’s responsibilities from the FCA’s Statement of Responsibilities. However, in the light of the various representations that were made regarding “responsibility”, I added wording to ensure there could be absolutely no doubt as to the meaning of responsibility and as to the distinction between responsibility and personal culpability.²
 - (b) Second, I do not follow the logic of Mr Bailey’s point here. Mr Bailey accepts that his first representation on this issue (i.e. that my report should not include reference to individual responsibility because (in his view) the Direction did not require it) was a “free-standing point”. Indeed, as I have highlighted, it was the first (and, in my view, primary) argument in his representations as to why I should delete reference to individual responsibility in the final report. Only after making this point did his representations make the separate argument that alleged uncertainty in the use of the term “responsibility” in the draft report was a further reason that references to individual responsibility should be deleted. I also note that the relevant section of Mr Bailey’s representations concludes as follows:

² See, for example, Section 11 of Chapter 1 of my report.

“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 (Emphasis added.)

Again, the use of the word “notwithstanding” clearly conveyed to me that his primary – and free-standing point – was that the report should make no attribution of “responsibility” to particular individuals within the FCA.

5. At the time I considered Mr Bailey’s representations, I thought (and it remains my view today) that his representations were making the primary argument that references to responsibility of any individuals should not appear in my report (either in the draft or final report) because, in his view, the Direction did not require such findings nor was it expected in these types of investigations. That point was not dependent on or connected to any perceived ambiguity in the way in which my draft report used the word “responsibility” as opposed to culpability. It was, as Mr Bailey admits, a “free-standing point”.
6. These arguments were not limited to Mr Bailey. In fact, the representations on behalf of the FCA made the same point using notably similar language:

*“Whilst these representations are directed at criticisms that have been made in the Draft Report of the FCA as an organisation, the FCA notes that the Draft Report also includes explicit criticism of a number of particular individuals. **Although paragraph 3(2) of HM Treasury’s 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’, the FCA does not consider that any benefit arises in terms of lessons learned (and the Draft Report’s findings are not strengthened) by the attribution of responsibility to particular current or former employees of the FCA.** The Draft Report also does not always clearly outline the temporal limits within the Relevant Period on proposed criticisms of individuals, based on what those individuals knew or had responsibility for at particular times and whether they should reasonably have taken different actions at those particular times. This, in the FCA’s view, risks creating unfairness to those individuals.”⁴ (Emphasis added.)*

Whether Mr Bailey was provided with fair opportunity to respond

7. It is unclear whether Mr Bailey’s note is asserting that he was not provided with a fair opportunity to respond to an alleged “criticism” that arose from changes that I made to the draft report in the light of his representations. His note states that I did not invite him to discuss what he referred to as my “criticism” but in fact was my expression of “disappointment” which I made in the final report regarding his representation that I should not make findings about individual responsibility. The corresponding footnote in Mr Bailey’s note states:

“In the review of Maxwellisation commissioned by the Treasury Select Committee, which reported in 2016, it was stated that the common law requires that a person be given a fair opportunity to respond to criticism prior to its publication in a report. Specifically, on the point of a new criticism that arises from a Representations Process, the review concluded

³ See paragraph 26 of Mr Bailey’s representations.

⁴ Paragraph 10.1 of the representations on behalf of the FCA.

that it is appropriate to seek the response of the subject of the proposed criticism if that person has not previously had a fair opportunity to respond to it.”

8. The relevant chronology of events is as follows:

<u>Date</u>	<u>Event</u>
Early October 2020	My team arranged for various individuals (including Mr Bailey) to have electronic access to my draft report for the purposes of the representations process.
30 October 2020	Mr Bailey’s legal representatives provided written representations in relation to criticisms in my draft report.
23 November 2020	I delivered my report to the FCA following consideration of all the representations made by those criticised in the draft report.
24 November 2020	My team uploaded the report as delivered to an electronic platform to which Mr Bailey, the FCA and others had access from that date.
25 November 2020	Mr Bailey’s legal representatives were given access to the delivered report on the electronic platform.
7 – 10 December 2020	I received comments from an employee at the FCA on the accuracy of certain factual statements in the delivered report. I considered those comments and, as a result, made certain minor amendments to the report.
10 December 2020	Following certain minor amendments to the report by my team (as described above and in the Legal Disclaimer section of the published report), my team submitted a final PDF copy to the FCA for onward transmission to HM Treasury for publication and printing.
17 December 2020	HM Treasury published my report. In advance of publication, it was known by the FCA (and it is to be presumed, also by Mr Bailey), that the likelihood was that HM Treasury would be published on this date.

9. Even if the changes to my report could be characterised as a new “*criticism*” of Mr Bailey,⁵ the chronology above demonstrates that he had a fair opportunity to respond to that criticism prior to the report’s publication. Mr Bailey would have been able to access my “final” report on 24 November 2020 (and his legal representatives were provided with access on the following day) which was over two weeks before the final PDF was sent to HM Treasury for publication and over three weeks before actual publication. I consider that this was more than sufficient time to respond to any perceived new criticisms. You will appreciate that Mr

⁵ A point which I do not necessarily accept in circumstances where my delivered report simply referred (in one instance) to my disappointment with the submission made by Mr Bailey and others that my report should not make findings about individual responsibility for the FCA’s deficiencies in regulating LCF. My report quoted some of the representations on this issue and explained why I disagreed with the points made. My report also stated: “*In expressly referring to a particular representation, the Investigation makes no criticism of the individual, group or organisation that made it; they were perfectly entitled to make any representation that they saw fit. Dame Elizabeth found the representations process to be a helpful exercise.*”

Bailey had submitted his representations on the entire draft report within a window of just over three weeks in October 2020. Further, I was working to a very tight timeframe at that stage. The Committee will be aware of the significant delays to the delivery of my report caused by the FCA's inability to provide my team with the necessary documents and information. The time period in which Mr Bailey could have responded to any perceived new "criticism" need to be viewed in that context.

10. Mr Bailey accepted, when questioned by you during his appearance on 8 February 2021, that he had access to the report before it was published. The relevant extract from the transcript is as follows:

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

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

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

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

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

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

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

Andrew Bailey: Having got this quite unexpected reaction, feeling that she had been unreasonably lobbied to make a point that had not been made, I felt that there was a real risk that lobbying again would make it worse. I would much rather just explain it. I cannot tell you that it is anything other than disturbing to me that this matter has had some public attention. If I had tried to, in some sense, resile from being named unconditionally, that would have been deservedly brought down upon me. I am sorry about this, but it has been a difficult point in this process."⁶

11. Mr Bailey appears to acknowledge that he could have written to me after reviewing the report and in advance of publication, but that he chose not to do so on the advice of his QC and for fear that any such representations could somehow make the situation worse. I would have been more than prepared to have received, and reviewed, any such further

⁶ See: <https://committees.parliament.uk/oralevidence/1692/html/>.

representations and given due consideration to them (as I did with all the representations and comments I received, including others made at the same late stage).

12. In this regard, I want to emphasise that, between 7 and 10 December 2020 (i.e. in between delivery of my report to the FCA on 23 November 2020 and publication), the FCA did pass on correspondence from an employee who had been provided with access to the delivered report and who was concerned about the accuracy of certain factual statements. I considered this individual's concern and, as a result, made minor amendments to my report. Mr Bailey could have done a similar thing.
13. In the circumstances, I reject any suggestion (to the extent it is being made) that Mr Bailey did not have a fair opportunity to respond to my expression of disappointment prior to my report's publication.

Broken Machine

14. I do not think there is any disagreement on this point. My letter of 8 February 2021 was simply making the discrete point that, as my report made clear, it was quoting Mr Bailey when it used the term "*broken machine*". This was in response to Mr Bailey's statement to the Committee during his appearance on 8 February that: "*In the report, Dame Elizabeth described the FCA that I inherited as 'a broken machine'. Those were her words.*"⁷ (Emphasis added.)
15. Mr Bailey is correct in his note of 22 March 2021 that the context in which my report uses the phrase "*broken machine*" does not suggest that I considered it to be an inaccurate description of the state of affairs when he joined in 2016. I was simply making the point that those words were his and not mine.

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 considers that it would be appropriate to publish this letter.

Yours sincerely,

Elizabeth Gloster

The Rt. Hon. Dame Elizabeth Gloster DBE

Encl.

⁷ See Mr Bailey's response to Q68: <https://committees.parliament.uk/oralevidence/1692/html/>.

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.