FINAL NOTICE

To: **David M Aaron (Personal Financial Planners) Limited (In Liquidation)**

Of: **C/o KPMG**
Liquidator
8 Salisbury Square
LONDON EC4Y 8BB

Date: **25 August 2004**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about a decision to cancel your permission to carry on regulated activities.

1. ACTION

1.1. The FSA gave you a Decision Notice on 16 July 2004 ("the Decision Notice") which notified you that for the reasons set out below, having taken into account the written representations of David Aaron, Andrew Jones, Michael Aaron and Stephen Aaron, and pursuant to section 45 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to cancel the permission granted to David M Aaron (Personal Financial Planners) Limited (In Liquidation) ("the Firm"). The decision had been made pursuant to Part IV of the Act in respect of the firm's failure to satisfy the Threshold conditions arising from breaches of the following Rules and Principles:

- until 1 December 2001 ("N2"), the Securities and Investments Board ("SIB") Principle 2 and the connected Rules of the Personal Investment Authority ("PIA"), including Adopted FIMBRA Rules, listed in the Appendix to this Notice ("the Appendix"); and

- after N2, the FSA's Principles for Businesses ("FSA Principles") 2 and 7 and the connected Rules in the parts of the FSA's Handbook entitled *Conduct of Business* ("COB Rules") and *Senior Management arrangements, Systems and controls* ("SYSC Rules") also listed in the Appendix.

2. THE SIB PRINCIPLES AND FSA PRINCIPLES, RELEVANT STATUTORY PROVISIONS AND OTHER REGULATORY RULES

2.1. The SIB Principles are universal statements of standards expected of firms. They were issued by the SIB and applied to PIA members.

2.2. SIB Principle 2 provided that a firm should act with due skill, care and diligence.

2.3. The FSA's Principles are set out in the part of the FSA's Handbook entitled *Principles for Businesses*. They are a general statement of the fundamental obligations of authorised persons under the regulatory system. They derive their authority from the FSA's Rule making powers as set out in the Act and reflect the FSA's regulatory objectives.

2.4. FSA Principle 2 provides that a firm must conduct its business with due skill, care and diligence.

2.5. FSA Principle 7 provides that a firm must pay due regard to the information needs of its clients and communicate information to them in a way that is clear, fair and not misleading.

2.6. Section 45 of the Act provides, among other things, that:

"(1) The Authority may exercise its power under this section in relation to an authorised person if it appears to it that-

(a) he is failing, or is likely to fail, to satisfy the threshold conditions;

(2) The Authority's power under this section is the power to vary a Part IV permission in any of the ways mentioned in section 44(1) or to cancel it."

2.7. Paragraph 4 of Schedule 6 to the Act ("Threshold condition 4 (Suitability)") states, among other things, that:

"(1) The resources of the person concerned must, in the opinion of the Authority, be adequate in relation to the regulated activities that he seeks to carry on, or carries on."

2.8. Paragraph 5 of Schedule 6 to the Act ("Threshold condition 5 (Adequate resources)") states:

"5. The person concerned must satisfy the Authority that he is a fit and proper person having regard to all the circumstances, including-

(a) his connection with any person;

(b) the nature of any regulated activity that he carries on or seeks to carry on; and

(c) the need to ensure that his affairs are conducted soundly and prudently."

2.9. The FSA's regulatory objectives established in section 2(2) of the Act include the protection of consumers and maintaining confidence in the financial system.

2.10. PIA Rule 1.3.1(2) provided that a PIA member must obey the PIA Rules, which included the Adopted FIMBRA Rules.

2.11. PIA Rule 1.3.1(6) provided that a PIA member which failed to comply with, inter alia, the PIA Rules or any of the SIB Principles was liable to disciplinary action.

3. REASONS FOR THE ACTION

3.1. The FSA has cancelled the permission granted to the Firm pursuant to Part IV of the Act in respect of its failure to satisfy the Threshold conditions. The failure to satisfy the Threshold conditions arises in respect of breaches of the SIB Principles and connected PIA Rules, including Adopted FIMBRA Rules, referred to in paragraph 1.1 and of the FSA's Principles and Rules also referred to in paragraph 1.1. The breaches, which occurred between January 1998 and June 2003, arose from failures on the part of the Firm in respect of the mis-selling of Structured Capital at Risk Products ("SCARPs") as follows:

- failure to issue advertisements and financial promotions that were clear, fair and not misleading;
- failure to make suitable recommendations;
- failure to maintain adequate records;
- failure to act with due skill, care and diligence; and
- failure of compliance oversight.

3.2. The Firm's failings were particularly serious because of the following factors:

- The Firm mis-sold a substantial number of SCARPs,
- the internal risk assessment process was fundamentally flawed;

- insufficient weight was placed on the downside gearing and fixed term nature of SCARPs;

- the financial promotions issued by the Firm contained misleading statements;

- The Firm failed to disclose that journalists had been paid to provide an "independent" commentary; and

- The Firm failed to keep adequate records of risk assessment meetings and complete records of individual sales.

3.3. The failings in this instance warrant the cancellation of the Firm's Part IV permission and the withdrawal of authorisation in that the breaches occurred over a number of years, were not isolated incidents and went to the heart of the way the Firm operated. The problems were systemic. The FSA recognises that the Firm is now in liquidation but considers that its misconduct was so serious as to require the removal of its Part IV permission by reference to that misconduct and that the underlying facts should be a matter of public record.

4. BACKGROUND

The Authorised Firm

4.1. The Firm, founded by Mr David Aaron in 1971, is an Independent Financial Adviser. Until 30 September 2000 the Firm operated as a Partnership. From 1 October 2000 the Firm became a privately owned limited company. The Firm operated from its premises in Woburn Sands, Milton Keynes.

4.2. The Firm was authorised by the FSA on 1 December 2001. It was previously authorised by the PIA or its predecessor from 18 July 1994 to 30 November 2001. The Firm had a good compliance history prior to these failings.

4.3. From information provided by the Firm, the FSA noted that between January 1998 and June 2003, the Firm completed approximately 53,563 transactions in regulated products, of which 14,995 were structured products, not all of which were SCARPs. This equated to 28% of total sales of all products made by the Firm during the period. The Firm was unable to provide the FSA with the number of SCARPs sold but the FSA believes that the total number of SCARPs sold by the Firm was at least 7,900.

4.4. The Firm had a mailing list of approximately 160,000 individuals who had had contact with the Firm and it conducted business by sending them publications promoting a variety of financial products. Approximately 30,000 of these individuals were customers of the Firm who had transacted business with it previously. Business was transacted with customers on both an “advisory” and “direct offer” basis. The Firm estimated that approximately 15% of the 14,995

structured products transactions were undertaken on an advisory basis, while 85% were direct offers.

Discovery of the issues

4.5. In March 2002, the Firm was included in an industry-wide thematic review of the sale of SCARPs by the FSA. The review included the desk-based examination of a selection of firms' training material, complaints and sales documentation. Concerns were identified regarding the suitability of sales and, as a result, a visit to the Firm was undertaken in March 2003. The visit was split between a general review of compliance related issues, including selling practices, complaints and advertising and a continuation of the review of SCARPs, building on the desk-based review.

4.6. As part of its process for marketing SCARPs the Firm used a Marketing Committee of its directors and senior advisers to decide upon the risk ratings that it would apply to the various versions of SCARPs that it marketed. However, the method by which the Firm assessed the risk profile of SCARPs was fundamentally flawed in that it placed undue reliance upon the Marketing Committee's own subjective views of past, current and future market conditions and failed to take adequate account of the downside gearing as well as the fixed term nature of SCARPs. The members of the Marketing Committee who were also directors of the Firm and their relevant controlled functions were:

- David M Aaron ("Mr David Aaron") - Director, Chief Executive, Apportionment and Oversight and Investment Adviser;
- Andrew Jones ("Mr Jones") - Director, Compliance Oversight, Money Laundering Reporting and Investment Adviser;
- Michael Aaron ("Mr Michael Aaron") - Director and Investment Adviser; and
- Stephen Aaron ("Mr Stephen Aaron") - Director.

4.7. On 22 April 2003, following the Supervision visit, which had been prompted by concerns arising from the desk-based review, the FSA wrote to the Firm regarding SCARPs stating "*We are still not satisfied that all those concerns about the suitability of sales have been allayed. We are discussing our conclusions and expect to write again shortly with a more detailed consideration of the outstanding issues*." Supervision did not subsequently write directly with a detailed consideration of the outstanding issues, but referred the Firm to Enforcement on 3 June 2003. Investigators were appointed on 27 June 2003. The Firm fully co-operated with the investigation into the sale of SCARPs.

Complaints

4.8. Since September 2003 the Firm received a substantial number of complaints relating to its marketing and sales of SCARPs. Following a decision by the Financial Services Ombudsman Scheme ("FOS") in respect of a complaint relating to a direct-offer SCARP sale, the Firm was placed into voluntary administration on 22 December 2003. the Firm is now in insolvent liquidation. Over 2,000 complaints relating to the sale by the Firm of SCARPS have now been received. The vast majority of these complaints were received after the publicity generated by the FSA's decision to impose a financial penalty on Lloyds TSB Bank plc in September 2003, arising from sales of a SCARP product.

5. CONTRAVENTION OF RELEVANT STATUTORY REQUIREMENTS

5.1. The failings by the Firm and the deficiencies in the Firm's risk assessment process are set out in full in the Investigation Report. A summary of the main breaches is as follows:

(1) Failure to issue advertisements and financial promotions that are clear, fair and not misleading.

5.2. Until N2, by virtue of PIA Rule 4.1 and Adopted FIMBRA Rules F28.3, F18.3(3), F18.7(1), F18.10.1, F18.11.3, the Firm was required to issue advertisements that provided customers with adequate information and which were clear, fair and not misleading. After N2 the requirement to issue financial promotions which are clear fair and not misleading have been contained in FSA Principle 7 and COB Rules 3.8.4 and 3.8.8. The Firm failed to comply with the Rules to which it was subject at the relevant time.

Facts and matters relied upon

5.3. PIA and FSA Rules required the Firm to ensure that it issued only advertisements and financial promotions respectively that were clear, fair and not misleading and that should have explained adequately the risks involved without unfairly accentuating the benefits.

5.4. The risks of SCARPS are significant because of the inflexible nature of the underlying investment vehicles. This inflexibility means that the risks SCARPs are greater than those of traditional "pooled" equity investments, such as Unit Trusts. The principle risks of SCARPs are:

(1) The fixed term nature of the contracts. SCARPs are designed to give maximum benefits only after a set period. If they are cashed in early, customers may get a poor return as the underlying investments may have to be sold.

(2) The return of capital is pre-determined because it is linked to an index or basket of shares. There is no facility to "manage" the investment to either enhance returns or reduce exposure to falling markets.

(3) Enhanced gearings can substantially reduce maturity values as they reduce the capital at a faster rate than falls in the relevant index. For example, a 2-for-1 gearing reduces the capital by 2% for each 1% fall in the relevant index.

(4) The charges are higher than traditional "pooled" equity investments such as unit trusts.

5.5. The Firm's failings in relation to advertising and financial promotion were important as 85% of the firm's sales of SCARPs were on a "direct offer" basis where there was no provision for advice.

5.6. The method by which the Firm assessed products was fundamentally flawed in that it understated the impact of the downside risk of SCARPs. The Firm placed reliance upon its own subjective views of past, current and future market conditions. As such, the risk assessment process mitigated against providing customers with a transparent view about the potential impact of a downside event. In addition, the Firm failed to take adequate account of the downside gearing of the products. As such, the risk ratings allocated to products enhanced downside gearings were misleadingly low and did not fully reflect the nature of the risk of these products.

5.7. The Firm failed to take adequate account of the fixed term nature of the product which compelled the customer to crystallise any loss at the end of the investment term. As such, the Firm did not take all material factors into account when assessing the risks of SCARPs.

5.8. The Firm failed to adopt a realistic approach to risk rating growth and income options. As such, the growth version of the SCARP was consistently downplayed in comparison with the income version.

5.9. Furthermore, the financial promotional material issued by the Firm was found to contain a number of unclear and misleading statements relating to the risk of SCARPs, including:

- comments and risk ratings from “independent” panellists; and

- descriptive comments made by the Firm.

5.10. The Firm quoted comments and risk ratings from supposedly "independent" panellists who were journalists to whom the Firm had, in fact, paid fees for their comments and opinions. These comments and risk ratings were, in fact, even less cautious than the Firm's own risk ratings, failing to take appropriate account of the products' fixed terms. The Firm's uncritical use of the quotes, as endorsing its risk ratings, compounded the misleading description given of the true risk of the SCARPs. Moreover, the fact that panellists had been paid for their contributions to marketing material was not disclosed nor otherwise brought to customers' attention.

5.11. On a number of instances the Firm included comments in SCARP promotional literature which created a misleading impression that the product was either of a low risk, or suitable for a cautious customer. The statements also included unnecessary references to guaranteed bonds and appeared to implicitly link the product to one which is guaranteed.

5.12. Furthermore, concerns were identified with SCARP marketing material issued by the Firm after the date on which PIA issued Regulatory Update 85 requiring:

- the disclosure of potential capital loss was not given sufficient prominence within marketing material; and

- back-testing information was not accompanied by suitable text to warn customers about using the information as an assessment of risk.

5.13. The prominence of the Firm's risk ratings and comments regarding the capital returns within the marketing material were overshadowed by statements setting out the product benefits and income/growth and were therefore inadequate.

5.14. The advertisements and financial promotions issued by the Firm were therefore unbalanced and did not provide the customer with sufficient information to make an informed decision.

(2) Failure to make suitable recommendations

5.15. Until N2 the Firm was required, by virtue of Adopted FIMBRA Rules F29.4.1(1), F29.5.1 and F29.5.3, to obtain in relation to its advised sales, sufficient relevant personal and financial information about its customers in order to be able to make suitable recommendations. From N2 the requirements have been contained in COB Rules 5.2.5, 5.4.3, 5.3.5 and 5.3.9. The Firm has failed to comply with the Rules to which it was subject at the relevant time.

Facts and matters relied on

Know your customer

5.16. Record keeping deficiencies have resulted in the Firm being unable to demonstrate that it has adhered to the Know Your Customer requirements by failing to establish customers' attitude to risk.

Explaining the risks

5.17. The Firm's product risk ratings were misleading as they were either unclear or inaccurate. These risk ratings were included within the Firm's marketing material and were the basis upon which the risks of SCARPs were communicated to customers. Therefore the Firm did not adequately explain the risks of the 2,250 SCARPs that were recommended by an adviser.

Suitability

5.18. SCARPs with a downside gearing that reflected the fall in an index or basket of shares would be suitable for customers with a "medium" level of tolerance to risk. However, SCARPs with a downside gearing that exaggerated the fall in an index or basket of shares should be only be recommended to customers that were willing tolerate a higher level of risk than "medium".

5.19. Notwithstanding the flaws identified with the Firm's risk assessment process, the review of customer files demonstrated that the Firm inappropriately recommended SCARPs that it had categorised as medium risk to customers that it had categorised as of lower risk.

5.20. Furthermore the Firm has recommended SCARPs as low risk investments as detailed in the advisers' Reason Why and Suitability Letters.

5.21. From the review of customer files there was no evidence to demonstrate that SCARPs were recommended to customers as part of their overall investment portfolios. The Reason Why and Suitability Letters did not set out how the SCARP fitted within a portfolio and would be suitable in light of the customers' attitude to risk.

(3) Failure to maintain adequate records

5.22. Until N2 the Firm was required, by PIA Rules 5.1.1 and 5.1.3 to maintain records to show that it had complied with the requirements of the regulator. From N2 the requirements to retain records have been contained in COB Rule 5.2.9. The Firm failed to comply with the Rules to which it was subject at the relevant time.

Facts and matters relied on

5.23. The following deficiencies in the Firm's record keeping standards were identified:

(1) The Firm was unable to demonstrate that it had correctly categorised sales as either "direct offer" or "advised"; and

(2) The Firm did not retain records of the rationale and discussions supporting the risk ratings allocated to SCARPs and was therefore unable to demonstrate how it had reached the categorisations awarded.

5.24. The review of customer files identified specific deficiencies with regard to SCARP recommendations to customers:

(1) failure to maintain records which permit a determination of the client's attitude to risk; and

(2) failure to maintain adequate records of customers' personal and financial circumstances.

5.25. The deficiencies identified by the FSA occurred prior to and post N2.

(4) Failure to act with due skill, care and diligence

5.26. Until N2 the Firm was required, by virtue of SIB Principle 2 to act with due skill, care and diligence. After N2 this requirement has been contained in FSA Principle 2. For the reasons set out in paragraphs 5.2 to 5.14 (failure to issue advertisements and financial promotions that are clear, fair and not misleading) and paragraphs 5.16 to 5.21 (failure to make suitable recommendations) the Firm has failed to comply with the Principle in force at the relevant time.

(5) Failure of compliance oversight

5.27. Until N2 the Firm was required, by virtue of PIA Rules 7.1.2(1) and 7.1.5, to have appropriate compliance arrangements that ensured that its staff carried out their duties in such a way that the Firm complied with the rules of the regulator. From N2 these requirements have been contained in SYSC Rules 3.1.1 and 3.2.6. The Firm failed to comply with the Rules to which it was subject at the relevant time.

Facts and matters relied on

5.28. The Firm failed to maintain adequate compliance arrangements appropriate to its size and the type of business that it operated because:

(1) the Compliance Officer was a prolific seller of structured products and regularly advised 200-300 customers thus calling into question the amount of time that he was able to allocate to compliance matters;

(2) The Firm's management and compliance function failed to identify that SCARPs with a 2-for-1 downside gearing were riskier products than 1-for-1 SCARPs or other equity-linked products.;

(3) The Firm's management and compliance function failed to put in place any additional compliance monitoring arrangements specifically to monitor the sale of SCARPs over and above its general monitoring arrangements; and

(4) the level and random nature of the compliance monitoring amounted was inadequate as it only amounted to approximately 1.5% of all sales.

6. APPLICATION OF THE POLICY ON CANCELLATION OF PART IV PERMISSION

6.1. Relevant extracts from the Enforcement Manual are set out in the Appendix to this Notice. The FSA has decided to cancel the Firm's Part IV permission and to withdraw its authorisation because on the basis of the facts and matters described above the Firm is failing to satisfy Threshold conditions 5 (Suitability) and 4 (Adequate Resources).

Threshold condition 5 (Suitability)

6.2. The FSA is not satisfied that the Firm is a fit and proper person in all the circumstances, including the need to ensure that its affairs are conducted soundly and prudently. The Firm has failed to conduct its business in compliance with proper standards and failed to demonstrate that it has or will have competent and prudent management and conducts, or will conduct, its affairs with the exercise of due skill, care and diligence.

Threshold condition 4 (Adequate Resources)

6.3. As a consequence of the Firm's failings a number of complaints were made to FOS. In the light of an adverse decision by FOS the Firm concluded that its business was no longer viable and went into voluntary administration. Subsequently the Firm was placed into insolvent liquidation. Therefore The Firm is failing to satisfy Threshold condition 4 (Adequate Resources).

7. IMPORTANT NOTICES

This Final Notice is given to you in accordance with section 390(1) of the Act.

Publicity

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Final Notice relates. Under those provisions, the FSA must publish such information about the matter to which this Final Notice relates as the FSA considers appropriate. The information may be

published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to the Firm or prejudicial to the interests of consumers.

The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

For more information concerning this matter generally, you should contact David Bates at the FSA (direct line: 020 7066 1446 /fax: 020 7066 1447).

Julia Dunn
Head of Department
FSA Enforcement Division

APPENDIX

RELEVANT REGULATORY PROVISIONS

1. PIA Rule 4.1 provided that anything said or written or any document sent, given or shown to an investor or potential investor in the course of its relevant business must be clear and fair and not misleading either in design or content.

2. PIA Rule 5.1.1 provided that a firm must keep records which were sufficient to show at any time that it had complied with the requirements of the Rule Book and establish procedures and controls to ensure that those records were made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.

3. PIA Rule 5.1.3 provided that a firm may hold its records in any form but it must keep them in English and up-to-date, and be able to produce them promptly.

4. PIA Rule 7.1.2 provided that a firm must establish procedures, including procedures for complying with the training and competence requirements in accordance with PIA Rule 2.6, with a view to ensuring that its investment staff and other employees and its appointed representatives and their employees carried out their functions in such a way that the firm complied at all times with the PIA Rules and the SIB Principles and that it kept those procedures under review and revised them as appropriate from time to time.

5. PIA Rule 7.1.5 provided that a firm must establish and maintain a system of internal control appropriate to the size and type of its business.

6. Adopted FIMBRA Rule F18.3 provided that a firm must be able to show that there were good grounds for believing each advertisement to be fair and not misleading.

7. Adopted FIMBRA Rule F18.7(1) provided that advertisements must be presented in a way that was likely to be understood by the persons to whom it was addressed, described clearly the investment or investment service to which it related and disclosed fairly the risks involved.

8. Adopted FIMBRA Rule F18.10.1 provided that advertisements included all appropriate disclosures, as specified. These included the requirement that where an advertisement included a quotation from any statement praising or recommending the investment or service advertised by the firm made by a connected person of the firm, the advertisement must disclose that fact.

9. Adopted FIMBRA Rule F18.11.3 provided that information contained in direct offer advertisements must be adequate and fair.

10. Adopted FIMBRA Rule F28.3 provided that a firm must ensure that anything it said or wrote to another person in the course of its business, and any document given or sent, was clear, fair and not misleading.

11. Adopted FIMBRA Rule F29.4.1 provided that a firm must, before performing any service for a client, obtain and record the personal and financial information necessary to make appropriate recommendations.

12. Adopted FIMBRA Rule F29.5.1 provided that a firm may recommend a specific investment or investment agreement to a client only if the firm had good grounds for believing it to be suitable for him in the light of the information he had given to the firm and of any relevant facts about him of which the firm were or ought to be aware.

13. Adopted FIMBRA Rule F29.5.3 provided that a firm must, before or when making a recommendation to a client, provide an explanation to him of the nature of the risks involved in the transaction in terms that he was likely to understand.

14. COB Rule 3.8.4 provides that a firm must be able to show that it has taken reasonable steps to ensure that a non-real time financial promotion is clear, fair and not misleading.

15. COB Rule 3.8.8 provides that a specific non-real time financial promotion must include a fair and adequate description of the risks involved.

16. COB Rule 5.2.5 provides that, before a firm gives a personal recommendation concerning a designated investment to a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that customer relevant to the services that the firm has agreed to provide.

17. COB Rule 5.2.9 provides that a firm must take and retain a record of a private customer's personal and financial circumstances that it has obtained in satisfying COB Rule 5.2.5.

18. COB Rule 5.3.5 provides that a firm must take reasonable steps to ensure that it does not in the course of designated investment business make any personal recommendation to a private customer to buy or sell a designated investment or effect a discretionary transaction for a private customer unless the recommendation or transaction is suitable for the private customer having regard to the facts disclosed by him and other relevant facts about the private customer of which the firm is, or reasonably should be, aware.

19. COB Rule 5.3.9 provides that an independent intermediary must not make a personal recommendation to a private customer to buy a packaged product if it ought reasonably to be aware of a generally available packaged product which would be more appropriate to the needs and circumstances of the private customer or a packaged product issued or operated by a connected product provider if it ought reasonably to be aware of another generally available packaged product which could satisfy the needs and circumstances of the private customer as well as the connected packaged product.

20. COB Rule 5.4.3 provides that a firm must not make a personal recommendation of a transaction with, to or for a private customer unless it has taken reasonable steps to ensure that the private customer understands the nature of the risks involved.

21. SYSC Rule 3.1.1 provides that a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

22. SYSC Rule 3.2.6 provides that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.

RELEVANT POLICY ON CANCELLATION OF PART IV PERMISSION

23. The FSA's policy on how it will use its own initiative power to cancel a firm's Part IV permission and withdraw authorisation is set out in Chapter 5 of the Enforcement Manual ("ENF").

24. As set out in ENF at 5.2.1(3), the FSA will consider its policy in relation to its powers to cancel a firm's Part IV permission under section 45 of the Act. The FSA's policy in relation to cancellation of a Part IV permission is set out in ENF 5.5.

25. ENF 5.5.1(1) states that the FSA will consider cancelling a Part IV permission where the FSA has very serious concerns about a firm or the way its business is or has been conducted and ENF 5.5.2 refers to examples of those circumstances that are set out at ENF 3.3.2.

26. ENF 3.3.2 (1) provides the example that the FSA may vary or cancel a Part IV permission under section 45 of the Act where it appears to the FSA that a firm is failing, or is likely to fail, to satisfy the Threshold conditions in relation to one or more, or all, of the regulated activities for which the firm concerned has a Part IV permission.

Threshold condition 5 (Suitability)

27. The FSA's policy in relation to Threshold condition 5 (Suitability) is set out in COND 2.5. COND 2.5.4(1) states that when determining whether a firm will satisfy and continue to satisfy the Threshold condition, the FSA will have regard to all relevant matters. COND 2.5.4 (2) states that "*relevant matters*" include but are not limited to a number of matters including whether a firm:

"(a) conducts, or will conduct, its business with integrity and its compliance with proper standards

(b) has or will have a competent and prudent management; and

(c) can demonstrate that it conducts, or will conduct, its affairs, with the exercise of due skill, care and diligence."

Conducting business with integrity and in compliance with proper standards

Further guidance is given in COND 2.5.6 on the relevant matters in relation to conducting a business with integrity and in compliance with proper standards and includes at:

COND 2.5.6(1) whether:

"*the firm ... ... is ready, willing and organised to comply with the requirements and standards under the regulatory system ... ...* "

COND 2.5.6(4) whether:

"*the firm has contravened …….…… any provisions of the Act or any preceding financial services legislation, the regulatory system.*"

COND 2.5.6(6) whether:

"*the firm has taken reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system that apply to the firm and the regulated activities for which it has, or will have, permission (see SYSC 3.2.6R to SYSC3.2.8R (Compliance))*".

Competent and prudent management and conducting its affairs with due skill, care and diligence

Further guidance is given in COND 2.5.7 on the relevant matters in relation to whether the firm has or will have a competent and prudent management and exercising due skill, care and diligence and includes at:

COND 2.5.7(5) whether:

"*the firm has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the regulatory system (see SYSC 3.1 (Systems and Controls)).*"

COND 2.5.7(9) whether:

"the *firm* has conducted enquiries (for example, through market research or the previous activities of the *firm*) that are sufficient to give it reasonable assurance that it will not be posing unacceptable risks to *consumers* or the *financial system*."

Threshold condition 4 (Adequate resources)

28. COND 2.4.2 states that threshold condition 4 requires the FSA to ensure that a firm has adequate resources in relation to the specific regulated activity which it seeks to carry on. In this context, the FSA will interpret the term "adequate" as meaning sufficient in terms of quantity, quality and availability, and "resources" as including all financial resources, non financial resources and means of managing its resources.

COND 2.4.4 states, among other things, that:

"*(1) When assessing whether a firm will satisfy and continue to satisfy threshold condition 4, the FSA will have regard to all relevant matters, whether arising in the United Kingdom or elsewhere.*"

"*(2) Relevant matters may include but are not limited to …*

(c) whether there are any implications for the adequacy of the firm's resources arising from the history of the firm; for example, whether the firm has …

(ii) entered into liquidation; or

(iii) been the subject of a receiving or administration order …

(d) whether the firm has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business (see COND 2.4.6G) and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; see SYSC 3.1(Systems and Controls) and SYSC 3.2 (Areas covered by systems and controls)."