

Report of the Independent Review into the FSA and FCA's handling of the Connaught Income Fund Series 1 and connected companies – The FCA response

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Contents

Abbreviations used in this document	3
1 Foreword	4
2 Our response to the Connaught Review's recommendations for us	6
3 Next steps	18
Annex 1	
The Review's findings	19
Annex 2	
The costs of the Review	22

Abbreviations used in this document

AIFMD	Alternative Investment Fund Managers Directive
BGC	Blue Gate Capital, the operator of the Fund between 2009-2012
CAM	Connaught Asset Management Limited, the asset manager of the Fund
CFM	Capita Financial Managers, the operator of the Fund between 2008-2009
DES	Delivering Effective Supervision change programme
FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
RAO	Regulated Activities Order
SMCR	Senior Managers and Certification Regime
UCIS	Unregulated Collective Investment Scheme

1 Foreword

- 1.1** This is our response to the Independent Reviewer's assessment of where the Financial Services Authority (FSA) and Financial Conduct Authority (FCA) went wrong in our handling of the Connaught Income Fund Series 1 (the Fund) and connected companies, and recommendations for us to act on. We are sorry for the errors we made in this case. We accept and will implement all the Connaught Review's recommendations.
- 1.2** The Fund entered liquidation in 2012, before we became the FCA, with aggregate principal losses estimated at £79m. Since then, investors have received over £80m, including over £58m of redress under the settlement we secured from Capita Financial Managers (CFM). Although the Fund failed 8 years ago and investors have now received these funds, the lessons of the failure are still highly relevant for us. We will use these recommendations, together with the recommendations from the report into our regulation of London Capital & Finance plc and the forthcoming report of the Independent Review into our work on interest rate hedging products, to improve the effectiveness of our regulation as we transform ourselves.
- 1.3** The key outcomes we want to achieve through our Transformation programme include:
- **Making faster and more effective decisions:** We want to act in a more integrated way and change our capabilities and culture. We will build on our significant investments in technology to simplify our processes, be more efficient and deliver better consumer outcomes. We must ensure that, whatever tool we use, we use it with the pace and decisiveness that matches the urgency of the issue.
 - **Prioritising outcomes for consumers, markets and firms:** We want all firms to give greater priority to the end outcomes for consumers and markets when they design and deliver services. We will be clearer with firms about the outcomes we expect them to achieve, as well as how we are targeting our own work to help ensure they do so.
 - **Changing our approach to intelligence and information:** We want to change how we identify, prioritise and act on information and intelligence we receive. Our approach to information and intelligence across our organisation will be more focused and coordinated so that our supervision better anticipates and deals swiftly with potential issues and misconduct, through a more complete and single view of every firm.
- 1.4** This Review reinforces the importance of continuing to transform ourselves to achieve these outcomes. I add my own public apology from the FCA to George Patellis, an important whistleblower who raised concerns that we should have acted on more promptly and decisively.
- 1.5** Although we have evolved in many ways since these events, there is much that we still need to do. We have already started many aspects of our Transformation programme. This will help us work better as one organisation, with our different functions integrating seamlessly to decide and resource our priorities. We have announced that we are merging our Supervision, Competition and Policy functions to help achieve this. We need to embed our Data Strategy and focus on Information and Intelligence as outlined in our Business Plan, so that we collect information and intelligence early,

join it up across the organisation, appropriately triage it and actively use it to prevent or manage harm earlier. We need to continue to replace and improve our technology systems. We need to ensure that areas of our staff training and systems are strengthened. This includes ensuring we give whistleblowers the attention, answers and ongoing support they need and deserve. And we must continue to invest in developing and maintaining the capabilities of our people.

- 1.6** Consumers also need better help to understand the extent of protection they can expect within and outside the scope of our regulation. Recent changes in legislation have brought sectors previously outside our regulation within it. Some activities sit right on the boundary between financial products we can effectively supervise and those where there is very little we can do to protect consumers under the current legislative framework.
- 1.7** Our response shows where we have already acted on areas the Connaught Review has made recommendations on. It is also clear where we and others have more to do.

Charles Randell, Chair of the FCA

2 Our response to the Connaught Review's recommendations for us

Background

- 2.1** We have carefully considered the Connaught Review's recommendations and the 5 key lessons identified in the Review. This response summarises these lessons, explains changes we have made since the key events which took place between February 2007 and March 2015, and sets out further work we have planned.
- 2.2** Our Board committed to conduct a Review into our own, and previously the FSA's, handling of the Fund. This followed a recommendation from the Financial Regulators' Complaints Commissioner when he investigated a complaint made by George Patellis, the former Chief Executive Officer of Tiuta Plc (the Fund's 'specialist partner').
- 2.3** We began the Review once we were confident that it would not prejudice our Enforcement proceedings against CFM and Blue Gate Capital (BGC), the operators of the Fund.
- 2.4** When the Fund entered into liquidation on 3 December 2012, aggregate principal losses to investors were estimated to be £79m. In November 2017, we issued the [Final Notice](#) to CFM. CFM agreed to pay up to £66m to investors who suffered loss as a result of investing in the Fund. This was over and above funds recovered through litigation between the liquidators of the Fund (on behalf of the investors) and the operators. This action was settled in January 2016 and resulted in a distribution of £18.5m to investors. This was also in addition to over £4m of other compensation, which included Financial Ombudsman Service (FOS) awards. Over £870,000 was paid out by the Financial Services Compensation Scheme (FSCS) after some advisers collapsed without being able to meet their liabilities.
- 2.5** We appointed Duff & Phelps to act as our agent to carry out the calculation and distribution of monies from the CFM settlement to investors. A total of £58,271,606 has been distributed to former investors in the Fund. We applied an interest rate of 0.52% to the sums paid to investors (to be applied over the period from each investor's capital investment until the date on which those monies were returned to each investor). This payment places investors as closely as possible back into the position they would have been in had they never invested in the Fund.
- 2.6** We are continuing our enforcement work on BGC and we expect to conclude this soon.
- 2.7** On 20 June 2019, we appointed Raj Parker to carry out the 'the Connaught Review' and we published the Terms of Reference, which outlined the issues it would cover. We produced these Terms of Reference after discussions with stakeholders including Fund investors, financial advisers, the Fund liquidators and MPs.

- 2.8** The Connaught Review covers the period from 1 February 2007 to 10 March 2015. This spans the early events involving the Fund and its associated entities, until we withdrew our support for the negotiations between the Fund and its operators to reach a settlement to address investor losses, and began to pursue enforcement proceedings.
- 2.9** We will use the Review's recommendations, together with the recommendations from the Independent Review into our supervision of London Capital & Finance and any recommendations from the forthcoming Independent Review of our work on interest rate hedging products, to improve our effectiveness. Although the Review notes we have evolved and improved since the events involving the Fund, we need to do more to transform the organisation so that different areas work more seamlessly together and to improve our systems and approach to data and intelligence. We will deliver some of these changes through our Transformation programme, one of our strategic business priorities outlined in our 2020/21 Business Plan.
- 2.10** This response includes guidance as covered by section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000. This guidance is made up of information and advice that we think desirable to give in response to the Review. To understand our response fully, we encourage people to read the Review. In the Annex 1 to this response, we set out relevant parts of the Review that will help in understanding the lessons for the FCA and why we have taken, or are taking, the proposed actions.

Lesson 1: Issues were caused by a lack of clarity about the role of operators and other market participants and the nature and extent of the regulatory perimeter

- The Connaught Review noted the changes to the regulatory requirements on Unregulated Collective Investment Schemes (UCIS) as a result of the Alternative Investment Fund Managers Directive (AIFMD) and the FCA's intervention to place restrictions on the promotion of UCIS to retail investors.
- It suggested we consider whether more work should be done to clarify the regulatory role of the various participants in this market, particularly operators.
- It found a lack of clarity about the nature of the obligations on the firms and individuals in this case and uncertainty about the extent of the perimeter and how to police it within the Regulator. It suggested we devote more training and resource to internal guidance for our staff to address attempts to circumvent regulatory requirements in UCIS and to give staff greater confidence in challenging information provided to them.
- It suggested that we provide greater clarity for consumers on the approach we will take when a firm undertakes both regulated and unregulated activities, and consider clarifying unclear legal regulatory positions through test cases.

The harm from UCIS and similar products

- 2.11** We have taken and will continue to take steps to address the harm from the sale of UCIS and similar investment products. As the Review notes, the introduction of the AIFMD in 2013 brought more onerous regulatory requirements on the operators of UCIS than existed during the period of the Review. We banned the promotion of UCIS to ordinary retail investors from 1 January 2014. Along with a number of close substitute products, together referred to as Non-Mainstream Pooled Investments (NMPs), UCIS can now only be marketed to high net worth and sophisticated investors.

- 2.12** In 2014, we introduced further rules limiting the direct marketing of non-readily realisable securities (NRRSs) to high net worth or sophisticated investors, or to retail investors who committed that they would not invest more than 10% of their net investible assets (excluding their home and pension) in unlisted debt or equity instruments. Potential investors were also to be warned that these investments 'may expose [the consumer] to a significant risk of losing all of the money or other property invested'. These safeguards aimed to reduce the numbers of consumers investing money that they could not afford to lose in highly risky products.
- 2.13** We continue to do extensive supervisory work to improve the suitability of advice and remove bad advice from the market, as reflected in our 2017 Assessing Suitability Review. We remain concerned that not enough defined benefit pension transfer advice is suitable, and that too many consumers are being advised into unsuitable, complex and high-risk products. Our supervision and enforcement work prioritises advice in the retirement income market where we see the most harm. We are currently undertaking investigations into over 30 regulated firms where the principal focus is defined benefit pension transfer advice.
- 2.14** Many people held UCIS in Self-Invested Personal Pensions (SIPPs). Our 2013 review of SIPP operators found significant failings in their due diligence of non-standard investments like UCIS. We issued updated guidance to clarify our expectations of their responsibilities and took action to raise standards of due diligence. In 2018, we wrote to the Work and Pensions Committee about this and continue to take supervisory and enforcement action against SIPP operators whose due diligence of non-standard investments is inadequate.
- 2.15** New and different types of high-risk investments constantly emerge and we regularly take action to reduce the risk to consumers. We have banned the sale of binary options and contingent convertible securities to ordinary retail investors. At the end of 2019, we announced a temporary ban on mass marketing high-risk speculative mini bonds to retail consumers. Following consultation, we have recently made this ban permanent, as well as extending it to products that some firms have used to circumvent the ban. In September 2019, we also established the Joint Supervision and Enforcement Taskforce (JSET). Its remit is to focus strategically on the drivers of harm we identified through our work in 2019 on mini-bonds and other high-risk investments, ensuring a coordinated response across the FCA.
- 2.16** There is still more for us to do to tackle the harm in the consumer investments market. Enabling effective consumer investment decisions is one of the strategic priorities in our 2020/21 Business Plan. In September 2020, we launched a Call for Input seeking views on how this market could be improved. The Call for Input closed on 15 December, and we will consider all responses before making recommendations and suggesting changes we can make to our own policies. But this is an area where we will have to work with others if we are to make real changes to the confusion caused by the complications in consumer protection.
- 2.17** The Call for Input explains that banning the sale or marketing of individual types of investment to certain types of investor is not always the most efficient way for us to prevent harm. While we must set out specifically what is banned to avoid unintended consequences, promoters often respond by producing new but very similar products that fall outside the scope of our ban. To tackle this, we need to be agile in identifying and acting on any attempts to circumvent the rules. We also need to seek intelligence from market participants actively.

- 2.18** The Call for Input also asks questions about whether the current exemptions from the Financial Promotions Order for high net worth and sophisticated investors remain fit for purpose. There has been a rise in unregulated introducers abusing these exemptions to market unsuitable high-risk and scam products to retail clients. To avoid the requirement for a financial promotion to be approved by an authorised person, unregulated introducers get consumers' contact details with the aim of coaching them to self-declare as sophisticated or high net worth. If the consumer does this, a firm can then market and subsequently sell them unsuitable investments. This is inherently difficult for us to police as it often involves individuals who are not authorised by us misrepresenting their activities as a legitimate use of the exemptions. Many prove difficult to trace and are sometimes based overseas. Where they can be traced, building a criminal case against them often requires action by other agencies who have powers that we do not.
- 2.19** The thresholds for determining who is a high net worth and sophisticated investor are determined by the Treasury and currently require self-certification of investment experience and annual income of £100k or assets of £250k. These thresholds have not been changed for 20 years and we consider that there is a case for the Government to review them and their operation. In addition, in the follow up to our Call for Input, we will consider whether it is appropriate to make clearer to investors what protections they are giving up by being certified as high net worth or sophisticated.
- 2.20** We know that risk warnings and restricting access to certain types of investor do not always prevent harm to retail investors when firms' marketing strategies encourage them to make poor choices. In January 2020 we issued a letter to alternative investment management firms who may operate UCIS and similar products to remind them of their obligation to ensure that investors are correctly categorised, adequately understand the risks of their investments and are not inappropriately exposed to products that carry risk beyond their risk profiles.
- 2.21** We will use the lessons from this Review, alongside the lessons from the Review on our regulation of London Capital & Finance and the responses to our Call for Input, to address what is in our own remit and to work with Government and others on wider issues to shape a consumer investments market that works better for consumers.

Clarifying the roles of participants in this market

- 2.22** We have already taken some steps to address this. Our letter in January covered in 2.20 above made clear that improving standards of governance in the alternative investment management market is a supervisory priority for us, with a particular focus on smaller firms manufacturing and marketing more esoteric products. We reminded operators that they must consider the appropriateness or suitability of investments with exposure to alternative assets and strategies for their target investors. This includes identifying the client type and investment need when manufacturing or distributing products, recognising that alternative products may only be appropriate for a niche market and complying with relevant restrictions on marketing to retail investors.
- 2.23** In the wider asset management market we have made rules and guidance to better outline the fiduciary responsibilities of asset managers, requiring them to act in the best interests of their investors and that their fund governance bodies are held accountable for their actions.

2.24 One of the key failures of the operators in this case was that they approved misleading financial promotions. Misleading financial promotions remain a major cause of concern. Promotions need only comply with FCA rules if they are communicated or approved by an authorised person. We alerted CEOs of firms involved in approving financial promotions for unauthorised persons in January 2019 and April 2019 that we would hold them to their obligations to ensure that these promotions were fair, clear and not misleading. In November 2019 we issued guidance for authorised firms which approve the financial promotions of unauthorised persons. We set out our expectations of the due diligence into the products being promoted that is required to ensure that a promotion is fair, clear and not misleading. This year we have worked with the Treasury on a consultation to establish a regulatory 'gateway' that a firm must pass through and get our consent before it can approve the financial promotions of unauthorised firms. Effective due diligence by qualified firms should ensure that fewer harmful products are promoted.

2.25 We accept that concentrating on financial promotions over business models and governance in this case was well-intentioned but insufficient. We have implemented a protocol so that our financial promotions team flag any action they take for a firm to the relevant portfolio supervisors. This means that supervisors can take into account the risks around the firm's financial promotions in their wider work with the firm. We recognise that, for this engagement to be effective, we need to do more to foster a culture of curiosity and scepticism and to make our supervisors highly attuned to harm which arises on our perimeter, which we discuss under Lesson 5.

Clarifying our perimeter externally and our approach to firms that undertake both regulated and unregulated activity

2.26 As the Review notes, the definition of the FCA perimeter – what is and is not regulated – is decided by the Government and Parliament through legislation. We devote the majority of our resources to supervising the activities Parliament has asked us to regulate in the Regulated Activities Order (RAO).

2.27 Whether an activity is regulated can be complex for firms and consumers to understand, and we agree that unscrupulous firms can seek to take advantage of ambiguities in the scope of our regulation. Changes to the landscape in which we operate, such as the development of new products, services and technologies which were not envisaged when a piece of legislation was written, can raise questions about whether something is regulated. This is why some of the most complex issues arise in relation to our perimeter, especially when there are questions as to whether we can use our powers.

2.28 We have now published 2 annual Perimeter Reports – in June 2019, and September 2020 – which aim to give greater clarity on our role and highlight where harmful issues are emerging at the edges of the legislative framework for investor protection. In our most recent report we committed to a discussion with the Economic Secretary on its contents and for the outcomes of that meeting to be made public. This meeting will also provide an opportunity for the Treasury and us to consider the responses to the Call for Input, with the aim of:

- Eliminating complexities in consumer protection across the different regulators and in the degrees of protection for different products.

- Drawing clear lines between products which can be sold to ordinary consumers and those which cannot, and the permissions that firms require to manufacture and market them.
- Drawing clear lines between those products and services which are eligible to be complained about to the FOS and those which are not, and which are protected by the FSCS and those which are not. This work should consider in particular whether the FSCS cover for advice on investments by authorised advisers remains appropriate for all investment products.

2.29 Raising consumer awareness of scams and unauthorised activity where they may not be protected is also an important part of our work. We provide resources to consumers through our ScamSmart campaigns, focusing particularly on pensions and investments scams. The campaign seeks to educate and inform consumers about the warning signs that prevail across a range of scams. Our objective is to reduce the scope of opportunity for scammers when consumers face difficult decisions around their savings and investments. We have issued over 1,100 warnings this year about unauthorised firms who appear to be promoting scams and frauds.

2.30 We also launched our enhanced Financial Services Register in July 2020 to make authorised firms' permissions clearer to users, and to include information on consumer protections and actions against individuals and firms. This aims to help users avoid scams, and navigate the different protections offered by the Financial Ombudsman Service and FSCS which we know are complex and which consumers can find confusing.

2.31 We will continue to work closely and share information with a range of partners, including the FOS, FSCS, law enforcement agencies, firms and consumer groups, both to tackle and prevent harm, and to raise consumer awareness of the increased risk of scams and help consumers protect themselves.

Clarifying the perimeter to our people

2.32 We agree that equipping our people with the right knowledge about how to tackle issues that arise on the edge of our perimeter is critical to giving them the confidence to act boldly and innovatively to prevent or mitigate consumer harm. While there are centres of expertise on perimeter issues throughout the FCA, including in our Unauthorised Business Department which polices the perimeter, we accept that there is more to do to give all our frontline staff the skills required.

2.33 By the end of the first quarter of next year, all frontline Supervisory, Authorisation and Enforcement staff will have completed mandatory training on 'FCA Powers and Unregulated Activities', 'Financial Accounting' and 'Business Model Analysis'. We will also add to our existing training on supervisory tools to give staff greater confidence in knowing when and how to intervene using relevant intelligence held across the FCA. We agree with the recommendation to consider test cases or similar means to establish the boundaries of the perimeter where these may be unclear.

2.34 We say more about giving our staff the confidence to act boldly in our response to Lesson 5.

Lesson 2: The Regulator should continue to improve information sharing between departments and its related IT systems and processes

- The Connaught Review found different sets of information, analysis, experience, priorities and concerns in the different teams involved in this case, and that different elements of emerging risk were not adequately communicated between teams.
- It found that the case management system in use at the time, Remedy, was ineffective in tracking contact and data points in relation to authorised entities and individuals, and in capturing regulatory history and intelligence in an appropriate and accessible way. This resulted in individuals tasked with the problems generated in this case not being aware of key pieces of information. The Review found that better information-sharing and technology would have assisted in ensuring that concerns were joined up.

Improving information sharing

- 2.35** We fully agree with the need to continue to improve our information and intelligence management and this is a key priority for us, including through our Transformation programme.
- 2.36** We receive a huge volume of information. In the 2019/20 business year we received over 204,000 calls from consumers and firms. We managed and assessed 1,153 whistleblower reports consisting of 2,983 allegations. We receive and monitor 38 million markets transactions a day. And we receive over 500,000 regular data submissions from firms every year. We also receive information from other regulators, law enforcement agencies, and from our own proactive reviews of market intelligence and data sources. It is vital that we make the best use of this intelligence.
- 2.37** In 2015 we introduced a new case management system, Intact. Unlike the old Remedy system, Intact is used across Authorisations, Supervision and Enforcement, which means intelligence about firms and their regulatory history can be captured, monitored, shared and used more effectively across departments and divisions. We have created a single standard system of labelling issues and products in our supervisory system and taxonomies of harm and causes of harm to better enable this.
- 2.38** However, we recognise that we have further to go to strengthen our intelligence handling and use of data across the FCA. As we said in our [Business Plan](#) for this year, as part of our Transformation programme, we are reviewing and making changes to how we identify, triage, prioritise and act on information and intelligence we receive. We are appointing a Chief Data, Information and Intelligence Officer to oversee a new dedicated Information and Intelligence function and the delivery of our new [Data Strategy](#), which we launched in January 2020.
- 2.39** We are investing in our systems and processes to enable us to work more efficiently and effectively, making better use of our sources of information. Our Data Strategy has the ambition to harness the power of data and advanced analytics to help us carry out better monitoring of harm, improve our analysis of data sources to detect and prevent misconduct, identify where we need to intervene in markets and use automation to help us act more quickly. Our plan is to have a 'single view of the firm', allowing us to join the dots more easily between different pieces of information and intelligence from different areas.

- 2.40** We recognise that we need to do better. We expect that these measures will ensure a more focused and coordinated approach to information and intelligence across the FCA. In turn, this will enable us to better anticipate and deal with potential issues and misconduct, at pace.

Lesson 3: The importance of effective coordination and oversight across different teams

- The Connaught Review noted that problems were caused by there being no team or decision maker who 'sat above the fray' and coordinated information and resources – including technical subject matter expertise – from across the various teams.
- It noted the work done to improve coordination between Supervision and Enforcement and suggested that the Regulator continue to improve on the work done on cross-team coordination not just after risks have crystallised, but also at an earlier stage.

Improving coordination and oversight

- 2.41** We agree with the Review's observations and know that there is more that we can do to ensure that those authorising, supervising, making policy for and taking enforcement action against a set of similar firms deliver against a common strategy and set of outcomes.
- 2.42** As the Review notes, coordination between Supervision and Enforcement has improved considerably since the period of the relevant events. Our 2016 Enforcement and Market Oversight (EMO) Review delivered significant changes in practice and process at the line between Enforcement and Supervision. We also published our Approach to Enforcement and released new Investigation Opening Criteria in 2018. These changes resulted in establishing a new model of collaboration which emphasises the importance of engaging Enforcement expertise early when Supervision encounters suspected serious misconduct and of collaborating fully both before and during investigations. It was agreed that an Enforcement investigation would be launched in every case of suspected serious misconduct and joint project boards between Supervision and Enforcement are now in place to both consider cases for opening an investigation and discuss ongoing investigations.
- 2.43** Our bolder approach to intervening means we are investigating more cases generally. As at September 2020, there are currently 611 cases open in Enforcement, compared to the 237 that were open 5 years ago. We are also using our intervention powers, such as requirements and restrictions on firms' permissions, to tackle harm caused by misconduct at a much earlier stage.
- 2.44** We also published our Approach to Supervision in March 2018. Business models as the drivers of harm are central to this approach. As part of our Delivering Effective Supervision (DES) change programme we now assign every firm to a portfolio of firms with similar business models. Each portfolio is supervised by a team with expertise in and knowledge of the firms' business models and an understanding of the associated risks of harm. As part of DES we implemented a Portfolio Assessment Model so that supervisors can produce a holistic overview of the portfolio, the potential harms from the business model and how effective the firms are at reducing or preventing them.

- 2.45** There is a lead supervisor for each portfolio who acts as a point of accountability for drawing together insight, intelligence and technical expertise from across the FCA about the firms in their portfolio, evaluating the crystallising harms and potential harms posed by that portfolio, and setting and implementing a strategy to address them. As such, we believe that coordination problems between teams dealing with the same firm should be less likely to arise in future.
- 2.46** We note, however, that some of these portfolios by necessity have a large number of small firms, where supervisors will continue to have to make difficult prioritisation decisions, through triaging very large volumes of information and intelligence, and using discretion and judgement to try to tackle the greatest sources of harm that can be identified.
- 2.47** Our Risk & Compliance Oversight and Internal Audit teams will complete a joint review of Supervision in 2021 to assess whether DES has been fully implemented and embedded effectively, and to identify areas for improvement, reporting to our Board's Audit Committee.
- 2.48** We fully recognise the power of cross divisional working and want to harness it more. In our [2020/21 Business Plan](#) we set out 4 strategic business priorities, each of which is led by a Director who is tasked to marshal resources from across the FCA to take bold and decisive steps to tackle the harm we see in the consumer investments, payments and consumer credit markets and in providing fair value over the next 1-3 years.
- 2.49** As the next step in making working between divisions seamless we have announced that we will be merging our Supervision, Policy and Competition divisions so that all our expertise is marshalled against the same set of consumer and market outcomes.
- 2.50** In our comments on Lesson 5 below, we describe some of the changes that have been made to our ways of cross-divisional working during the coronavirus pandemic. We will take the lessons learned from this Review and these more recent structural developments into account as part of our Transformation programme.

Lesson 4: Continue to invest in and update systems regarding whistleblowers

- The Connaught Review noted that the information provided by whistleblowers can be vital, is often the only source of critical information and that whistleblowers should be given proper aftercare following any reporting.
- It noted the improvements we have made to our whistleblowing processes, and hoped that we will continue improving the manner in which we interact with whistleblowers and use the information they provide.

Our approach to whistleblowing

- 2.51** We agree with the Review that whistleblowing intelligence is a uniquely valuable source of information in identifying actual harm, potential harm and markets that are not working well. In 2019/20 we assessed and addressed 1,153 whistleblower reports consisting of 2,983 separate allegations.

- 2.52** We have made changes to our whistleblowing policy and processes since Connaught which go to address the inadequate treatment of whistleblowing intelligence in this case. We now have a dedicated whistleblowing function which acts as the point of contact for all external whistleblowers. This did not exist when the events in this case occurred. This team assesses the information received, before anonymising the information to ensure whistleblowers' identities are protected. Where the whistleblower has more detailed information or when they would like to speak directly to us, we arrange for them to be debriefed by specialist staff. They are often accompanied by subject matter experts. Any access to whistleblowing case information is also strictly controlled.
- 2.53** The whistleblowing team shares the anonymised information with relevant FCA teams to review and take appropriate action. The whistleblowing team is responsible for managing the relationship with the whistleblower and supporting any investigation. At the end of the process, the team gives the whistleblower feedback. We recognise this aftercare is an important part of the process and that it may provide the whistleblower with reassurance and closure in relation to the matter they raised with us.
- 2.54** Each case that is progressed within Supervision is allocated to an individual supervisor. We have service level agreements in place to ensure the action in every case is recorded and tracked. Updates are shared with the Whistleblowing Team throughout the life cycle of the case and management information is produced to allow senior leaders to monitor progress. We also have procedures to ensure that relevant information is shared with other regulators and law enforcement agencies where appropriate.
- 2.55** In our revised process, whistleblowing cases cannot be closed without a Head of Department's sign-off. This ensures greater ownership by and accountability on the relevant supervisory Heads of Department to ensure that cases are properly assessed and appropriate action and decisions are taken. We continuously assess our governance and controls around the use of whistleblowing intelligence.
- 2.56** All our staff must now take a mandatory training course to help them identify when someone may be a whistleblower reaching out to the FCA. Supervisors and others who have a more direct involvement working on whistleblowing information must also undergo more advanced training to help them to act on the information provided without compromising the whistleblower. We also have whistleblowing champions throughout Supervision, Authorisations and the Contact Centre and online guidance to support whistleblowing case handlers.
- 2.57** We are keen to ensure there is continuous improvement in all aspects of our management of whistleblowing. As part of this we are looking at ways to improve the content and frequency of the feedback we provide to whistleblowers, although there are legal limitations to the extent of feedback that can be provided. We are also improving our whistleblowing web pages to provide more information so that the whistleblower journey is better understood and to provide reassurance, clarity and confidence in the FCA's whistleblowing service.
- 2.58** Whistleblowers should always have the confidence to raise their concerns with the FCA. It is also important that firms have the appropriate culture and processes in place to encourage staff to speak up internally. When staff do speak up they should be able to trust their employer to fully investigate their allegations and have measures in place to ensure their anonymity and provide them with appropriate protection.

Lesson 5: The culture of the Regulator

- The Connaught Review found that our approach was 'cautious, reactive and often characterised by a focus on reasons to defer rather than reasons to take action.' This manifested itself in a confused strategy and lack of early investigation, and a decision to monitor Tiuta in an insufficiently challenging way.
- It noted that 'the Regulator today is not the same as it was when it handled the issues I have reported on.' The Review also reflected upon an evolution in our regulatory confidence and approach since the events, including a different approach to opening Enforcement investigations, a more systematic approach to Authorisations decisions, more proactive supervision of small firms and a Supervision/Enforcement model that uses identifying and preventing harm as a starting point. The Review noted a more commercial approach within our General Counsel Division, clearer decision-making models, and greater encouragement for staff to challenge and test the information they receive.
- The Review encouraged us to continue to evolve our culture, noting the difficulty in judging the right time to intervene, and whether an intervention that is too heavy or public might itself lead to greater harm than a 'wait and see' approach with lighter mitigants in place. It suggested that the recommendations would serve to ensure such judgements are better informed, improved, and more robust.

Our culture

- 2.59** As a conduct regulator, we require firms we regulate to pay close attention to their cultures. How financial services employees behave impacts our mission to prevent harm. To lead by example, it is essential that we hold ourselves to account on our own culture. Fast-tracking a more unified FCA and greater pace and agility in addressing harm are overarching priorities for our ongoing Transformation programme.
- 2.60** This Review helps us do this. There is no doubt that the events in this case are a salutary reminder of the importance of intervening earlier and more boldly where we have the evidence of harm, and intervening to address the root cause of the harm rather than just some of its symptoms, such as poor financial promotions. Although, as the Reviewer notes, aspects of small firm supervision across nearly 60,000 firms will be necessarily reactive, and there will always be difficult questions about the proportionality both of our interventions and the use of our resources, we know that we do not yet always get this balance right.
- 2.61** We fully recognise that there is more to do to ensure our staff have the confidence to act quickly where they see misconduct and avoid the inaction caused by waiting for the perfect amount of information or lack of understanding of the powers available. This requires a cultural and behavioural shift to enable us to anticipate issues, scrutinise intelligence and challenge business models with a sceptical mindset, and respond at pace.
- 2.62** To do this we are investing in training our supervisors, creating a culture of assertive supervision where they have the confidence to make better judgements and earlier decisions. Training focuses on the four core skills of our capability framework: judgement, engagement, delivery and self-management.

- 2.63** We have already implemented a capability programme in Supervision and Authorisations to develop and deliver an extensive range of training and knowledge-sharing in key areas. We will develop and roll out further training and testing within 6 months.
- 2.64** We are also embedding a Supervision quality assurance framework. Quality assurance covers a broad range of activities which are designed to provide a level of confidence that judgements, processes, standards and controls are appropriate and adhered to. Quality assurance dashboards are open to all staff to review, to help to foster an open culture of continuous improvement and learning, sharing best practice and capability building.
- 2.65** Ways of working adopted during the coronavirus crisis are an early embodiment of some of our target outcomes: operating across divisions, and with a pace and agility that enables us to reduce harm assertively and protect consumers. Examples include:
- implementing policy changes in days, and mobilising outcome-focused teams that combine expertise from across our divisions and departments
 - responding quickly to changes in demand for resource and capabilities through triage and incentivising flexibility in our workforce
 - taking decisions and actions swiftly with less bureaucracy to deliver critical change responsive to daily circumstances
 - heightening focus on timely and clear communication and engagement with consumers and firms
- 2.66** Our Transformation programme will capture the lessons learned from different ways of working during this extraordinary period, so that we can reach some of our target cultural outcomes, such as agile prioritisation and resourcing, more quickly.
- 2.67** We face having to make the difficult judgements the Review describes in this lesson every day. We will not always get them right, and not all our stakeholders will always agree that we will have done the right thing. As the economic effects of the coronavirus crisis continue to be felt, we will face many challenges to act as one organisation performing at its best to deliver good outcomes at pace. Among the firms which we regulate for prudential standards, we expect to see a number of firm failures. The measures we have already taken since Connaught, the lessons from the Connaught Review and the other independent reviews into interest rate hedging products and London Capital & Finance, and our commitment to our Transformation programme, should lead to improved and more robust judgements and outcomes for consumers.

3 Next steps

- 3.1** We will fully incorporate the lessons from this Review into our assessment of how effectively our current actions are delivering, as well as our ongoing Transformation programme, which is a key focus of our Chief Executive and Executive leadership team. We will report on the progress of our Transformation programme in our 2020/21 Annual Report and at 6-monthly intervals until the recommendations from this and the reviews into London Capital & Finance and interest rate hedging products have been substantially implemented. We will carry out comprehensive assurance work on our implementation of the Review's recommendations, which our Board and its Audit and Risk Committees will oversee. The Chairs of the Board and these two Committees will issue a report within our Annual Reports explaining how those bodies have performed this oversight role.
- 3.2** We are determined to learn the lessons of this Review to help us drive higher standards in the vital consumer investment market.

Annex 1

The Review's findings

1. This Annex signposts the key parts of the Review that are relevant to understanding the findings and the lessons for the FCA. These are set out under each of the Lessons 1-5.

For Lesson 1 (roles of operators and other market participants and the regulatory perimeter)

2. The Review's key findings about a lack of clarity about the role of operators and other market participants and the nature and extent of the regulatory perimeter are set out in paragraphs 255-260 of section I and summarised in section B. In particular, it considers that the lack of clarity about the nature of those regulatory obligations was a key reason for the issues that arose in this case. Added to this was the general uncertainty about the perimeter and how to police it (see, for example, paragraph 257).
3. The Review sets out the regulatory and enforcement powers of the regulator at the relevant time at section C, and summarises the regulation and supervision of Tiuta, CFM and BGC at paragraphs 40-43. As against that backdrop, it describes the factual background in some detail (see section D and the chronology to Appendix 2).
4. Section E sets out the Review's more detailed findings as to the issues that arose in respect of our regulation of Tiuta, CFM and BGC and the individuals associated with these entities, and our response to intelligence. As set out above, it considers there to be a strong relationship between the lack of clarity about the nature of the relevant regulatory obligations and these issues.
5. The Review further considers, at Section F, the question of whether our jurisdiction at the time impacted our ability to meet its statutory objective of protecting consumers (see the summary at Section B). The Review highlights how our approach was impacted by our perception of the limits of our own jurisdiction. It further finds that we did not, when made aware of solvency and financial misconduct concerns at Tiuta, subject the relevant entities themselves to detailed scrutiny or analyse the risks to investors in detail – choosing instead to take action mainly on the financial promotions side of the Fund's activities.

For Lesson 2 (information sharing between departments)

6. The Review's key findings about information sharing between our departments are set out in paragraphs 261-265 of section I and summarised in section B.
7. The Review highlights the importance of information sharing between our departments by explaining that individuals from CAM and Tiuta were in contact with various departments on a number of occasions (see section D). It also sets out how the teams at the FSA were set up and their priorities (see section C).

8. Section E sets out more detailed findings that our information sharing was insufficient, that the silos within departments and a lack of a centralised records system meant that staff did not have a clear overview of the regulatory history of a company or individual (for example, see paragraphs 165-168). The Review considers that the inadequate information sharing resulted in Enforcement being unaware of various issues in Tiuta and CAM's regulatory history and that we were not able to deploy until later staff who had particular expertise and who could have provided particular insight into the issues (for example, paragraphs 170-172). Our 2013 revisions to policies relating to information sharing are also set out in paragraph 187.

For Lesson 3 (effective coordination and oversight across teams)

9. The Review's key findings about our lack of effective coordination and oversight are set out in paragraphs 266-269 of section I and summarised in section B.
10. It sets out in section C the structure of supervision that applied at the time both generally and to Tiuta, CFM and BGC in particular. In section D (see also Appendix 2) it sets out the events and interactions between different teams in Supervision and between Supervision and Enforcement, demonstrating how different areas with responsibility for different entities failed to coordinate and how there was the absence of overall decision making.
11. Section E sets out more detailed findings. The Review concludes that there was an absence of overall responsibility for the appropriate regulatory response to the issues that had emerged and were emerging, that teams were structured on a siloed basis in a way that was not well equipped for dealing with funds of this type where different components of the fund were supervised by different areas, and that the lack of coordination meant that we could not deploy expertise effectively (see for example paragraphs 146, 158 and 165-172). The Review notes the improvement in coordinated working that occurred after our Complex Events Team became involved in the investigation.

For Lesson 4 (whistleblowers)

12. The Review's key findings about how we responded to Mr Patellis and other whistleblowers are set out in paragraph 270 of section I and summarised in section B.
13. The Review explains that our supervision of small firms at the time relied, at least in part, on whistleblowers such as Mr Patellis (see section B and section C). The Review's finding that our response to Mr Patellis was inadequate, despite his senior position and the supporting material he provided and the concerns he and other whistleblowers raised, is detailed in the Review (see section D and Appendix 2). The Review finds that our response damaged our reputation and led directly to the Review (see section A).
14. Section E sets out the Review's more detailed findings that our response to whistleblower information was slow and inadequate, did not take Mr Patellis's allegations sufficiently seriously, and that we should have investigated the allegations properly and then reassessed red flags and intelligence we already had (for example, see paragraphs 144, 150-152, 156, 169-171, 182-203 and 207). The Review also

identifies inadequacies in our treatment of Mr Patellis after he had met us to set out his allegations. It considers Mr Patellis to be a key whistleblower. Our policies at the time are also set out together with the fact that changes were implemented that improved our handling of whistleblowers and whistleblowing information in 2013 and subsequently.

For Lesson 5 (culture)

- 15.** The Review's key findings about our culture are set out in paragraphs 271-273 of section I and summarised in section B.
- 16.** The Reviewer explains his view that we had a cautious and reactive approach to supervision. The Review notes that our teams tended to behave in an overly cautious way and therefore took delayed actions (see section D and the chronology to Appendix 2). The FSA's general approach to supervising firms is set out in section C.
- 17.** Section E sets out the Review's more detailed findings that our initial response to information was inadequate and cautious and that further responses were slow and insufficiently coordinated (for example, see paragraphs 144 -145 and 159 -162). As a result, there was a lack of understanding of the overall picture and lack of challenge to information provided by Tiuta (for example, see paragraphs 146 -152).

Annex 2

The costs of the Review

1. An independent report of this length and complexity inevitably calls for a high level of specialist expertise. The total external costs of the review since it was commissioned to the end of November 2020 are approximately £3.9 million including VAT. There will be additional costs beyond November 2020.

Service	Amount (incl. VAT)
Independent Reviewer and Direct Support Team	£2.7m
Legal advice and other support for FCA and employees	£1.2m
Total	£3.9m

