

LCF Mini-Bond Holders Withdraw Appeal Against FSCS

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The Financial Services Compensation Scheme (FSCS) confirmed on 23 August that London Capital and Finance (LCF) mini-bond holders have withdrawn their appeal against an important March 2021 High Court decision dismissing their judicial review claim. FSCS confirmed that the litigation had been concluded without any change to any of its earlier decisions on LCF claims.

The judicial review

The case arose from the collapse of LCF in January 2019, leaving around 11,000 mini-bond holders with total losses of £237 million. The FSCS had, up to February 2021, paid out around £56.2 million in compensation to approximately 2,900 LCF mini-bond holders. However, claims based solely on the sale of the LCF mini-bonds were being rejected, as FSCS had concluded that was not of itself a regulated activity, because. For bonds issued post-MIFID2, the key issue was that the bonds were not “transferable securities”. FSCS was only upholding the small minority of claims by mini-bond holders who could show they were given negligent financial advice by LCF, or who transferred money from ISAs to pay for LCF mini-bonds, entailing other regulated activities.

In High Court proceedings, four affected investors argued that the bonds were transferable and they should be entitled to compensation. [Mr Justice Bourne disagreed](#) and the claim was dismissed. The LCF bondholder representatives applied for permission to appeal on 19 April 2021 and on 26 May 2021, Mr Justice Bourne granted permission.

Counting the costs

Shortly after securing permission to appeal the leading mini-bond holders’ representatives indicated that an appeal was unlikely to proceed due to the FSCS’s refusal to extend an existing costs agreement to any appeal. The mini-bond holders had been receiving *pro bono* legal representation. FSCS, which is funded predominantly through levies on financial services firms, was incurring legal costs that would be passed on through the levy if not recovered under costs orders.

In a statement made by the mini-bond holders’ representatives, it was noted that the four claimants would be personally at risk of having to pay all of FSCS’s legal costs if the appeal failed. Whilst

FSCS agreed not to seek its legal costs of the High Court case, it appears no such agreement could be secured for the appeal. The claimants expressed frustration that *“By refusing to agree not to pursue costs against the four of us personally if an appeal is unsuccessful, the FSCS knows it is stifling the possibility of the appeal going ahead”*.

The claimants had hoped to crowdfund for adverse costs but FSCS felt unable to provide the claimants with a budget for the potential costs exposure so a crowdfunding target could be set. It is not clear whether a cost capping order was sought as an alternative. The claimants have called for the FSCS to reconsider its position on costs.

A successful appeal was estimated to be worth approximately £25 million to the LCF investors and £70 million to the taxpayer.

Other avenues for compensation

Separately, in April 2021 it was confirmed that more than 1,000 LCF mini-bond holders had complained to the FCA about its failure to supervise LCF’s activities adequately. The regulator was heavily criticised by the [Gloster Report](#) into the LCF collapse, published in November 2020, and has now said that it will make further compensation payments to a small number of bondholders it failed to protect directly, being those that attempted to contact the regulator directly with concerns before the firm collapsed. The Government is also establishing an *ad hoc* compensation scheme for LCF investors intended to refund 80% of their investment up to a cap of £68,000. That scheme will be administered by FSCS. More detail on the FCA and Government schemes can be found [here](#) and [here](#).

SPB comment

Given its responsibilities to levy payers the position of the FSCS is understandable, but it is unfortunate that the opportunity to test the regulatory status of mini-bonds at appellate level has seemingly been missed. It is hard to argue with the technical basis for the High Court’s judgment, but from a policy perspective it appears anomalous that investments that were so widely marketed to retail investors should fall outside the ambit of FCA regulation and the statutory compensation scheme that FSCS operates.

LCF is one of several high-profile mini-bond issuer collapses over recent years, as the permissive regulatory environment for non-bank lending innovation in the post-financial crisis years has arguably fueled a string of failures of mini-bond issuers and related peer-to-peer, crowdfunding, and online lending firms. The FCA’s ban on the retail mini-bond sales (on a temporary basis from 1 January 2020, and permanently from 1 January 2021) has protected consumers from further harm. Unfortunately FSCS, the FCA, and thousands of investors, are still grappling with the regulatory implications and consequences of activity that predated that ban.

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