COMPENSATION (LONDON CAPITAL & FINANCE PLC AND FRAUD COMPENSATION FUND) BILL

EXPLANATORY NOTES

What these notes do

These Explanatory Notes relate to the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill as brought from the House of Commons on 23 September 2021 (HL Bill 55).

- These Explanatory Notes have been prepared by HM Treasury and the Department for Work and Pensions, in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by Parliament.
- These Explanatory Notes explain what each part of the Bill will mean in practice; provide background information on the development of policy; and provide additional information on how the Bill will affect existing legislation in this area.
- These Explanatory Notes might best be read alongside the Bill. They are not, and are not intended to be, a comprehensive description of the Bill.

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Overview of the Bill

1 The purpose of the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Bill is:

- To establish the financial authority to enable the Treasury to incur expenditure in relation to the payment of compensation to customers of London Capital & Finance (the 'Scheme').
- To provide power to the Secretary of State to make a loan to the Board of the Pension Protection Fund (PPF) and for that loan to form a part of the funds of the Fraud Compensation Fund.

Policy background

London Capital & Finance

1 London Capital & Finance plc (LCF) was a Financial Conduct Authority (FCA) authorised firm which issued non-transferable debt securities (known as "minibonds"). The firm went into administration in January 2019, at which point they had over 11,000 investors who had invested £237 million in total. The majority of LCF's investors were ineligible for compensation from the Financial Services Compensation Scheme (FSCS) as the issuance of LCF's minibonds was not a regulated activity.

2 As a consequence of the failure and the losses suffered by bondholders, in May 2019 the Economic Secretary to the Treasury issued a direction, pursuant to sections 77(1) and (2) and 78(5) and (6) of the Financial Services Act 2012, to the FCA, that it was in the public interest that an investigation be undertaken into the relevant events relating to the regulation of LCF.

3 The FCA appointed a former Court of Appeal judge, Dame Elizabeth Gloster, to undertake that investigation. In December 2020, Dame Elizabeth's report was published. It concluded that the FCA did not discharge its functions in respect of LCF in a manner which enabled it to effectively fulfil its statutory objectives during the relevant period.

4 In view of the range of factors contributing to the scale of losses for bondholders and the regulatory failure identified by Dame Elizabeth Gloster's report, the government decided to establish a compensation scheme for LCF bondholders. This provision authorises the Treasury to incur expenditure in relation to the Scheme. The government announced via Written Ministerial Statement on 17 December 2020 that it would establish the scheme and provided details on the scheme's terms via Written Ministerial Statement on 19 April 2021.

Pension Schemes (Fraud Compensation Fund)

5 The Bill gives the Secretary of State the power to make a loan to the Board of the PPF which will enable the payment of compensation to eligible occupational pension schemes following the High Court case of *The Board of the PPF v Dalriada* ([2020] EWHC 2960 (Ch)).

6 The Fraud Compensation Fund (FCF) is a compensation scheme that is administered by the PPF and was established under the Pensions Act 2004. The FCF can assist if an occupational pension scheme has its assets reduced as a consequence of an offence involving dishonesty and the scheme employer is insolvent and unable to make good the shortfall caused by the offence.

7 Trustees, scheme managers, members, scheme beneficiaries, scheme administrators and their representatives can all make an application for compensation. Any compensation is paid directly to the Trustees of the scheme.

8 The High Court case of *The Board of the PPF v Dalriada* determined that pension liberation schemes are eligible to apply to the FCF for compensation. Pension liberation fraud involves members being persuaded to transfer their pension savings from legitimate schemes to fraudulent schemes with promises of high investment returns. The Court's finding had immediate effect from 6 November 2020. The PPF has estimated that the compensation payments claimed will be in the region of £350 million.

9 The FCF is funded by a levy on eligible pension schemes and at the time of the judgment had assets of £26.2m. Even with future levy income, the expectation is that there will be unfunded liabilities in the region of £200m to £250m.

Legal background

London Capital & Finance plc

10 The Treasury intends to use Part 15A of the Financial Services and Markets Act 2000 (FSMA) to require the FSCS to administer the Scheme on the Treasury's behalf. Part 15A was inserted by the Financial Services Act 2012 (FSA 2012) and it enables the FSCS to administer a scheme for the payment of compensation to customers of financial services providers at the direction of the Treasury.

11 Section 224F of FSMA enables the FCA to make rules in connection with the exercise of the FSCS of the functions in respect of any scheme administered under Part 15A. Section 224F(5) permits the FCA to apply or modify any existing provision (rule) of the FSCS to apply to a Part 15A scheme. This power will enable the scheme to draw upon the existing powers and processes of the FSCS where needed for the functioning of the Scheme. However, section 224F(1) of FSMA requires the FCA to make rules in order to transfer existing provisions to apply to the Part 15A scheme.

12 Such rules are subject to the rule-making requirements in section 138I of FSMA which require, for example, a public consultation to be undertaken by the FCA and a cost-benefit analysis to be carried out. This Bill disapplies these rule-making requirements for the purposes of the FCA applying its existing rules to the Scheme to reflect the fact that existing rules have already been consulted upon and to avoid any unnecessary delays to compensation payments.

Pension Schemes (Fraud Compensation Fund)

13 The Pensions Act 2004 makes provision with regard to the PPF and scheme funding and other miscellaneous provisions relating to the sources of funding for the Board of the PPF and the FCF. Northern Ireland has separate but corresponding legislation to the Pensions Act 2004 (the Pensions (Northern Ireland) Order 2005 No.255).

14 Part 2 of the Pensions Act 2004 establishes the Board of the PPF ("the Board") to provide compensation for members of defined benefit occupational pension schemes in the event of the scheme's sponsoring employer becoming insolvent and leaving the scheme with insufficient funds to pay its members' pensions.

15 The Board has two main functions: to administer the PPF, which pays compensation to members of defined benefit occupational pension schemes, and the Fraud Compensation Fund ("the Fund") which pays compensation to defined benefit and money purchase occupational pension schemes in cases of fraud and misappropriation of scheme assets. It replicates some of the functions of the Pension Compensation Board, abolished by Part 9 of the Pensions Act 2004.

16 Section 115 enables the Board to borrow money subject to a prescribed borrowing limit, which is specified by the Secretary of State (by order). The Board is permitted to borrow money from a deposit taker (defined in that section) and it also allows the Board to provide security for any money that it borrows.

17 Chapter 4 of Part 2 of the Act describes what is payable to the Fund and how what is held in the Fund may be spent. Section 188(1) lists what the Fund will consist of, including money borrowed from a deposit taker to enable the Board to meet liabilities. Section 188(3) lists the types of payments that are permitted out of the Fund and section 188(4) states that only those amounts specified in subsection (3) may be paid out of the Fund.

18 Sections 115 and 188 of the Pensions Act 2004 extend to Northern Ireland.

Territorial extent and application

London Capital & Finance plc (LCF)

19 Clause 1 extends and applies to the United Kingdom. The main subject matter of this clause relates to the expenditure on a compensation scheme launched in response to matters relating to the regulation of financial services. Financial services is a reserved matter. The provisions within this clause do not touch on matters which are devolved to the Scottish Parliament, Senedd Cymru or the Northern Ireland Assembly.

Pension Schemes (Fraud Compensation Fund)

20 The clause contains an amendment to the Pension Act 2004. The provisions being amended extend and apply, and the new section being added is intended to extend and apply, to England and Wales, Scotland and Northern Ireland.

21 Clause 2 does not contain any provisions which engage the legislative consent process in the Scottish Parliament or Senedd Cymru.

22 Occupational pensions are a transferred matter in Northern Ireland. There is a convention that Westminster will not normally legislate with regard to matters that are within the legislative competence of the Devolved Administrations without the consent of the legislature concerned. A Legislative Consent Motion for Northern Ireland will be required.

23 See the table in Annex A for a summary of the position regarding territorial extent and application in the United Kingdom. The table also summarises the position regarding legislative consent motions.

Commentary on provisions of Bill

Clause 1: Compensation payments to customers of London Capital & Finance plc

24 *Subsection (1)* allows the Treasury to incur expenditure in relation to compensation to customers of LCF who have been adversely affected by matters identified in the Gloster Report.

25 *Subsection (2)* specifies that subsection 3 applies where the Treasury requires, under Part 15A of FSMA, the FSCS to administer a scheme for the purposes of paying the compensation mentioned in the previous subsection.

26 *Subsection (3)* disapplies FCA rule-making requirements contained in Section 138I of FSMA, such that existing rules pertaining to the FSCS can be applied to the scheme without the need for the FCA to undertake a full public consultation and impact assessment.

27 *Subsection (4)* specifies that, for the purpose of this section, “Gloster Report” means the Report of the Independent Investigation into the Financial Conduct Authority’s Regulation of London Capital & Finance plc, as revised on 10 December 2020.

Clause 2: Loans to the Board of the Pension Protection Fund

28 Clause 2 amends the Pensions Act 2004.

29 *Subsection (2)* inserts a new section 115A, which gives the Secretary of State a power to lend money to the Board of the PPF, for the Board’s functions, under Chapter 1 of Part 2 of the Act and any corresponding provision in Northern Ireland (Part 3 of the Pensions (Northern Ireland) Order 2005). The loan will be made to the Board on terms that the Secretary of State will determine.

30 *Subsection (3)* amends section 115 Pensions Act 2004 to clarify that the borrowing cap applied to the Board is limited to any borrowing that takes place under section 115.

31 *Subsection (4)* amends section 188(1) Pensions Act 2004 (Chapter 4 of Part 2 of the Pensions Act 2004) to broaden the list of the contents of the Fund, to include money borrowed by the Board, under new section 115A. It also extends the type of payment permitted from the Fund to allow repayment of money borrowed by the Board from the Secretary of State.

Clause3: Extent, commencement and short title

32 Clause 3 provides the short title of the Bill.

33 Clauses 1, 2 and 3 of the Bill come into force on Royal Assent.

Financial implications of the Bill

34 The upfront cost of the London Capital & Finance plc compensation scheme is expected to be in the region of £120m. The Treasury will take an assignment of bondholders' rights in the insolvency proceedings, allowing the department to recover a portion of the compensation paid out as assets are sold by the administrators.

35 The Bill confers a new power on the Secretary of State, specifically to provide a loan to the Board of the PPF. This additional power will involve increased expenditure. However, expenditure in relation to this Bill will be repaid by the income received from the FCF levy on eligible occupational pension schemes. There will be no impact on DWP expenditure in the long term, as it is the policy intent of this measure that the capital and principal in relation to the loan will be repaid.

36 The loan is estimated to be within a range of £200–£250m and will be repaid by the FCF levy on eligible pension schemes. The FCF levy rates and repayment period, currently estimated to be between 10 and 15 years, will be subject to public consultation, which is timetabled for autumn 2021.

Parliamentary approval for financial costs or for charges imposed

37 A money resolution and a ways and means resolution were made and the Bill was passed by the House of Commons on the 22 September.

38 There will be expenditure for the purposes of the payment of compensation to customers of London Capital & Finance plc and on the making of loans to the Board of the PPF for the purposes of their fraud compensation functions. Those heads of expenditure require a money resolution.

39 As explained above, it is expected that money raised by the fraud compensation levies imposed under section 189 of the Pensions Act 2004 and Article 171 of the Pensions (Northern Ireland) Order 2005 will be used to repay loans made by the Secretary of State. Although this is an existing charge on the people, having to repay loans made by the Secretary of State will mean an increase in the rate of the levy. The increase in that charge requires a ways and means resolution.

Compatibility with the European Convention on Human Rights

40 Section 19 of the Human Rights Act 1998 requires the Minister in charge of a Bill in either House of Parliament to make a statement about the compatibility of the provisions in the Bill with the Convention rights (as defined in section 1 of the Act).

41 As the purpose of the Bill is to establish the financial authority necessary to enable the Treasury to incur expenditure and to provide power to the Secretary of State to make a loan, the Bill does not engage Convention rights.

42 Therefore, in the opinion of Viscount Younger of Leckie, the provisions of the Bill are compatible with Convention rights and he has made a statement to this effect.

Related documents

43 The following documents are relevant to the Bill and can be read at the stated locations:

- Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc by Dame Elizabeth Gloster
    - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf
- Written Ministerial Statements on London Capital and Finance
    - https://questions-statements.parliament.uk/written-statements/detail/2021-04-19/hcws922
    - https://questions-statements.parliament.uk/written-statements/detail/2020-12-17/hcws678
- The Board of the PPF v Dalriada judgment.
    - https://www.bailii.org/ew/cases/EWHC/Ch/2020/2960.html

Annex A – Territorial extent and application in the United Kingdom

44 The provisions of this Bill extend and apply to England and Wales, Scotland and Northern Ireland.

Provision	**Extends to E & W and applies to England?**	**Extends to E & W and applies to Wales?**	**Extends and applies to Scotland?**	**Extends and applies to Northern Ireland?**	**Would corresponding provision be within the competence of Senedd Cymru?**	**Would corresponding provision be within the competence of the Scottish Parliament?**	**Would corresponding provision be within the competence of the Northern Ireland Assembly?**	**Legislative Consent Motion sought?**
1 [LCF Compensation Scheme]	Yes	Yes	Yes	Yes	No	No	No	No
2 [Loans to the Board of the Pension Protection Fund]	Yes	Yes	Yes	Yes	No	No	Yes	Yes (NI)

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