

Compliance Code Cracker – London Capital & Finance report, individual accountability and the FCA

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Given the lack of regulatory action against senior managers by the Financial Conduct Authority (FCA), the analysis of individual accountability in the context of the Senior Managers and Certification Regime (SMCR) in the London Capital & Finance review (LC&F) is instructive. More than 11,400 investors lost more than £230 million in savings due to the collapse of investment firm in early 2019. LC&F sold mini-bonds, which promised annual returns to investors of up to 8% but little of the money went into safe interest-bearing investments. It was instead funnelled into speculative property developments, horses for equestrian events, oil exploration in the Faroe Islands and even a helicopter bought for a company controlled by LC&F. Some customers claim they were misled, including by the FCA, over whether their investments were protected by the regulator. Its enforcement team was also warned three years ago about the firm but failed to act.

The conclusion reached was that the FCA had failed to discharge its functions in respect of LC&F in a manner which had enabled it to fulfil its statutory objectives, and that the bondholders had been entitled to expect, and receive, more protection from the regulatory regime in relation to an FCA-authorized firm than had been delivered by the FCA. With regards to individual accountability, however, Dame Elizabeth Gloster, who undertook the review, said in the [report](#) that the inference

that could be drawn following the identification of an individual as having been found "responsible" for one aspect of the FCA's deficient regulation of LC&F was not that the individual had had specific knowledge of the relevant problem, or that the individual had failed to take reasonable steps to address it.

Gloster further emphasised that the investigation had not made findings about personal culpability (as opposed to responsibility) because it had not found it necessary to do so to answer the questions put to it. Nor had the investigation made findings about whether there had been any causal connection between the actions or omissions of specific individuals within the FCA and losses suffered by bondholders, she said.

She also explained that, in her report, the term "responsibility" had been used in the sense in which that term was employed in the [FCA Statements of Responsibility](#) and the FCA Management Responsibilities Map — as a sphere of activities or functions of the FCA for which a senior manager bore ultimate accountability. As noted in the [Treasury Committee's Report on the Press Briefing on the FCA's Business Plan for 2014/15](#), that document had been prepared in response to recommendations of the Parliamentary Commission on Banking Standards that such a map should allocate key responsibilities to individuals which should, as far as possible, be compliant with the SMCR the UK regulators had imposed on firms.

Representations about the meaning of the word "responsibility" Gloster's explanation of her use of the word "responsibility" was prompted by the fact that — in the representations process — a number of participants had asked the investigation not to make findings about individual responsibility for the FCA's deficiencies in regulating LC&F. Andrew Bailey, the former chief executive of the FCA, for

example, had asked that references to responsibility resting with specific identified/identifiable individuals should be deleted. Bailey had objected on the basis, inter alia, that there was "an inherent ambiguity" in the use of the word "responsibility". Ambiguity is the quality of being open to more than one interpretation.

There are (at least) three principal interpretations of the meaning of the word "responsible": the state or fact of having a duty to deal with something or of having control over someone/something; having to report to (a superior) and be answerable to them for one's actions; and being the primary cause of something and so able to be blamed or credited for it.

Statements of responsibility and FSMA 2000

Section [60\(2\)\(A\)](#) of the Financial Services and Markets Act 2000 (FSMA) provides that the appropriate regulator must require an application for authorisation to contain, or be accompanied by, a statement setting out the aspects of the affairs of the authorised person concerned which it is intended the person will be responsible for managing in performing the function. Section 60(2B) provides that a statement provided under sub-s (2A) is known as a "statement of responsibilities".

This requirement equates to the first of the three proposed meanings of "responsible". This is the meaning the review purports to have used — and definitely not "personal culpability", which corresponds with the third of the proposed meanings. It would appear, however, that that was not the only one of the three possible meanings employed in the report. As noted above, Gloster said the use of the word "responsible" did not necessarily mean the individual had had specific knowledge of the relevant problem(s), or that the individual had failed to take reasonable steps to address them. This reference to "reasonable steps" is related to

the duty of responsibility in [s 66A5](#) of FSMA. This provides that, for the purposes of action by the FCA under s 66, a person is guilty of misconduct if any of conditions A to C is met in relation to the person. Condition C provides that the person: has at any time been a senior manager in relation to an authorised person and that there has been (or continued to be) a contravention of a relevant requirement by the authorised person; the senior manager was at that time responsible for the management of any of the authorised person's activities in relation to which the contravention occurred; and the senior manager did not take such steps as a person in the senior manager's position could reasonably be expected to have taken to avoid the contravention occurring or continuing.

There is a considerable body of [guidance](#) on what this means in [6.2.9FG](#) of the FCA Decision Procedures and Penalties Manual (DEPP). The guidance sets out factors senior managers should take into account when considering the issue of what would be reasonable steps to take to avoid a contravention occurring or continuing.

Responsibility for policy deficiencies

The [report](#) states that the responsibility for the policy deficiencies identified in paras 3.6 to 3.10 of chapter 2 rested with Jonathan Davidson, who had overall responsibility for the FCA's policies in respect of financial promotions as part of his role as executive director for supervision- retail and authorisations; albeit he did not have direct oversight of those policies.

These are defined in chapter 1 of the report as policies, procedures, statements, guidance and training materials which are produced by, and available to, FCA staff. These materials describe how the FCA and its staff should perform their roles and responsibilities and how they should

assist the regulator in complying with its statutory objectives together with their practical interpretation and application.

One of the policy deficiencies cited in the report was the absence of a policy to consider LC&F's marketing beyond the limited and purely reactive contact with the Financial Promotions Team, notwithstanding LC&F's repeated financial promotions breaches and other red flags, such as LC&F's high rates of growth; warnings from third parties that LC&F was engaged in fraud or serious irregularity; awareness that mini-bonds carried particular risks for consumer; and awareness of the unusual way in which LC&F was using mini-bonds.

The report also found that there was no policy which required any team in the Supervision Division to consider holistically how LC&F's repeated financial promotions breaches had reflected on the firm's business. It found that the lack of connectivity between the Financial Promotions Team and the Authorisations Division had led to LC&F's first [variation of permission \(VOP\) application](#) being processed and approved without reference to its breaches of the financial promotion rules.

Another policy deficiency cited by the report was the fact that, unless concerns by the Financial Promotions Team were sufficiently serious to be passed on to Enforcement, they were closed as being within risk tolerance. The result was that, in practice, it was difficult for the Financial Promotions Team to escalate matters.

DEPP 6.2.9EG provides that — when determining under [s 66A\(5\)\(d\)](#) of FSMA whether or not an SMF manager has taken such steps as a person in their position could reasonably be expected to take to avoid the contravention of a relevant requirement by the firm occurring (or continuing) — there are additional considerations to which the FCA would expect to have regard. They include whether the SMF

manager had exercised reasonable care when considering the information available to them.

They also include whether, where the SMF manager was aware of, or should have been aware of, actual or suspected issues that involved possible breaches by their firm of relevant requirements relating to their role or responsibilities, they had taken reasonable steps to ensure the issues had been dealt with in a timely and appropriate manner.

Inappropriate policies for Contact Centre's handling of fraud allegations
The report found that the policy documents used by the FCA's Contact Centre had been unclear about whether call-handlers should have referred allegations of fraud or serious irregularity regarding the unregulated activity of FCA-authorized firms more widely within the Supervision Division. The report found, further, that the unclear nature of FCA policies had undermined the transmission of information from the Contact Centre to the wider Supervision Division, even though facilitating the transmission of such information had been a reason for bringing the Contact Centre's services in-house.

FCA's approach to perimeter

The investigation concluded that those policy failures had reflected broader problems with the FCA's approach to the perimeter. The FCA had recognised, at senior management level, that it was entitled to act in respect of authorised firms which conducted unregulated activity beyond the perimeter, and that there were problems with the FCA's approach to such activity.

This recognition had not, however, resulted in change at lower, operational levels of the organisation to prevent the failures of regulation which had occurred in respect of LC&F. The lack of clarity in Contact Centre policy documents was an example of this broader deficiency in relation to 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 had rested with the executive committee and with Bailey, the report found.

Role of supervision division

The report found that responsibility for this policy failure with regard to the handling of fraud allegations by the Contact Centre was not solely attributable to the FCA's attitude to its perimeter. Responsibility also rested with management of the Supervision Division, and in particular with those elements of management responsible for the Contact Centre. The report said the FCA internal audit final report dated November 13, 2015 had found that intelligence from unprompted consumer contacts had not been utilised effectively. The report had identified a number of action items to remedy these problems, including the need to refresh all training materials so that they captured criteria for identifying, gathering and passing on consumer intelligence to internal stakeholders, and rolling out refresher training to all contact centre employees.

Despite those concerns, however, Contact Centre training materials had remained deficient. The report noted Davidson had expressed the view that, while he had not had any role in the commissioning of the internal audit, he would have had a role in responding to it. The investigation concluded, therefore, that responsibility for the failings rested with Davidson solely, given that oversight of the Contact Centre fell within his remit.

DEPP [6.2.9EG\(10\)](#) provides that one factor senior managers should take into account when considering what might constitute reasonable steps to avoid a contravention occurring or continuing is: "whether the SMF manager took reasonable steps to satisfy themselves, on reasonable grounds, that, for the activities for which they were responsible, the firm

had appropriate policies and procedures for reviewing the competence, knowledge, skills and performance of each individual member of staff to assess their suitability to fulfil their duties".

In the light of these findings it is unsurprising that Davidson has made a representation that it was neither necessary nor appropriate for individuals to be identified as bearing particular responsibility for the matters which were the subject of the criticisms in the draft report.

Irrespective of the wider implications for FCA policy regarding the issues which arose during this inquiry, the insistence that the term "responsibility" had been used in the sense in which it was employed in the [FCA Statements of Responsibility](#) and the FCA Management Responsibilities Map — as a sphere of activities or functions of the FCA for which a senior manager bore ultimate accountability — clearly only told part of the story. The report had gone further in allocating responsibility in the third meaning of the word — as being the primary cause of something, and so able to be blamed for it.