
FINAL NOTICE

To: **London Capital & Finance plc (in administration)**
Reference Number: **722603**
Address: **45 Gresham Street, London EC2V 7BG**
Date: **11 October 2023**

1. ACTION

- 1.1. For the reasons given in this Final Notice, the Financial Conduct Authority ("the Authority") hereby publishes a statement censuring London Capital & Finance plc ("LCF") for contravening regulatory requirements (pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act")).
- 1.2. The Authority would have imposed a substantial financial penalty on LCF for the serious failings in this case. However, the Authority has considered the impact that a financial penalty would have on LCF given that it is currently in administration, insolvent, and that there is a significant liability to its creditors (principally bondholders, who invested with LCF, and the FSCS, which has administered two compensation schemes for bondholders). Taking this into account, the Authority does not consider it appropriate to impose a financial penalty on LCF and instead publishes a censure to the effect that LCF failed to ensure that its financial promotions were fair, clear and not misleading (in contravention of COBS 4.2.1(1)R).
- 1.3. Had LCF not been in administration and insolvent the Authority would, in addition, have required LCF to pay restitution in respect of both the profit it gained from its misconduct and the losses suffered by bondholders as a result, using the Authority's powers under section 384 of the Act. Due to the way in which LCF operated, precisely quantifying the profit that accrued to it as a result of the

contravention would not have been straightforward, but restitution for losses would have been readily quantifiable and substantial totalling around £237.2m (less any amounts recovered for bondholders by LCF's Administrators).

2. SUMMARY OF REASONS

2.1. During the period of misconduct described in this Notice, namely from 7 June 2016 to 10 December 2018 ("the Relevant Period"), LCF was authorised by the Authority as a credit broker and to carry out advising and arranging in relation to certain investments. However, the business it conducted, the raising of finance from the general public through the issuance of minibonds ("the minibond business") which was then loaned to third-party corporate entities ("the corporate borrowers"), was unregulated and not subject to rules made by the Authority save in respect of the issuance of financial promotions related to that business.

2.2. On 30 January 2019, LCF entered administration. This followed the action taken by the Authority on 10 December 2018 when LCF was directed to immediately withdraw its promotional material because the way the firm was marketing its minibonds was unfair, unclear and misleading (for further detail see this [Supervisory Notice](#)).

2.3. It subsequently became apparent that the problems at LCF ran far deeper than those outlined in the Supervisory Notice. LCF's Administrators' first report in March 2019 stated that:

"[t]here are a number of highly suspicious transactions involving a small group of connected people which have led to large sums of the Bondholders' money ending up in their personal possession or control".

2.4. The Authority's action, as set out in this Notice, is a part of a much wider series of actions being taken in relation to matters connected to LCF. This includes, but is not limited to:

- (1) criminal investigations by the Serious Fraud Office (in relation to fraud and money laundering offences);
- (2) civil court action for the recovery of funds by LCF's Administrators against a wide range of persons; and
- (3) regulatory investigations by the Financial Reporting Council (in relation to audit activity).

2.5. The Authority recognises that LCF may have knowingly participated in the defrauding of its bondholders and that, if it did so, criticisms of aspects of LCF's financial promotions are secondary issues. Nevertheless, the Authority considers it important to set out the key ways in which LCF's financial promotions misled prospective investors and bondholders regardless of whether there was an underlying fraud and LCF's knowledge thereof.

2.6. With that in mind, this Notice sets out the most important ways in which, during the Relevant Period, LCF failed to ensure that its financial promotions were fair, clear and not misleading, thereby breaching COBS 4.2.1(1)R ("the fair, clear and not misleading rule"), as follows:

- (1) LCF targeted retail investors including using seemingly independent comparison websites that unfairly and misleadingly compared much safer third-party investments (promising lower interest rates) with the minibonds offered by LCF (promising much higher interest rates). These comparison websites were typically seen by potential investors after an online search for "*best ISA rate*" or similar. The comparison websites were not in fact independent of LCF and were simply being used by it to drive traffic to its website.
- (2) LCF claimed it would lend funds raised to carefully selected UK corporate borrowers which had undergone a full financial review. This claim was untrue and misleading because the corporate borrowers were not independent of LCF or each other, they were not carefully selected, and LCF conducted no meaningful due diligence before lending.
- (3) Despite the numerous assurances LCF provided to prospective investors in its financial promotions about the safety and security of its minibonds, including that the loans made by LCF were secured against assets of the relevant borrowing company with a maximum loan to value of 75% (so that, for example, for a loan of £750,000 LCF would have taken security over £1m of the borrowing company's assets), the funds loaned were in fact on the whole not secured against realisable assets held by the corporate borrowers.
- (4) LCF's financial promotions gave the misleading impression there were no hidden fees, charges, or deductions when in fact for every £1 invested, LCF paid fees of 25.5% to meet its online marketing and other support service costs and these fees were not disclosed to prospective investors.

- (5) Not only was the impression given that there were no hidden fees misleading and unfair, the 25.5% in fees paid by LCF was passed on directly to the corporate borrowers (unbeknownst to potential investors who were not even aware of the fees). This meant that in order for bondholders to receive the interest promised on the minibonds (most of which were offered at interest rates of between 6.5% and 9.1%, although rates went as high as 11%), as well as their capital back, the corporate borrowers needed to generate very high rates of return to cover the 25.5% of hidden fees over and above: (a) the high level of interest due to bondholders; (b) a disclosed lending fee due to LCF of 2%; and (c) a disclosed 2% interest 'turn' charged annually by LCF. The failure to disclose that LCF's business model depended on the corporate borrowers being able to generate commensurately large rates of return made LCF's financial promotions unfair and misleading because it meant investors could not accurately assess the risk of investing in LCF's minibonds.
- (6) The minibonds LCF marketed as ISA bonds were not in fact qualifying investments for inclusion within an ISA wrapper. LCF's misleading marketing in this regard induced 8,388 investors to invest £108m in LCF ISA bonds, many of them transferring out of legitimate ISA qualifying investments (rendering the investors potentially liable to tax).
- (7) Even though LCF's minibond business was not regulated by the Authority, LCF's financial promotions prominently featured the fact it was authorised by the Authority. This resulted in an unmerited 'halo effect' as LCF's highlighting of its authorised status in this way presented an unjustified impression of integrity to prospective investors.

3. DEFINITIONS

3.1. The definitions below are used in this Notice:

"the Act" means the Financial Services and Markets Act 2000;

"the Authority" means the Financial Conduct Authority;

"bonds/minibonds" means non-transferable debt securities issued by LCF and marketed to retail investors;

"bondholder" means individual investors who invested in a LCF minibond;

“COBS” means the Conduct of Business Sourcebook, part of the Authority’s Handbook;

“Company A” means one of the corporate borrowers who obtained loans from LCF;

“corporate borrowers” means the 12 UK registered companies to which LCF loaned bondholder funds;

“the fair, clear and not misleading rule” means COBS 4.2.1(1)R which states that a firm must ensure that a communication or financial promotion is fair, clear and not misleading;

“financial promotion” means, in the context of this Notice, an invitation or inducement to engage in investment activity that is communicated in the course of business;

“the financial promotion rules” means any or all of the rules in Chapter 4 of COBS that impose requirements in relation to a financial promotion;

“FSCS” mean the Financial Services Compensation Scheme;

“HMRC” means Her Majesty’s Revenue and Customs;

“Information Memorandum” means, in the context of a bond issue, a document published by the issuer that should provide prospective investors with all relevant information, including about risks, to enable them to make an informed decision about whether to invest;

“ISA” means an Individual Savings Account;

“LCF” means London Capital & Finance plc;

“the minibond business” means LCF’s raising of finance from the general public through the issuance of minibonds;

“the Relevant Period” means 7 June 2016 until 10 December 2018; and

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber).

4. FACTS AND MATTERS

LCF as a regulated entity

- 4.1. LCF was incorporated on 12 July 2012 and was initially regulated by the Office of Fair Trading in respect of consumer credit activities. On 1 April 2014, the regulation of consumer credit transferred from the Office of Fair Trading to the Authority and LCF was one of the approximately 50,000 firms whose regulator changed to become the Authority. Following this change, LCF registered for interim permission with the Authority to carry on its existing consumer credit activities and it made an application for Authority authorisation on 21 October 2015.
- 4.2. During the period from 2012 to early-2015, LCF engaged in very little commercial activity and filed accounts showing it to be either a dormant company or one generating low revenue.
- 4.3. LCF became regulated by the Authority on 7 June 2016 as a limited permission credit broker and it is from that point that the financial promotion rules applied to LCF.
- 4.4. LCF's minibond business was not dependent on it being authorised by the Authority.
- 4.5. On 1 November 2017, HMRC granted LCF ISA manager status but this did not, and was not meant to, involve HMRC ascertaining whether or confirming that the investments being sold by LCF qualified for inclusion within the ISA wrapper. The Authority was not involved in the grant of ISA manager status and at no point did the Authority ascertain whether or confirm that the investments being sold by LCF qualified for inclusion within the ISA wrapper. Being an ISA manager is not an activity regulated by the Authority.

LCF's minibond business and regulation

- 4.6. Whilst LCF's minibond business itself was designed to mostly fall outside of Authority regulation, LCF's financial promotions relating to the minibond business were caught by the Authority's financial promotion rules.
- 4.7. The central COBS financial promotion rule is the fair, clear and not misleading rule (COBS 4.2.1(1)R) which states that communications or financial promotions must

be “*fair, clear and not misleading*”. This key, simple rule, is the thread that links the majority of the financial promotion rules together.

The meaning of financial promotion

- 4.8. Section 21 of the Act sets out that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity (in other words, for the purposes of this Notice, must not communicate a financial promotion) unless they are an authorised person, or the content of the communication is approved (for the purpose of section 21) by an authorised person.
- 4.9. Issuing financial promotions is not itself a regulated activity under the Act.
- 4.10. A financial promotion can be made in many formats such as an advert in a newspaper, a social media post, or an Information Memorandum. What is, or is not, a financial promotion is fact dependent. Over the course of the Relevant Period (and before), LCF issued hundreds of separate financial promotions, although the core promotions which set out most detail about the bonds being sold and the risks involved were LCF’s Information Memoranda, brochures and website.

The minibond business

- 4.11. LCF’s only business was commercial lending funded by minibonds issued in its own name which were targeted towards, and sold predominately to, retail investors who then became bondholders. The bonds were of varying terms, between 1 and 5 years, and offered high rates of interest to investors. LCF’s sale of bonds increased during 2015, accelerated in 2016, and further increased in 2017 once it became a HMRC ISA manager with the introduction for sale of what LCF described as ISA bonds. LCF’s supposed ISA bonds proved to be very popular with prospective investors.
- 4.12. A total of 15 different bonds were issued by LCF and sold to prospective investors between 2013 and December 2018. Of these, 3 were issued and closed before the Relevant Period and 5 started to be issued before but also sold during the Relevant Period (with the rest all being issued and sold during the Relevant Period). Eleven bonds were named ‘Series 1’ through to ‘Series 11’ and 4 were described by LCF as ISA bonds named ‘ISA Series 1’ through to ‘ISA Series 4’. In total, LCF issued

over 16,700 bonds to 11,625 bondholders. The bonds, issue dates, interest offered, terms and value of investments are set out below.

Bond	Issue date	Interest	Term	Bond value
Series 1	2013	Unknown	1 year	Unknown
Series 2	Sep 13 to Jan 16	8.5%	1/3 years	£286,040
Series 3	Dec 15 to Oct 18	3.9%	1 year	£7,393,900
Series 4	Nov 15 to Dec 18	6.5%	2 years	£16,972,300
Series 5	Dec 15 to Feb 17	8%	3 years	£24,910,300
Series 6	Feb 16 to Dec 18	6.5%	2 years	£5,088,500
Series 7	Jan 16 to Dec 18	8%	3 years	£14,257,800
Series 8	Feb 17 to Sep 17	8%	3 years	£24,998,800
Series 9	Feb 14 to Sep 15	11%	2/5 years	£408,000
Series 10	Aug 17 to Dec 18	8%	3 years	£32,219,900
Series 11	Jun 18 to Dec 18	8.95%	5 years	£2,514,700
ISA Series 1	Dec 17 to Jul 18	8%	3 years	£50,002,900
ISA Series 2	Dec 17 to Dec 18	6.5%	2 years	£20,671,435
ISA Series 3	Jun 18 to Dec 18	8.95%	5 years	£30,187,982
ISA Series 4	Jun 18 to Dec 18	8%	3 years	£7,294,940

- 4.13. The highest interest rate offered by LCF for its bonds was 11% (on the Series 9 bond), but the vast majority offered interest rates between 6.5% and 9.3% and approximately 80% of the funds raised were in bonds with interest rates of 8% or above.
- 4.14. All the bonds sold by LCF were high-risk investments, lacking FSCS protection and locking bondholders into a set term holding non-transferable minibonds. This meant that there was a high risk for bondholders that some, or all, of their investment could be lost. LCF's business model was also unusual at the time as the minibonds were mass-marketed to the public rather than being aimed towards discrete selected investors. LCF was not raising funds to support its own business and was instead loaning funds to the corporate borrowers who were third party corporate entities. This further increased risk for bondholders as the funds raised

and loaned were no longer within LCF's control and were open to dissipation by third parties with whom bondholders had no relationship.

4.15. Each bond issue sold by LCF was accompanied by numerous financial promotions in different formats with the aim of generating as much interest from the public as possible. During the period in which it traded, LCF issued hundreds of financial promotions. These promotions can be grouped into 7 main categories:

- (1) Information Memoranda;
- (2) brochures;
- (3) direct email promotions;
- (4) LCF's website;
- (5) investment comparison websites;
- (6) press adverts; and
- (7) adverts on social media.

4.16. Financial promotions such as the comparison websites acted as an initial 'hook' to generate interest and drive traffic to LCF's website. Thereafter LCF's website and, in particular, its Information Memoranda, set out in detail the key features of the bonds including what the risks of investing were and how the loan process and security worked. These Information Memoranda were supposed to provide the detail behind the headline selling points (such as the rate of interest offered) and should have enabled prospective investors to make informed decisions about whether to invest with LCF. The Information Memoranda were available on LCF's website and prospective investors could also gain access to them via LCF's call centre.

4.17. The financial promotions issued by LCF presented a persuasive case for investment if their claims were taken at face value. The main points used to persuade potential investors to invest were as follows:

- (1) there was a high fixed rate of interest;
- (2) prospective corporate borrowers would be carefully selected UK corporate entities and subject to a full financial review and lending assessment prior to any lending decisions being made;

- (3) LCF would hold security over existing assets of the corporate borrowers with a maximum loan to value ratio of 75%;
- (4) an impression was given that there were no hidden fees or charges for bondholders;
- (5) the ISA bonds would be tax free investments; and
- (6) LCF was authorised by the Authority.

Use of investment comparison websites to attract bondholders

- 4.18. The most common way in which bondholders were introduced to LCF was via seemingly independent investment comparison websites which were funded by LCF. The websites had names such as *best-savings-rate.co.uk* and LCF ensured search engines were paid large sums so that the comparison websites were displayed at or near the top of the first page of relevant search results.
- 4.19. The main purpose of the investment comparison websites was to target and draw-in prospective investors to the LCF minibond business by comparing LCF bonds favourably (but unfairly) against, for example, bank and building society accounts paying much less interest and to link potential investors to the LCF website where an application to invest could be made.
- 4.20. As shown in the screenshot immediately below this paragraph, a prospective investor visiting the comparison websites would, in that typical example, be presented with a table of supposedly ISA eligible products listed in descending interest rate order with LCF's "*Fixed rate ISA*" at the top showing as paying 8.95%. Lower down the table included, for example, bank and building society accounts paying around 2%. This was an unfair comparison between very different products, but it had the effect of inducing prospective investors to click on a link which took them to the LCF website.

Best Savings Rate

Compare the best investment and savings account rates

Rates checked daily

1 hour ago

Current best rate:

8.95%

Best Fixed Rate Savings Accounts & ISAs 2018

Compare the top 10 savings accounts rates in the UK. These fixed-rate ISAs lock in your money for a fixed period of time, achieving a better than average interest rate which can beat inflation.

Fixed Rate Savings Accounts

All Terms

LCF

Account Type

Innovative Finance ISA

Open With

£5,000

Interest Rate:

8.95%

BEST RATE

Security Scheme

Asset-backed security managed by an independent security trustee.

MORE INFO

BLACKMORE

Account Type

Fixed Rate ISA

Open With

£5,000

Interest Rate:

7.90%

Security Scheme

Capital Protection Scheme New Investors: Invest now and receive £150 cashback.

MORE INFO

Lending Works

Account Type

IFISA

Open With

£100

Interest Rate:

6.00%

Security Scheme

Not covered by FSCS

MORE INFO

ZOPA

Account Type

Innovative Finance ISA

Open With

£1,000

Interest Rate:

4.50%

Security Scheme

Capital at Risk. Not FSCS.

MORE INFO

LANDBAY

Account Type

Fixed Rate ISA

Open With

£5,000

Interest Rate:

3.54%

Security Scheme

Not FSCS covered

MORE INFO

SHAWBROOK

Account Type

Fixed Rate Cash ISA

Open With

£5,000

Interest Rate:

2.25%

Security Scheme

FSCS

MORE INFO

Virgin Money - 5 Year Fixed Rate Cash E-ISA				
	Account Type Fixed Rate Cash ISA Open With £1	Interest Rate: 2.11%	Security Scheme FSCS	MORE INFO
Coventry Building Society - Fixed Rate ISA 30.11.2023				
	Account Type Fixed Rate ISA Open With £1	Interest Rate: 2.10%	Security Scheme FSCS	MORE INFO
Leeds Building Society - 5 Year Fixed Rate ISA				
	Account Type Fixed Rate Cash ISA Open With £100	Interest Rate: 2.05%	Security Scheme FSCS	MORE INFO
Skipton Building Society - 5 Year Fixed Rate Cash ISA				
	Account Type Fixed Rate Cash ISA Open With £500	Interest Rate: 2.01%	Security Scheme FSCS	MORE INFO

- 4.21. The websites did not make clear that they were linked to LCF and funded by it and instead gave the appearance of being independent from both LCF and the LCF minibonds they were promoting. Unbeknownst to prospective investors, the costs of operating and promoting the websites were actually paid by LCF out of bondholder funds from hidden fees charged upfront to the corporate borrowers.
- 4.22. The investment comparison websites used by LCF were not fair comparison websites as they did not compare like-for-like products. LCF's bonds were placed at or near the top of a list including bank and building society accounts, with LCF bonds almost always being featured first because of the high interest rates they offered compared to others in the table.
- 4.23. LCF paid fees of approximately £13.5m that went to the operators of search engines to promote its investment comparison websites. This shows how important this line of marketing was to LCF. The 3 main investment comparison websites used by LCF were visited approximately 11.8m times by prospective investors following internet searches and LCF's website was subsequently visited via links on the sites approximately 4.2m times. The Authority's understanding is

that more than one third of all bondholders who purchased an LCF minibond did so having first visited one of the investment comparison websites.

- 4.24. On the basis that the investment comparison websites were neither independent of LCF but appeared to be, nor genuine in the sense they did not compare similar products, LCF's use of them was both unfair and misleading.

Claims in LCF's financial promotions about lending process did not match reality

Summary of the position

- 4.25. Despite the numerous assurances LCF provided to prospective investors in its financial promotions about its rigorous lending process and the safety and security of its bonds, the truth of the matter is LCF loaned bondholder funds to just 12 connected corporate borrowers and did not operate its lending process as described to potential investors.
- 4.26. The corporate borrowers were not independent of each other, nor were they independent of LCF. This runs counter to the description of how LCF claimed it would make its lending decisions as set out in the financial promotions provided to prospective investors.

What LCF told prospective investors it would do

- 4.27. Prospective investors were told via LCF's financial promotions that LCF's modus operandi was to identify opportunities to provide finance within the UK's small and medium sized enterprise sector from which it would generate income via loan interest and associated fees charged to corporate borrowers. LCF highlighted that lending to such enterprises had dropped substantially and as such they were starved of funding which increased demand for short to medium term credit facilities. LCF's stated aim was to fill this gap, and the demand for investment, by raising funds from prospective investors by issuing them with "*secured bonds*" and using the proceeds of the bonds to make loans to the small and medium sized enterprises.
- 4.28. Prospective investors were told that LCF's directors would use their network of contacts in the financial, accounting and legal professions to source lending opportunities. LCF stated that loaned funds would be secured against assets of the corporate borrowers. LCF also assured prospective investors that no funds would be lent without it first carrying out rigorous financial due diligence on the

prospective corporate borrowers and that, when funds were loaned, LCF would carry out ongoing monitoring to spot any signs of potential default. LCF's promotions stated:

"LC&F intrinsically involves itself in all aspect of the funding lifecycle, from the raising of capital via bonds through to the securing of Borrowing Companies and the application, pre-lending due diligence and legalities of all loans, on-going monitoring of each Borrowing Company's performance and asset strength, loan interest and principal repayments and finally bond interest and principal investment payments to bond holders."

Claims about LCF's lending process

4.29. According to its financial promotions, LCF would only lend funds to a corporate borrower after conducting *"full due diligence [on the corporate borrowers] prior to lending"* including a *"full financial review"*, *"lending assessment"* and, if required, *"a further financial analysis [on the corporate borrower] via an independent accountant and or surveyor"*. This was known as LCF's lending process and it stated LCF would carry out the following steps in relation to the prospective corporate borrower:

- (1) a historical financial review to seek to analyse the performance of the prospective borrowers for the last three years to determine whether the current profitability of the prospective borrower was sustainable;
- (2) an appraisal of the property assets of the prospective borrower to assess the current market value of the property offered as security;
- (3) an appraisal of non-property assets of the prospective borrower to ascertain their value;
- (4) an assessment of projected turnover and profits of the prospective borrower to *"demonstrate that both interest and principal are able to be repaid"*;
- (5) an assessment of repayment proposals *"to determine if the repayment proposals are realistic, understandable and in line with the financial information (historical and forecasted) provided by the potential Borrowing Company"*;
- (6) an assessment of the prospective borrower's company management, track record and experience *"to determine if the leadership and management of*

the company has sufficient experience and depth of knowledge to deliver the financial performance required to repay any borrowing”;

(7) *“on-going monitoring of loans”* by checking each prospective borrower’s *“performance and asset strength, loan interest and principal repayments and finally bond interest and principal payments to Bond Holder”* with the object being *“... to identify early any difficulties a borrowing company may be experiencing”*; and

(8) [for loans above £2m] LCF would hold a non-executive position on the prospective borrower’s Board.

LCF’s lending process in reality

- 4.30. The reality of LCF’s lending process was nothing like that described in its financial promotions. Nine of the 12 borrowers had been incorporated for less than a year at the point they entered into loan facilities with LCF so it would have been impossible for LCF to have looked at 3 years of financial information. Of these 9, 7 were formed a matter of a few days or weeks before the loans were made.
- 4.31. The vast majority of the corporate borrowers had no active trading histories (even those that had existed longer than a few days) and LCF did not carry out meaningful financial due diligence. LCF was not able, therefore, to understand what future revenues the borrowers aimed to generate to meet their huge liabilities to LCF (which in turn had liabilities to bondholders) and how they intended to do this. As a result, LCF could not assess the viability of corporate borrowers repaying interest and loans from their trading activities.
- 4.32. In addition, for the most part lending was not secured against realisable assets held by the corporate borrowers, despite the assurances in the financial promotions to the contrary. Assurances were also given that the maximum loan to value ratio would be 75%. The term ‘loan to value’ is commonly used in relation to mortgage lending with lenders determining loans based on the value of the property being purchased and, especially combined with what prospective investors were told about property assets of corporate borrowers being appraised (see paragraph 4.29(2) above), is likely to have led prospective investors to think that loans to corporate borrower were secured against land and other physical property. LCF was in effect lending huge sums of bondholder funds to the corporate borrowers on an unsecured basis. This hugely increased the risks bondholders faced when investing in LCF’s minibond business.

An example – Company A

- 4.33. The contrast between the way in which LCF's financial promotions described its lending process and reality is starkly set out in the example of Company A, one of the corporate borrowers.
- 4.34. During the Relevant Period a loan facility agreement was executed for LCF to loan £7m of bondholder funds to Company A, which had only been incorporated 3 days before the loan facility was agreed, and its directors had links with LCF and the majority of the other corporate borrowers.
- 4.35. There is no evidence that before entering into the loan facility agreement, or at any point thereafter, LCF took proper due diligence steps such as assessing projected turnover and profits, repayment proposals, the business plan, company management, track record and experience (and it is difficult to see how this could have been meaningfully done in relation to a company that was only 3 days old).
- 4.36. Company A did not own any realisable assets which could act as security for LCF and LCF carried out no meaningful ongoing monitoring of the business once the lending decision had been made (and no member of LCF sat as a non-executive director on its Board).

Hidden fees and unsustainable rates of return

- 4.37. A prospective investor on reviewing LCF's financial promotions would have been likely to form the impression that their investment (of, say, £10,000) would be onward lent to corporate borrowers (as part of a loan of, say, £1m) with relatively small (in contrast to the reality) fees being paid by the corporate borrower. LCF financial promotions stated as follow:
 - (1) A corporate borrower would pay LCF a 2% set-up fee (so £20,000 on a £1m loan).
 - (2) LCF would also earn income by charging a 2% interest 'turn' on funds lent. In other words, on a bond paying 8% annually to investors LCF would charge corporate borrowers 10% annually and keep the 2%.
 - (3) Under a heading "*Are there any hidden fees, charges or deductions?*" was stated "*LCF will take no fees or make any deductions or charges of any kind on the interest paid by the Bond*". This gave the false and misleading

impression that there were no hidden fees when in fact there were hidden upfront fees of 25.5% because LCF paid that amount to certain service providers and charged those to the corporate borrowers by deducting the same amount from loan monies. In other words, in the example of a £1m loan, the corporate borrower would in fact receive only £725,000 (a total of 27.5% having been deducted, 25.5% in hidden fees and 2% for the disclosed set-up fee).

- 4.38. Therefore, in an example of a 3 year 8% LCF minibond with a corporate borrower being lent £1m but only receiving £725,000, the corporate borrower needed to generate commensurately high rates of return to cover the 25.5% of hidden fees over and above: (a) the high level of interest due to bondholders; (b) the disclosed lending fee due to LCF of 2%; and (c) a disclosed 2% interest 'turn' charged annually by LCF. The failure to disclose that LCF's business model depended on the corporate borrowers being able to generate commensurately large rates of return made LCF's financial promotions unfair and misleading because it meant investors could not accurately assess the risk of investing in LCF's minibonds.

The ineligibility of LCF's ISA bonds for inclusion within an ISA wrapper

- 4.39. With the introduction of its ISA bonds in 2017, LCF began to target retail investors who were familiar with ISA products. LCF's financial promotions encouraged prospective investors to transfer funds from non-LCF ISAs they already held into LCF ISA bonds.
- 4.40. LCF's financial promotions described its ISA bonds as debentures which qualified as investments which could be part of the (then) relatively new Innovative Finance ISA wrapper. LCF stated that this would allow investors to benefit from "*tax-free income*" and that existing ISA balances could be transferred into the LCF ISA bonds. LCF further stated that prospective investors' annual ISA allowance could be used to invest in the bonds and that investors might be able to transfer multiple years of saving from existing ISA balances into the LCF ISA bonds. Investors were told that the LCF ISA bonds were free from capital gains tax and income tax and that all interest received would be earned tax-free.
- 4.41. In order for bonds to be qualifying investments for an Innovative Finance ISA they have to meet certain conditions, including that they are transferable (see Regulation 8A(2) and (4) of the Individual Savings Account Regulations 1998/1870). LCF's ISA bonds did not in fact qualify as ISA investments as they were non-transferable. The Information Memoranda issued by LCF contained clear

statements about the non-transferability of the bonds. For example, the full title of the bond set out in large letters on the first page of the Series 1 ISA Bond was:

"London Capital & Finance Plc
Series 1 ISA, 3-year 8% Bonds
(Non-Transferable Securities)".

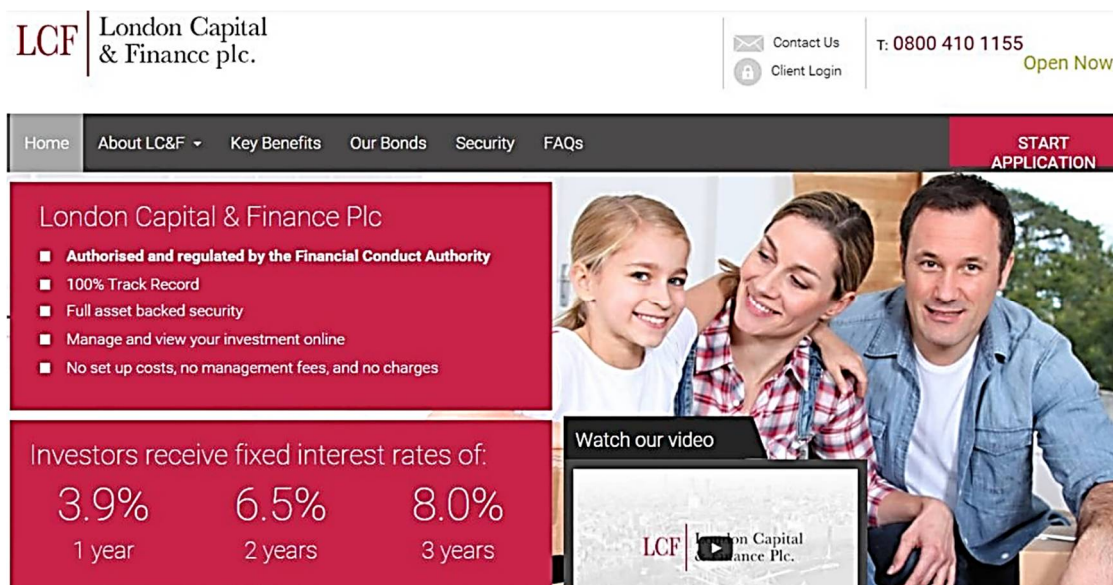
On page 2 it stated:

"Bonds are NOT transferable
The Bonds are not transferrable".

- 4.42. Prospective investors were misled by LCF's financial promotions which should never have described the bonds as ISA bonds.

Halo effect offered by Authority authorised status of LCF

- 4.43. A significant number of LCF's financial promotions, and in particular LCF's website where a prospective investor is likely to have looked early on in their journey to making an investment decision, made reference to LCF being authorised by the Authority with prominently placed statements such as "*LC&F is authorised and regulated by the Financial Conduct Authority ...*" or "*Authorised & regulated by the Financial Conduct Authority for credit broking activities.*" Whilst more detailed aspects of LCF's financial promotions, such as the Information Memoranda, would sometimes state that the bonds being advertised were not regulated, or did not fall within the scope of credit broking activities, that was insufficient to overcome the 'halo effect' brought about by the way in which LCF presented its Authority authorised status which created an unjustified impression of integrity to prospective investors and which provided a false level of comfort to investors when no such comfort was merited.
- 4.44. An example of this can be seen on LCF's website which, in 2017, stated that LCF was: "*Authorised and regulated by the Financial Conduct Authority*" in bold as the first point on the homepage: .



- 4.45. In the context of selling the minibonds to retail investors, the authorised status of LCF was of no relevance whereas the unregulated nature of the bonds (and the effect of that on FSCS coverage) was highly relevant. As such, in order for the promotions to have been fair, clear and not misleading, the information about the unregulated nature of the minibond business, and lack of FSCS coverage, should have featured much more prominently than LCF's authorised status (if the latter was referred to at all).

5. FAILINGS

- 5.1. During the Relevant Period LCF failed to ensure that its financial promotions were fair, clear and not misleading, thereby breaching COBS 4.2.1(1)R as follows:

- (1) LCF targeted retail investors including using seemingly independent comparison websites that unfairly and misleadingly compared much safer third-party investments (promising lower interest rates) with the minibonds offered by LCF (promising much higher interest rates). These comparison websites were typically seen by potential investors after an online search for "best ISA rate" or similar. The comparison websites were not in fact independent of LCF and were simply being used by it to drive traffic to its website.
- (2) LCF claimed it would lend funds raised to carefully selected UK corporate borrowers which had undergone a full financial review. This claim was untrue and misleading because the corporate borrowers were not independent of LCF or each other, they were not carefully selected, and LCF conducted no meaningful due diligence before lending.

- (3) Despite the numerous assurances LCF provided to prospective investors in its financial promotions about the safety and security of its minibonds, including that the loans made by LCF were secured against assets of the relevant borrowing company, with a maximum loan to value of 75% (so that, for example, for a loan of £750,000 LCF would have taken security over £1m of the borrowing company's assets) the funds loaned were in fact on the whole not secured against realisable assets held by the corporate borrowers.
- (4) LCF's financial promotions gave the misleading impression there were no hidden fees, charges, or deductions when in fact for every £1 invested, LCF paid fees of 25.5% to meet its online marketing and other support service costs and these fees were not disclosed to prospective investors.
- (5) Not only was the impression given that there were no hidden fees misleading and unfair, the 25.5% in fees paid by LCF was passed on directly to the corporate borrowers (unbeknownst to potential investors who were not even aware of the fees). This meant that in order for bondholders to receive the interest promised on the minibonds (most of which were offered at interest rates of between 6.5% and 9.1%, although rates went as high as 11%), as well as their capital back, the corporate borrowers needed to generate very high rates of return to cover the 25.5% of hidden fees over and above: (a) the high level of interest due to bondholders; (b) a disclosed lending fee due to LCF of 2%; and (c) a disclosed 2% interest 'turn' charged annually by LCF. The failure to disclose that LCF's business model depended on the corporate borrowers being able to generate commensurately large rates of return made LCF's financial promotions unfair and misleading because it meant investors could not accurately assess the risk of investing in LCF's minibonds.
- (6) The minibonds LCF marketed as ISA bonds were not in fact qualifying investments for inclusion within an ISA wrapper. LCF's misleading marketing in this regard induced 8,388 investors to invest £108m in LCF ISA bonds, many of them transferring out of legitimate ISA qualifying investments (rendering the investors potentially liable to tax).
- (7) Even though LCF's minibond business was not regulated by the Authority, LCF's financial promotions prominently featured the fact it was authorised by the Authority. This resulted in an unmerited 'halo effect' as LCF's

highlighting of its authorised status in this way presented an unjustified impression of integrity to prospective investors.

6. SANCTION

- 6.1. The Authority's policy for imposing a public censure and financial penalty is set out in Chapter 6 of DEPP.
- 6.2. The Authority has considered the disciplinary and other options available to it and has concluded that a public censure is the appropriate sanction in the circumstances of this case.
- 6.3. The Authority would have imposed a substantial financial penalty on LCF for the serious failings in this case. However, the Authority has considered the impact that a financial penalty would have on LCF given that it is currently in administration, insolvent, and that there is a significant liability to its creditors (principally bondholders, who invested with LCF, and the FSCS, which has administered two compensation schemes for bondholders). Taking this into account, the Authority does not consider it appropriate to impose a financial penalty on LCF and instead publishes a censure to the effect that LCF failed to ensure that its financial promotions were fair, clear and not misleading (in contravention of COBS 4.2.1(1)R).
- 6.4. Had LCF not been in administration and insolvent the Authority would, in addition, have required LCF to pay restitution in respect of both the profit it gained from its misconduct and the losses suffered by bondholders as a result, using the Authority's powers under section 384 of the Act. Due to the way in which LCF operated, precisely quantifying the profit that accrued to it as a result of the contravention would not have been straightforward, but restitution for losses would have been readily quantifiable and substantial totalling around £237.2m (less any amounts recovered for bondholders by LCF's Administrators).

7. PROCEDURAL MATTERS

- 7.1. This Notice is given to LCF under section 390 of the Act. The following statutory rights are important.

Decision maker

- 7.2. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

Publicity

- 7.3. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the Authority must publish such information about the matter to which this Notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to LCF or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.
- 7.4. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contacts

- 7.5. For more information concerning this matter generally, contact Gareth Buttrill at the Authority (gareth.buttrill@fca.org.uk).

Kerralie Wallbridge

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division