HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number 8550, 24 December 2020

London Capital & Finance

By Steve Browning

Contents:

1. Mini-bonds and failure
2. Scope of investigations
3. Findings from the FCA investigation
4. Compensation for bondholders
5. Parliamentary activity

Contents

Summary **3**

1. Mini-bonds and failure **4**
1.1 Further information and advice 5

2. Scope of investigations **7**
2.1 Serious Fraud Office 7
2.2 Financial Conduct Authority 7
Delays to the reporting date 8
2.3 Financial Reporting Council 9

3. Findings from the FCA investigation **10**
3.1 Recommendations 11
For the FCA 11
For HM Treasury and the Government 12
Reaction to the findings 12

4. Compensation for bondholders **15**
4.1 Financial Services Compensation Scheme 15
4.2 Further compensation initiatives 16

5. Parliamentary activity **18**

Cover page image copyright: Image by PixArc from Pixabay

Summary

11,625 bondholders invested about £237m in the products sold by London Capital & Finance Plc (LC&F). LC&F failed in January 2019. The administrators estimated in March that investors might only get 20% of their investment back.

Individuals at LC&F are being investigated by the Serious Fraud Office. The Government launched an independent investigation into how the Financial Conduct Authority (FCA) regulated 'mini-bonds' and supervised LC&F. Most recently, the Financial Reporting Council announced an investigation of the audits of LC&F over the relevant period.

Mini-bonds are a way of raising finance – generally by less established firms – with higher levels of risk and interest. They are also 'illiquid', because they can't be sold on before they mature.

A complication of the case is that 'mini-bonds' were not themselves regulated by the FCA, but giving financial advice about them was.

The Financial Services Compensation Scheme is reviewing bondholders' experiences and potential eligibility for compensation. In 2020 it paid compensation to some investors who had switched stocks and shares ISAs to LC&F mini-bonds. It also faced a judicial review of its approach to compensation.

In December 2020, the report from the independent investigation was published. It was strongly critical of the FCA's approach, contending that the regulator had failed to fulfil its statutory objectives. For instance, it had inadequately considered issues beyond its "regulatory perimeter" or concerns raised about LC&F. The report made 13 recommendations to the FCA and to the Government, all of which have been accepted.

The Government announced that the combination of circumstances was such that it would establish its own compensation scheme for LC&F bondholders – a somewhat exceptional response. But there have been calls for further scrutiny and some criticism of the exclusion of "personal culpability" from the review.

1. Mini-bonds and failure

LC&F went into administration on 30 January 2019, following a series of interventions by the regulator, the Financial Conduct Authority (FCA). The FCA had found LC&F's advertising to be "misleading, not fair and unclear", and so ordered the firm to withdraw all of its marketing materials on 10 December 2018. Because of "serious concerns about the way the firm was conducting its business", the FCA also ordered LC&F to cease conducting all regulated activity on 13 December 2018.[1] Among other inappropriate or misleading representations, LC&F was marketing its 'mini-bonds' (the product it sold to investors) as eligible for inclusion in ISAs when they were not.[2]

What are mini-bonds?

Many companies raise funds by issuing bonds, typically through stock markets and to corporate investors. The company pays interest based on assessment of risk. Smaller or less-established companies are unlikely to be able to use such approaches, so they may choose to issue mini-bonds. While the basic principle is the same, mini-bonds are sold direct to investors. They will typically involve lower levels of initial investment and are likely to offer higher rates of interest.

But they are 'illiquid' investments because unlike corporate bonds they can't be sold on before they mature. While the higher interest rates may make them attractive, the added risks and lack of liquidity mean that investors may lose their money. In addition, their sale is not regulated by the Financial Conduct Authority and investment in them ins not protected by the Financial Services Compensation Scheme.

The Financial Times has published a useful overview of mini-bonds.

As at December 2018, 11,625 bondholders had invested around £237m in LC&F products.[3] That money was then lent by LCF to a small number of borrowers. As of 25 March 2019, the administrators estimated a return to the Bondholders from the assets of the Company of as low as 20% of their investment.[4]

The administrators highlighted major discrepancies between the way LC&F presented itself to investors and the reality of their operations:

- There are concerning connections between people currently or previously involved with LCF and people currently or previously involved with the Borrowers and subBorrowers.
- The fact that c£236m of Bondholder monies has been lent by LCF to a small number of Borrowers and sub-Borrowers shows a lack of the spread of risk that one would expect from a professional portfolio manager. It is especially concerning that c£122m was lent to one Borrower, notwithstanding that Borrower on-lent a large proportion of that money to a number of sub-Borrowers.

1 FCA, London Capital and Finance Plc enters administration, 5 November 2019
2 FCA, Second Supervisory Notice to London Capital & Finance plc, 17 January 2019
3 Smith & Williamson, Administrators' report, 25 March 2019, p7
4 Ibid., p5

> - The Bondholders believed that their money was being lent to a wide portfolio of UK small and medium sized enterprises ('SMEs') but they now find that it has been lent to a small number of complex businesses with substantial risk profiles and which are often dependent on foreign and/or exotic (such as oil & gas) assets.[5]

They also noted that the bondholders are very concerned:

> - that they have been characterised as sophisticated lenders when, in reality, they are often people who have invested their life savings in LCF financial products for the best possible return. The Bondholders are very upset that the boards of directors of the Borrowers and sub-Borrowers have viewed them as investors with an interest in investments with high risk profiles.
> - that LCF was planning to engage in debt for equity swaps with the Borrowers and sub-Borrowers, using the monies lent by the Bondholders. The Bondholders had seen no evidence in any of the Information Memoranda indicating that Bondholder monies might be used in this way.
> - that there are corporate transactions involving the Borrowers and sub-Borrowers which involve companies with similar names, frequent name and accounting date changes, Companies House strike off notices and the same individuals.[6]

The administrators confirmed that they would "take the appropriate legal actions against any and all parties which are found to have caused loss to the Bondholders through any improper actions".[7]

The collapse of LC&F has led to various investigations, as discussed in the following sections.

- The Financial Services Compensation Scheme considers whether investors are entitled to compensation, and if so, how much.
- The Financial Conduct Authority has worked with HM Treasury to establish an independent investigation into its own role and wider questions relating to mini-bonds.
- The Serious Fraud Office investigates criminal activities associated with the case.

1.1 Further information and advice

The following websites provide information about developments in the case and investigations (and may be more up to date than information provided in this briefing):

- The Financial Services Compensation Scheme manages a webpage that publishes developments in the LC&F case (including an email service for updates), as well as wider questions and answers.
- The Financial Conduct Authority has published a general overview of the case with links to the various investigations and sources.

---

5 Smith & Williamson, Update to Bondholders, 21 February 2019, p5
6 Smith & Williamson, Update to Bondholders, 21 February 2019, p6
7 Ibid.

- The Serious Fraud Office has a case page, which includes updates for investors.
- The independent investigation has a webpage with an overview of its work, including the full report.
- Smith & Williamson have a webpage with an overview of the progress of the administration.

2. Scope of investigations

2.1 Serious Fraud Office

The Serious Fraud Office (SFO) announced on 18 March 2019 that it had opened an investigation into individuals associated with London Capital & Finance Plc. Four individuals were arrested in Kent and Sussex on 4 March 2019. They were then released pending further investigation, as was another person arrested in Sussex on 19 June.[8] The SFO is working in conjunction with the FCA.

In August 2019, the SFO appealed to all investors in LC&F (and to anyone who thought they might have invested) to complete an online questionnaire to support the investigation.

2.2 Financial Conduct Authority

As the scandal unfolded, concerns arose about the speed and scale of the FCA's own response to emerging evidence, with some claims that independent financial advisers had contacted the regulator about LC&F's activities up to several years before it took any action.[9]

An important issue for the FCA is that of its "regulatory perimeter", which constrains what it can do. In the case of LC&F, **selling** mini-bonds was not a regulated activity, but **advising** consumers to buy them would have been.

On 1 April 2019, the Government ordered an independent investigation into the regulatory supervision of LC&F and the regulation of mini-bonds. It published a more detailed Direction on 23 May.

The Financial Conduct Authority published further details of its investigation in July:

> On 23 May 2019, following a request from the FCA's Board, the Economic Secretary to the Treasury directed the FCA to carry out an independent investigation into the circumstances surrounding the collapse of LC&F. At the same time, the Treasury announced its approval of the proposed appointment of Dame Elizabeth Gloster to lead the Investigation. While her appointment was being finalised, Dame Elizabeth signed an agreement, which enabled the FCA to share restricted information and thereby begin work/reading in. Her appointment was formally made on 10 July 2019.
>
> The independent investigation will consider the FCA's actions, policies and approach when regulating LC&F. Alongside this, the Treasury also announced it would review the wider policy questions raised by the case of LC&F. These relate to the regulatory and tax treatment of the kinds of retail investment products issued by London Capital and Finance (often referred to as 'mini-bonds').

The investigation's website includes further detail and sets out the scope and limitations, noting that it will exclude considerations of individual compensation:

> Specifically, the investigation will consider whether the FCA discharged its functions in respect of LCF in a manner which

8 Serious Fraud Office, London Capital & Finance, 21 August 2019
9 See, for instance, FTAdviser.com, "Making sense of London Capital & Finance", 7 October 2019

enabled it effectively to fulfil its statutory responsibilities. This means that the investigation will focus on:

- Whether the FCA adequately supervised LCF's compliance with its rules and policies
- Whether the FCA had in place appropriate rules and policies relating to the communication of financial promotions by LCF
- Whether the FCA had established appropriate policies for responding to information provided by third parties regarding the conduct of LCF
- Whether those policies were properly applied
- Whether the FCA received information of significance concerning the conduct of LCF during the relevant period
- Whether the FCA responded appropriately to such information
- Whether the permissions that LCF was granted were appropriate for the business activities which it carried on

Dame Elizabeth Gloster and her team are very conscious of the considerable financial and personal impact which the events concerning LCF have had on many of those who placed, and lost, investments with LCF.

However, as set out above, the remit of the investigation is to consider the conduct of the FCA over the period 1 April 2014 to 30 January 2019. That means that the investigation will not be in a position to determine:

- Whether individual bondholders are entitled to compensation
- The location or recoverability of any investments following the collapse of LCF
- Whether any criminal or civil liability attaches to those involved in the events of LCF.

The earlier Direction from the Government specified that the Investigation must be completed within twelve months of the Investigator's appointment, although it also noted that the approach and timing must not prejudice the SFO/FCA investigation.

Delays to the reporting date

But on 3 June, *The Times* reported that the investigation would be extended to the end of September 2020. This was later further delayed to late November. While part of the initial delay arose from the effects of the coronavirus pandemic, the *Times* report hinted at frustrations with the FCA's own systems:

> Dame Elizabeth Gloster [...] has written to the authority warning that it will not be possible to complete her work by July 10. A date of September 30 has been agreed.
>
> Dame Elizabeth [...] said that the authority's "difficulties in providing documents and information have had a significant impact on the timetable" and that the delay may cause anguish for investors.

> Mel Stride, chairman of the Treasury select committee, said that MPs planned "to get to the bottom of what role the FCA had in the delay".
>
> […]
>
> Dame Elizabeth said she believed the regulator's explanations that the issues had been due to "unexpected technology challenges" and were not "deliberate non-cooperation", but added: "These delays have impacted my timetable significantly."
>
> She said that she had first expressed concerns in December over how long it was taking the regulator to provide documents. She noted that the authority had told her last month that it had accidentally failed to search "various datasets" for relevant material.
>
> Charles Randell, chairman of the FCA, said that the regulator had agreed to the extension and in a letter to Dame Elizabeth said that he shared her concerns about the impact on investors.

In August, Dame Elizabeth wrote to the FCA noting late provision of documentation and relevant considerations, all of which would inevitably delay the report, which would now be delivered by 23 November:

> In my letter of 15 May, I explained that the revised target date for completion of my investigation would be Wednesday, 30 September 2020 on the basis that the senior employee interviews were completed during the first half of June 2020 and there were no significant issues arising from outstanding data.
>
> Since my 15 May letter, the FCA has produced a large volume of documentation that should have been provided previously and, in addition, senior FCA employees have, during the course of interviews, relied heavily on two change programmes (the relevance of which had not been highlighted before June 2020) in explaining the FCA's regulation of LCF during the Relevant Period.
>
> Reviewing and considering these new issues has required a significant amount of work from my team which obviously was not factored into the target date for completion in my letter of 15 May. Regrettably, as I have explained to you, I will therefore need to revise the target date for delivery of my report. This letter sets out the revised timeline and the reasons for the further delay.

2.3 Financial Reporting Council

In June 2020 the Financial Reporting Council (FRC) announced an investigation into "the audits of London Capital & Finance plc for the one month period ended 30 April 2015 (carried out by Oliver Clive & Co.), the year ended 30 April 2016 (carried out by PwC) and the year ended 30 April 2017 (carried out by EY)".

3. Findings from the FCA investigation

Dame Elizabeth's report[10] was published on 10 December 2020. It is almost 500 pages long. The investigation website includes a summary and explanation of the main findings.

Most fundamentally, the investigation "concluded that the FCA did **not** discharge its functions in respect of LCF in a manner which enabled it effectively to fulfil its statutory objectives. In all the circumstances, the Investigation concludes that the Bondholders, whatever their individual personal circumstances, were entitled to expect, and receive, more protection from the regulatory regime in relation to an FCA-authorised firm (such as LCF) than that which, in fact, was delivered by the FCA."

The Direction had set out some specific questions for the Investigation. The investigation website sets out summary answers to the questions, all of which are strongly critical of the FCA's approach:

- **Were the permissions granted to LCF appropriate for its business activities?** The Investigation concluded that the permissions granted to LCF were not appropriate for the business that it carried on.
- **Did the FCA adequately supervise LCF's compliance with its rules and policies?** The Investigation concluded that the FCA did not adequately supervise LCF's compliance with the FCA's rules and policies.
- **FCA's handling of information from third parties regarding LCF.** The FCA's handling of information from third parties regarding LCF was wholly deficient. This was an egregious example of the FCA's failure to fulfil its statutory objectives in respect of the are regulation of LCF.
- **Did the FCA have in place appropriate rules and policies relating to the communication of financial promotions by LCF?** The FCA had appropriate rules to regulate the communication of financial promotions by LCF. The FCA also had sufficient power under the relevant legislation to monitor LCF's financial promotions and to intervene if there was a breach. However, the FCA did not have in place appropriate policies.

The report contends that there were "significant gaps and weaknesses in the policies and practices implemented by the FCA to analyse the business activities of regulated firms." It puts them into three categories:

1 The FCA's "approach to its regulatory perimeter" was too limited. It did not encourage staff to look beyond the perimeter to consider LCF's wider activities. Most of LCF's revenue came from non-regulated activities, which were by their nature not

---

10 Elizabeth Gloster, Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc, 23 November 2020, revised 10 December 2020

scrutinised. But the fact that some activities were regulated gave a stamp of "respectability" to the firm's wider "risky, and potentially fraudulent" products, particularly for "unsophisticated" consumers.

2 Although the FCA had raised concerns about breaches of its financial promotion rules on six occasions, these were dealt with in isolation and did not result in wider holistic review. This meant that potential misuse of LCF's regulated status to promote the sale of unregulated products was not considered.

3 Staff who reviewed information submitted by LCF had no had enough training to adequately identify signals of fraud and irregularity.

The report argues that these failures meant that the FCA was unable to recognise the real risks to consumers or the numerous "red flags" emerging.

It also considers questions of individual management responsibility and comments on the matter very cautiously – it is careful to note that this is not about "the personal culpability of any individuals or groups of individuals".

3.1 Recommendations

The report made 13 recommendations – nine for the FCA's policies and practices, and four for the Treasury and Government regarding the wider regulatory regime.[11] All the recommendations have been accepted by the relevant parties.

For the FCA

1. The FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically.
2. The FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the nonregulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.
3. The FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA.
4. The senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken

[11] Elizabeth Gloster, op. cit., p291-308

into account by staff involved in the day-to-day supervision and authorisation of firms.

5. The FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.

6. The FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.

7. The FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (e.g. artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.

8. The FCA should take urgent steps to ensure that all key aspects of the DES Programme that relate to the supervision of flexible firms are now fully embedded and operating effectively.

9. The FCA should consider whether it can improve its use of regulated firms as a source of market intelligence.[12]

For HM Treasury and the Government

The investigation also considered how the wider regulatory regime affected the FCA's ability to supervise LC&F. It made the following wider recommendations:

10. The Treasury should consider addressing the lacuna in the allocation of ISA-related responsibilities between the FCA and HMRC.

11. The Treasury should consider whether Article 4 of MiFID II or section 85 of FSMA should be extended to non-transferable securities.

12. The Treasury should consider the optimal scope of the FCA's remit.

13. The Treasury and other relevant Government bodies should work with the FCA to ensure that the legislative framework enables the FCA to intervene promptly and effectively in the marketing and sale through technology platforms, and unregulated intermediaries, of speculative illiquid securities and similar retail products.

Reaction to the findings

Both the FCA and the Government have accepted the recommendations and have committed themselves to working together to implement them.

Charles Randell, Chair of the **FCA**, said:

12 Financial Conduct Authority, FCA responds to independent reviews into its regulation of London Capital & Finance and Connaught, 17 December 2020

> We accept all the recommendations that have been made to the FCA and we are profoundly sorry for the mistakes we have made.
>
> 'The collapse of LCF has had a devastating effect on many investors and we will do everything we can to conclude our investigations as quickly as possible and support the recovery of further funds for investors.
>
> 'The FCA has always prioritised supervising regulated activities which affect the most vulnerable in our society, who often have very limited financial choices. We also introduced measures designed to prevent harm for those consumers who had more ability to choose. These reports not only highlight operational mistakes; they also indicate that the measures we introduced may not have been as effective as we wanted and challenge the balance that we struck at that time.[13]

The FCA went on to note that it had made restrictions on the marketing of illiquid securities (such as mini-bonds permanent, and that over the coming six months it would undertake a number of key actions, including:

- Restructuring the FCA to better act on insights
- Becoming more "data-enabled" to improve information and intelligence
- Introduce a "use it or lose it" exercise to reconsider authorisation of firms that have not earned any income from regulated activities – and so address the problem of firms "add[ing]…credibility to their unregulated activities
- Tackle pension scams with the DWP, as well as online scams more widely, and reinforce consumer warnings about them
- Improve staff skills and confidence in reviewing information about firms with complex business models.[14]

John Glen, Economic Secretary to the Treasury, made a Written Statement[15] accepting the four recommendations to **the Government** and outlining proposals for implementing them. Among other things, this would include promoting wider consumer understanding of the investment risks inherent in certain ISA products, as well as considering including online advertising in the financial promotions regime and working with DCSMS "to ensure that fraudulent online advertising is addressed as a priority harm through its Online Advertising Programme". He also announced that the Treasury would set up a compensation scheme for bondholders, as discussed below.

Several MPs have however called for more parliamentary review of the role and effectiveness of the FCA:

> Peter Gibson, chairman of the All-Party Parliamentary Group on Personal Banking and Fairer Financial Services, said the two reports about the regulator's handling of the London Capital & Finance and Connaught failures that were published last week

[13] Financial Conduct Authority, op. cit.
[14] Ibid.
[15] UIN HCWS678, 17 December 2020

> provided "irrefutable evidence" that the FCA is failing to regulate effectively and that an inquiry is needed.
>
> Mr Gibson said the industry needs " timely and targeted transformation" to ensure the regulator is fit for purpose and holding firms to account.

Pat McFadden, **shadow Economic Secretary**, stated that it was "only right" that the Government should establish a compensation scheme, but added that the case had raised wider questions about the effectiveness of the FCA, particularly as Brexit meant that its responsibilities were about to expand.

More widely, the BBC reported that the recommendations had surpassed **bondholders**' expectations:

> Andrea Hall, who speaks for a campaign group of hundreds of LCF Bondholders said the report revealed "gross regulatory failure" by the FCA.
>
> "The FCA threw this back in our faces. I'm ecstatic that all the hard work to prove it has been worthwhile and has been acknowledged," she said. "This review is better than we could have imagined."

The Financial Times, however, highlighted concerns about the exclusion of the question of "personal culpability" from the report. In particular, Andrew Bailey had moved from being the CEO of the FCA to becoming Governor of the Bank of England:

> Mr Bailey's move to the central bank earlier this year was opposed by consumer campaigners, including former anti-Brexit activist Gina Miller, after a series of company failures had raised questions about the effectiveness of the FCA during his tenure.
>
> He apologised to LCF bondholders in response to the report. "When I was asked to lead the FCA in July 2016 it was clear that a substantial reform programme to the supervision of many of its 60,000 firms was essential . . . I am sorry those changes did not come in time for LCF bondholders," Mr Bailey said.
>
> But campaigners criticised Mr Bailey for refusing to take further responsibility. Members of the Transparency Task Force, a lobby group pushing for regulatory reform, pointed out that in his own representations to the Gloster review, Mr Bailey included a demand "to delete references to 'responsibility' resting with specific identified/identifiable individuals".
>
> Ms Miller noted that the FCA had introduced a specific senior managers' regime to hold individual bankers and financial services employees to account for their mistakes. "There is no other organisation where you would not have senior management responsibility," she said.

4. Compensation for bondholders

When a financial services firm fails, customers who lost money may be able to claim compensation up to certain limits from the Financial Services Compensation Scheme (FSCS). Whether customers are eligible depends on the product they bought: whether or not that product was regulated and protected.

The "mini-bonds" sold by LC&F were not regulated by the Financial Conduct Authority (FCA) and not protected by the Financial Services Compensation Scheme (FSCS), and so do not qualify for FSCS compensation. There are other circumstances that allow customers to claim compensation. For example, if LC&F was advising customers to buy these bonds, there would be a basis for compensation, because providing financial advice is a regulated activity. FSCS stated (6 March 2019):

> FSCS understands that the firm issued its own mini-bonds to investors on a non-advised basis. This activity is not a regulated activity under the Regulated Activities Order and, therefore, is not FSCS-protected. For this reason, while the firm is insolvent, we're not accepting claims against the firm.
>
> Should we determine that there are circumstances that give rise to potentially valid claims, we'll begin to accept claims against London Capital & Finance plc. If this happens, we'll communicate this to customers on our website. We're working closely with the Administrators to understand more about how the firm carried out its regulated activities.

4.1 Financial Services Compensation Scheme

In January 2020, the FSCS reported that it would:

- protect the 159 bondholders who switched from stocks and shares ISAs to LC&F bonds
- be unable to protect the 283 bondholders who dealt with LC&F before it was authorised to carry out financial services business on 7 June 2016
- continue to consider whether some customers had received "misleading advice" from LC&F "and so have valid claims for compensation", although it suspected that many customers would not qualify.[16]

By the end of February, the FSCS had paid £2.7 million to 135 customers in the first group.[17]

In May it announced that it would begin issuing decisions to customers who had received misleading advice, and hoped to complete this process by the end of September. At that point it would offer further advice to customers who believe that they might still have a claim. By 17

[16] Financial Services Compensation Scheme, "London Capital & Finance plc" (accessed 23 December 2020).
[17] Ibid.

December, the FSCS had paid out "just over £50.9m in compensation to 2,584 LCF bondholders who held 3,440 LCF bonds". [18]

In September, though, the FSCS's approach was challenged by four bondholders who

> are acting as claimants in a judicial review "to ask the court to quash and reverse a decision of the FSCS not to compensate LCF investors (other than the 'lucky few' with external stocks and shares Isa re-investments)," according to the case's crowdfunding site…
>
> The review will only consider the eligibility of FSCS to compensate LCF investments made after 3 January 2018, when Mifid II came into effect.
>
> "On this date, UK financial regulations changed in a way which should in our view extend coverage to LCF investments," the claimants wrote.
>
> The review has two grounds, one of which relates to all investors after 3 January 2018 and the other of which relates to investors in LCF Isa products after that date.

The case is due to be heard from 19 January 2021.

4.2 Further compensation initiatives

The strength of the findings of the Gloster review expanded the scope for compensation for LC&F bondholders, even though the investigation explicitly excluded ruling on such questions.

The Economic Secretary's Written Statement in response to the review noted that the FCA would "consider claims for compensation from LCF bondholders through their complaints scheme, which is available to bondholders who believe they have suffered financial loss as a result of actions or inactions of the FCA".

But his response went further. In exceptional circumstances, the Government may set up its own compensation scheme, as had been the case with Equitable Life. While he reiterated the role of regulation to try to prevent rather than to compensate for losses, he announced that the circumstances in the LC&F case were such that the Treasury would indeed establish a compensation scheme in 2021:

> The Government recognises that LCF's failure and the loss of investment has had a significant and distressing impact on LCF's bondholders. With any investment there is a risk that, sometimes, investors will lose money. The purpose of regulation is to ensure that investors have the right information to understand their risk. Within this system, even the best regulators, doing everything right, will not be able to, and should not be expected to, ensure a zero-failure regime. And the Government cannot, and should not be expected to, step in to compensate for every failure and every loss.
>
> But it is clear in the case of LCF that there are multiple, complex reasons why people lost money. And the Government recognises that there is likely to be some variation in how much of their

[18] Financial Services Compensation Scheme, op. cit.

investment bondholders are able to recover through these processes.

The Government therefore announces that, taking into consideration the specific and complex set of circumstances surrounding the collapse of LCF, the Treasury will set up a compensation scheme for LCF bondholders. The scheme will assess whether there is a justification for further one-off compensation payments in certain circumstances for some LCF bondholders.

I will provide a further update in the New Year with more detail on the Government's approach.

5. Parliamentary activity

The Chair of the Treasury Select Committee wrote two letters about LC&F, asking the FCA to investigate and report on possible regulatory failures, and asking whether mini-bonds should be regulated:

- Chair to Chair of FCA re LC&F, published 19 March 2019
- Chair to Economic Secretary re LC&F, published 19 March 2019

The response from the Chair of Financial Conduct Authority to Chair re London Capital and Finance was published on 26 March 2019.

The case of LC&F speaks to a wider concern about consumers being misled about the protections that are in place for certain financial products. Consumers may be misled into thinking that a certain financial product is regulated by the FCA, on the basis that the company selling the product does conduct certain other regulated activities. The appearance of regulation may convey a misplaced sense of safety. The FCA CEO, Andrew Bailey, spoke about this issue in oral evidence to the Treasury Committee on 15 January 2019:

> As you know, we authorise activities. We give permissions for activities, strictly speaking, and we come across firms that, in their presentation of their authorisation, give the impression that they are authorised for absolutely everything they do, whereas in fact what they do is mostly not regulated, and they have a small authorisation somewhere, but they give the impression to consumers that they are authorised. That is a source of great concern to me, because people are being misled by this.[19]

On 2 June 2020, Mel Stride, Chair of the Treasury Committee, wrote to the FCA expressing his concern about the delay to the investigation.

As discussed earlier, various MPs, notably from the All-Party Parliamentary Group on Personal Banking and Fairer Financial Services, have called for more parliamentary scrutiny of the role and effectiveness of the FCA.

A number of PQs have also been asked about LC&F.

[19] Treasury Committee, Oral evidence: The work of the Financial Conduct Authority, HC 475, 15 January 2019, Q434

BRIEFING PAPER
Number 8550
24 December 2020

About the Library

The House of Commons Library research service provides MPs and their staff with the impartial briefing and evidence base they need to do their work in scrutinising Government, proposing legislation, and supporting constituents.

As well as providing MPs with a confidential service we publish open briefing papers, which are available on the Parliament website.

Every effort is made to ensure that the information contained in these publicly available research briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

If you have any comments on our briefings please email papers@parliament.uk. Authors are available to discuss the content of this briefing only with Members and their staff.

If you have any general questions about the work of the House of Commons you can email hcenquiries@parliament.uk.

Disclaimer

This information is provided to Members of Parliament in support of their parliamentary duties. It is a general briefing only and should not be relied on as a substitute for specific advice. The House of Commons or the author(s) shall not be liable for any errors or omissions, or for any loss or damage of any kind arising from its use, and may remove, vary or amend any information at any time without prior notice.

The House of Commons accepts no responsibility for any references or links to, or the content of, information maintained by third parties. This information is provided subject to the conditions of the Open Parliament Licence.