Financial Services Authority

# FINAL NOTICE

| | | |
|---|---|---|
| To: | **Mr Julian Peter Harris** | **Julian Harris Financial Consultants** |
| Of: | **Julian Harris House<br>Musgrove Stores<br>Musgrove<br>Ashford<br>Kent<br>TN23 7UN** | |
| FSA reference number: | **JPH00014** | **153566** |
| Date: | **4 November 2011** | |

## 1. ACTION

1.1 For the reasons given in this notice, the FSA hereby:

(1) imposes on Julian Peter Harris ("Mr Harris") a financial penalty of £49,000, pursuant to section 66 of the Financial Services and Markets Act 2000 (the "Act"), because he was knowingly concerned in the contraventions by Julian Harris Financial Consultants ("JHFC") and Julian Harris Mortgages Limited ("JHML") (together the "Firms") of Principle 3 (Management and control) of the FSA's Principles for Businesses (the "Principles");

(2) withdraws Mr Harris' approval, pursuant to section 63(1) of the Act, to perform the controlled function of CF10 (Compliance Oversight) in relation to JHFC because he lacks the competence and capability to perform that function, and

(3) makes an order, pursuant to section 56 of the Act, prohibiting Mr Harris from performing the CF10 (Compliance Oversight) function and carrying out any other compliance oversight-related functions in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm (the "Prohibition Order") because Mr Harris is not competent to perform any such compliance function. The effective date of this action is 4 November 2011.

1.2. Mr Harris agreed to settle this matter at an early stage of the FSA's investigation and therefore qualified for a 30% (Stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have sought to impose a financial penalty of £70,000 on him.

## 2. SUMMARY OF REASONS

2.1 The FSA has taken the action referred to in paragraph 1.1 above because Mr Harris was knowingly concerned in the Firms' contraventions of Principle 3. These breaches occurred during the period from 31 October 2004 to 22 July 2010 (the "Relevant Period").

2.2 In particular, the Firms breached Principle 3 as they failed to:

(a) put in place adequate recruitment arrangements to check that Appointed Representatives ("ARs") were solvent, otherwise fit and proper, and suitable to act on behalf of the Firms prior to their appointment. In some cases incompetent or dishonest individuals were appointed, and unsuitable advice was given to clients. Mr Harris directly caused the Firms' non-compliance with the rules and guidance set out in Chapter 12.4 of the Supervision Manual ("SUP") part of the FSA's Handbook of rules and guidance (the "FSA Handbook") relating to the appointment of ARs;

(b) implement and maintain adequate monitoring of the ARs and advisers (both in terms of quality of advice and training and competence) to ensure their

compliance with regulatory requirements. Even where issues were identified by the Firms, remedial steps were not later followed up and steps were not taken, including increasing the levels of monitoring, to mitigate the risk of further breaches occurring. Mr Harris directly caused the Firms' non-compliance with the rules and guidance set out in SUP 12.6 relating to the monitoring of ARs;

(c) ensure that there was an appropriate level of resources at the Firms to monitor the ARs and advisers to ensure the suitability of their advice, and where appropriate enforce compliance with relevant requirements, in accordance with SUP 12.4.2R(3)(b). Specifically, during the Relevant Period an average of 70 ARs were allocated to each T&C supervisor;

(d) put in place adequate T&C arrangements (as set out in SUP 12.6.11G) to ensure that ARs and advisers achieved and maintained the appropriate level of competence to provide suitable advice to customers;

(e) put in place adequate systems and controls to reduce the risk of financial crime, mortgage fraud in particular, and to identify and manage conflicts of interest;

(f) ensure that adequate due diligence was being undertaken, including financial checks and verification of identity, on the ARs and advisers prior to their appointment, and that they had sufficient expertise and appropriate systems and controls in place (in accordance with SUP 12.4.2R(3)(b)) prior to taking on a large number of ARs in short succession. The Firms subsequently failed to monitor adequately the activities of the ARs and advisers over a period of almost six years and particularly during 2009 and 2010 when the Firms took on a large number of ARs in short succession. The Firms failed to ensure that ARs did not conduct regulated activities prior to them becoming formally registered with the FSA;

(g) ensure that their own internal procedures in relation to recruitment and compliance monitoring of ARs and advisers were followed; and

(h) ensure that appropriate remedial steps were taken in response to previous issues raised by the FSA and external compliance consultants about inadequacies in the Firms' controls over its ARs and advisers.

2.3 As the sole shareholder and proprietor and the individual responsible for compliance related matters, Mr Harris was knowingly concerned in the Firms' breaches of Principle 3, which requires that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

2.4 The FSA considers the Firms' breaches to be serious because they lasted for a prolonged period and, as a result of them, new advisers and ARs were not subject to adequate vetting before being appointed and were not adequately trained or monitored after appointment. In some cases incompetent or unfit individuals may have been appointed, and customers may have been exposed to the risk of receiving unsuitable advice. Furthermore, the Firms were exposed to the risk of being used to facilitate financial crime and in respect of some ARs it appears that this risk crystallised. Mr Harris was knowingly concerned in the Firms' breaches of Principle 3.

## 3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

3.1 The relevant statutory provisions and regulatory requirements, to the extent not set out in the body of this Notice, are set out in the Annex to it.

## 4. FACTS AND MATTERS

JHFC

4.1 Mr Harris, trading as JHFC, operates as a sole trader. This business is a network of independent financial advisers which currently has 10 appointed representatives (JHFC previously had 36 ARs in total) and 26 individuals approved to perform the CF30 Customer function. JHFC has been authorised by the FSA since 1 December 2001 to perform the following regulated activities:

(1) advising on pension transfers and pension opt-outs;

(2) advising on a home reversion plan;

(3) advising on investments (except on pension transfers and pension opt outs);

(4) advising on regulated mortgage contracts;

(5) agreeing to carry on a regulated activity;

(6) arranging (bringing about) a home reversion plan;

(7) arranging (bringing about) deals in investments;

(8) arranging (bringing about) regulated mortgage contracts;

(9) making arrangements with a view to a home reversion plan;

(10) making arrangements with a view to regulated mortgage contracts; and

(11) making arrangements with a view to transactions in investments.

4.2 Mr Harris is approved to perform the following controlled functions in relation to JHFC:

(1) CF10 Compliance Oversight;

(2) CF11 Money Laundering Reporting; and

(3) CF30 Customer.

JHML

4.3 JHML is a mortgage and general insurance advisory network, which currently has 88 ARs and a total of 105 advisers (JHML previously had 149 ARs in total). It has been authorised since 31 October 2004 to carry out the following regulated activities:

(1) advising on a home reversion plan;

(2) advising on investments (except on pension transfers and pension opt outs);

(3) advising on regulated mortgage contracts;

(4) agreeing to carry on a regulated activity;

(5) arranging (bringing about) deals in investments;

(6) arranging (bringing about) regulated mortgage contracts;

(7) making arrangements with a view to regulated mortgage contracts; and

(8) making arrangements with a view to transactions in investments.

4.4 Mr Harris is the sole director and 100% shareholder of JHML and is approved to perform the following controlled functions in relation to JHML:

(1) CF1 Director;

(2) CF3 Chief Executive;

(3) CF11 Money Laundering Reporting;

(4) CF28 Systems and controls; and

(5) CF29 Significant management

Mr Harris is also responsible for insurance mediation activity at JHML**.**

FSA visit

4.5 The FSA's Small Firms and Contact Division ("SFCD"), now part of the Supervision Division in the Conduct Business Unit, carried out a supervisory visit to JHFC and JHML in July 2010. SFCD had identified that the Firms, but particularly JHML, had experienced rapid growth in the size of their networks in 2009. The purpose of the visit was to assess the effectiveness of the Firms' systems and controls over the activities of their ARs. The visit identified that JHML had not taken remedial action recommended by SFCD in relation to recruitment procedures, spans of control and monitoring of advisers since the FSA's previous visit to JHML in January 2010.

Compliance review

4.6 Following the July 2010 visit by SFCD, the Firms agreed voluntarily to instruct an independent external compliance consultant to conduct a compliance review of the business of JHFC and JHML. The Firms also undertook to the FSA not to appoint any further ARs.

4.7 The external compliance consultant performed a review of the following documents relating to the Firms' ARs: 50 recruitment files, 50 T&C files and 160 customer files. The compliance consultant identified the following issues:

(1) Inadequate training and T&C procedures:

(a) There was no correlation between the training plans for ARs and advisers and the weaknesses that had been identified from reviews of their client files. For example, the training file for one AR showed consistent failures in the compilation of suitability reports together with evidence of a potential lack of integrity. This was not addressed in the AR's ongoing T&C plan and there was no indication that JHML had taken any steps to remedy it or consider whether to terminate the AR.

(b) There were no procedures to ensure that T&C supervisors were properly trained and assessed as competent and no ongoing process to confirm their competence. There was evidence of lack of competence on the part of T&C supervisors.

(c) There was no evidence that ARs and advisers had achieved and were maintaining appropriate levels of competence. T&C Supervisors did not follow the T&C scheme and their record-keeping was inadequate.

(d) There were inadequate spans of control with up to 70 ARs and advisers assigned to each T&C supervisor.

(e) Annual "fit and proper" checks on ARs and advisers were inadequate. There was no evidence that verification of annual accounts, bank statements and management accounts was being undertaken (as per SUP 12.6.2G).

(2) Inadequate recruitment procedures:

(a) 96% of recruitment files contained insufficient evidence to demonstrate that the AR or adviser was fit and proper at the time of recruitment.

(b) There were inadequate financial checks (as required by SUP12.4.2R (2)(a)) and identity verification was conducted by third parties or without sight of original documents.

(c) There was a lack of objectivity in assessing applicants because the Firms' own supervisory and compliance staff had assisted in the preparation of applications from ARs and advisers and had also provided references.

(d) There were failures to assess fitness and propriety effectively. Examples included:

(i) an AR whose financial records should have indicated to JHML a precarious financial position. JHML nonetheless submitted an application to the FSA for individual approval. The application was later withdrawn by JHML only after the issue was raised by the FSA; and

(ii) an AR was facing repossession of his residential property and had three outstanding County Court Judgements and a persistent overdraft. JHML failed to adequately assess whether the AR was solvent and otherwise fit and proper.

(e) Applications for individual approval were submitted to the FSA before the Firms had completed due diligence checks on the ARs, and ARs had been allowed to write business before references had been received and before they appeared on the FSA Register.

(3) Inadequate monitoring of ARs and advisers:

(a) Monitoring of ARs and advisers was ineffective and there was no assessment of whether fair outcomes for consumers were being achieved. Some files reviewed internally by JHML's compliance staff had been graded as compliant despite further failings being present in the files.

(b) There was a lack of evidence of research of the market and suitability of recommendations, and there were inconsistencies between income declared in fact finds and income declared in application forms.

(4) Unsuitable advice:

(a) 78% of the 160 client files reviewed contained insufficient information to permit an assessment of suitability of advice.

(b) The internal file reviews performed by the Firms' compliance team were unjustifiably generous. Some files had been graded "Pass" or "Provisional Pass" despite there being insufficient evidence of affordability or suitability on file. There was no follow-up procedure and no clear evidence of remedial action being taken where issues had been identified by the compliance team.

(5) Inadequate conflict of interest controls:

There was a potential conflict of interest for Business Development Managers who also acted as T&C supervisors and were incentivised by receiving a share of the commission earned by any advisers that they recruited (in breach of SYSC 10.1.4R(2)). This created the risk that unfit advisers would be recruited and mis-selling would not be rectified. This issue was first notified to the Firms during the FSA's January 2010 visit, but its recommendations for additional controls to manage the conflict of interest had not been implemented by the time the FSA conducted a further visit to the Firms in July 2010.

(6) Financial Crime:

Information received by the FSA from a lender suggested that an AR had withdrawn a number of mortgage applications after (and because) the lender had requested proof of income. The AR had been removed from the lender's panel. Of the 30 files reviewed for this AR, 48% of the files contained financial crime indicators, including contradictory evidence of income in fact finds and application forms and inconsistent identification signatures. JHML's monitoring process failed to identify this potential mortgage fraud.

(7) Consumer detriment:

78% of files reviewed did not demonstrate whether the customer had received suitable advice. 9% of the files reviewed demonstrated unsuitable advice. One AR's files contained inconsistent fee disclosures, evidence of overcharging of fees and numerous customer complaints about his fee agreements which JHML had taken no action on.

4.8 As a result of its review, the compliance consultant recommended the termination of unfit ARs and advisers, new recruitment procedures, a new T&C scheme, training for T&C supervisors, new fact find and recommendation documents, and a programme to contact customers to establish suitability retrospectively and, if necessary, pay redress. The recommendations made by the compliance consultant were accepted by the Firms, who agreed to take remedial action.

4.9 Mr Harris, JHFC and JHML were referred to the FSA's Enforcement and Financial Crime Division on 2 February 2011. The investigation team reviewed some historic material relating to the compliance framework and culture of the Firms prior to the major expansion of the networks in 2009. That review highlighted that even prior to the rapid expansion of the Firms, particularly JHML, the level of dedicated compliance resource had not been adequate for the size of the businesses. Although Mr Harris had introduced improvements in some areas in response to issues raised in routine compliance audits, he had failed to address a number of serious issues which continued to feature every year.

4.10 The scope of the remedial action was extended to add further client file reviews for two more mortgage ARs identified as potentially fraudulent. In addition, when the consultants sample-checked recruitment, T&C and client files in March 2011, they found that the quality of files remained unsatisfactory. The results of the reviews were provided to Mr Harris and the Firms' compliance staff who were tasked with carrying out additional work on the files. The files were then re-submitted to the consultants who have reported steady improvements in the quality of the files as the action plan approached completion. The Firms have now implemented systems and controls, which according to the consultants, now comply with regulatory requirements.

## 5. FAILINGS

5.1. The FSA concluded that the misconduct summarised above demonstrated that Mr Harris was knowingly concerned in the Firms' breaches of Principle 3. The FSA viewed Mr Harris' failings as serious as it places great importance on the role of senior management who are responsible for ensuring that the businesses that they oversee comply with regulatory requirements and standards. SUP 12.6.7G further states that the responsibility for the control and monitoring of the activities of an AR rests with the senior

management of the authorised firm. Mr Harris, as the sole proprietor and sole shareholder of JHFC and JHML, personally took a decision to allow the Firms to take on a large number of ARs but failed adequately to consider the risks associated with this and how this would impact on the Firms' ability to meet regulatory obligations going forward. Mr Harris was directly responsible for the structure, organisation and practices at the Firms, including those relating to the appointment and monitoring of ARs and advisers. Even where breaches were raised with him directly, he failed to take remedial steps promptly.

## 6. SANCTIONS

Withdrawal of approval and prohibition order

6.1 The FSA had regard to the guidance in Chapter 9 of the Enforcement Guide ("EG") in proposing to withdraw Mr Harris' approval to perform the CF10 (Compliance Oversight) function and imposing the Prohibition Order. The relevant provisions of EG are set out in Annex A of this Notice.

6.2 The FSA concluded that Mr Harris lacks the requisite competence and capability, and is therefore not fit and proper, to perform the CF10 (Compliance Oversight) function at JHFC or at any other authorised firm. It was therefore necessary and proportionate, in order to achieve its regulatory objectives of consumer protection and the prevention of financial crime, for the FSA to exercise its power to withdraw Mr Harris' approval to perform the CF10 (Compliance Oversight) function in relation to JHFC and make the Prohibition Order.

Imposition of a financial penalty

6.3 The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the version of the Decision Procedure and Penalties Manual ("DEPP") in force prior to 6 March 2010, which formed part of the FSA Handbook. All references to DEPP in this section are references to that version of DEPP, which changed on 6 March 2010, in force at the relevant time of Mr Harris' misconduct. The conduct in question occurred between 31 October 2004 and 22 July 2010. Accordingly, the majority of the conduct occurred prior to 6 March 2010, and the version of DEPP in force prior to 6 March 2010 has been applied for the purpose of this warning notice. When determining the appropriate level

of financial penalty the FSA also had regard to Chapter 7 of EG (set out in an Annex to this notice).

6.4 DEPP 6.1.2G stated that the principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behavior.

6.5 In determining whether a financial penalty is appropriate under the policy in place before 6 March 2010, the FSA is required to consider all the relevant circumstances of a case. Applying the criteria set out in DEPP 6.2.1G and DEPP 6.4.2G (regarding whether or not to take action for a financial penalty or public censure, and if so which sanction), the FSA considered that a financial penalty of £70,000 before any discount is an appropriate sanction. This is because Mr Harris was knowingly concerned in the Firms' breaches of the rules in SUP 12. In particular, the Firms did not carry out sufficient vetting and monitoring of ARs and advisers to establish whether they complied and were continuing to comply with regulatory requirements. There is therefore a need to send out a strong message to other individuals performing a senior management role that they have a responsibility to ensure that the authorised firm complies with regulatory obligations.

6.6 The guidance in DEPP prior to 6 March 2010 sets out a non-exhaustive list of factors that may be of relevance in determining the level of the financial penalty. The FSA considers that the factors set out below are particularly relevant in this case.

***The nature, seriousness and impact of the breaches in question (DEPP 6.5.2G(2))***

6.7 The FSA concluded that Mr Harris exercised inadequate management and control over compliance related matters at the Firms, which resulted in them breaching Principle 3 during the Relevant Period. The Firms' failings were serious as they failed to ensure that their ARs and advisers were fit and proper and remained suitable to undertake regulated activities, therefore exposing customers to the risk of unsuitable advice and in some instances exposed to potential mortgage fraud. The issues referred to at section 2 above were identified by the FSA, rather than by the Firms or Mr Harris, and recommendations made by the FSA were not implemented when it visited the Firms again in January 2010. In addition, there has been a history of inadequate resourcing of the compliance function at the Firms even before their rapid expansion in 2009. In determining the level of the

financial penalty to be imposed on Mr Harris, the FSA also had regard to the nature of the requirements he caused the Firms to breach and the duration of the breaches, which was over a period of almost six years despite issues being raised with him directly by external compliance consultants during this time.

***The extent to which the breach was deliberate or reckless (DEPP 6.5.2G(3))***

6.8 The FSA considered that Mr Harris did not deliberately cause the Firms to contravene Principle 3, but in failing to take reasonable steps to ensure that the Firms complied with regulatory requirements, even after external compliance consultants and the FSA brought regulatory breaches to his and the Firms' attention, Mr Harris' actions were reckless. Mr Harris appears to have prioritised the expansion of the Firms over ensuring that they complied with their regulatory obligations. Mr Harris failed to appreciate or attend to the Firms' responsibilities in relation to the recruitment and supervision of ARs and advisers and these breaches went on for a prolonged period of time. Mr Harris did not have sufficient understanding of the regulatory requirements associated with appointing and monitoring ARs and advisers to ensure that the Firms complied with Principle 3.

***Whether the person on whom the penalty is to be imposed is an individual (DEPP 6.5.2G(4))***

6.9 The FSA recognises that the financial penalty imposed on Mr Harris is likely to have a significant impact on him as an individual.

***The size, financial resources and other circumstances of the person on whom the penalty is to be imposed (DEPP 6.5.2G(5))***

6.10 The FSA has assessed Mr Harris' financial position and considered his ability to pay the financial penalty. The FSA's view is that the penalty is proportionate to the seriousness of the breaches and Mr Harris has indicated that he is able to pay the penalty. The FSA has no evidence to suggest that Mr Harris will be unable to pay a penalty of the level proposed.

***The amount of benefit gained or loss avoided (DEPP 6.5.2G(6))***

6.11 The FSA has not determined that Mr Harris deliberately set out to accrue additional profits or avoid a loss through the way in which he ran the Firms. However, as Mr Harris operates JHFC as a sole trader and is the 100% shareholder of JHML, he stood to benefit from the significant levels of commission generated by the Firms' ARs and advisers.

***Conduct following the breach (DEPP 6.5.2G(8))***

6.12 Mr Harris co-operated with the FSA's investigation. The FSA also took into consideration the mitigating factors referred to in paragraph 6.14 below. Mr Harris has shown a willingness to rectify the issues set out in section 2 above and satisfy the FSA that regulatory requirements will be met in the future. Mr Harris also voluntarily agreed in August 2010 that the Firms would be subject to a restriction whereby they would not be permitted to appoint any further ARs until such time as approval is given by the regulator.

***Disciplinary record and compliance history (DEPP 6.5.2G(9))***

6.13 The FSA took into account the fact that Mr Harris has previously been the subject of disciplinary action by the FSA and also by its predecessor, the Personal Investment Authority ("PIA"). Mr Harris' sole trader business, JHFC, was subject to a £15,000 fine and ordered to pay costs of £7,500 for pensions review related failings in December 2001. In addition, JHFC was also fined £10,000 by the PIA in July 1998, after failing to seek relevant information about the circumstances and investment objectives of its clients and had failed to organise and control its affairs in a responsible manner.

Mitigating and aggravating factors

6.14 The FSA took into account the following factors and steps taken by Mr Harris which have served to mitigate his failings:

(1) the FSA saw no evidence from which it could conclude that Mr Harris' misconduct was deliberate;

(2) in response to the concerns raised by the FSA in August 2010, Mr Harris gave a voluntarily undertaking that the Firms would not appoint any further ARs until remedial action has been taken to the satisfaction of the FSA;

(3) Mr Harris, on behalf of the Firms, voluntarily agreed to appoint an external compliance consultant to perform a review of client files and the Firms' processes, including the recruitment, monitoring and training of ARs. In response to the issues raised by the FSA and by the external compliance consultant Mr Harris ensured that the Firms took prompt remedial action, including the termination of unsuitable ARs, revising the Firms' processes in

relation to the appointment and monitoring of Ars, and a past business review is being performed. The Firms, and Mr Harris, have incurred over £96,000 in fees charged by external firms for compliance and financial reviews following the FSA's visit and have committed further resources to paying consumer redress where unsuitable advice is identified;

(4) Mr Harris took steps to appoint a dedicated compliance manager to oversee compliance matters at the Firms and who will also replace Mr Harris as the CF10 (Compliance Oversight) function holder at JHFC;

(5) Mr Harris agreed voluntarily to appoint an independent external compliance consultant to perform quarterly reviews of the Firms regulated activities for a minimum period of two years and implement any recommendations made; and

(6) Mr Harris has co-operated with the FSA's investigation and accepted the failings set out in this Warning Notice.

6.15 The FSA also took into consideration aggravating factors:

(1) Mr Harris failed to take prompt remedial steps even after the FSA and an external compliance consultant had notified him of the weaknesses in systems and controls regarding the appointment and monitoring of ARs and advisers, which could lead to regulatory breaches;

(2) Mr Harris' failings lasted for a prolonged period of almost six years;

(3) Mr Harris' failure to organise and control the Firms resulted in the Firms being used to further financial crime, including potential mortgage fraud; and

(4) Mr Harris, trading as JHFC, was the subject of disciplinary action on two previous occasions.

## 7. PROCEDURAL MATTERS

### Decision Maker

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

7.2 This Final Notice is given under section 390 and in accordance with section 387 of the Act. The following statutory rights are important.

### Manner of and time for Payment

7.3 The financial penalty of £49,000 must be paid in full by twelve equal monthly instalments commencing from 12 October 2012.

### If the financial penalty is not paid

7.4 If all or any of the instalments of the financial penalty is outstanding on its due date for payment the FSA may recover the outstanding amount as a debt owed by Mr Harris and due to the FSA.

### Publicity

7.5 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 FSA must publish such information about the matter to which this 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 you 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**

7.6 For more information concerning this matter generally, contact Chris Walmsley (direct line: 020 7066 5894/fax: 020 7066 5895) of the Enforcement and Financial Crime Division of the FSA.

**……**

**Tom Spender**
**Head of Department**
**FSA Enforcement and Financial Crime Division**

## ANNEX A

## RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND GUIDANCE

### 1. Statutory provisions

1.1 The FSA's statutory objectives, set out in section 2(2) of the Act, include the protection of consumers.

1.2 Section 205 of the Act provides that:

"*If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act or by any directly applicable Community regulation made under the markets in financial instruments directive, the Authority may publish a statement to that effect*"

1.3 Section 206(1) of the Act provides that:

"*If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act … it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate*".

### 2. Relevant Handbook provisions

In exercising its power to issue a public censure, the FSA must have regard to relevant provisions in the FSA Handbook. The main provisions relevant to the action specified above are set out below.

### 3. Principles for Businesses

3.1 Under the FSA's rule-making powers as referred to above, the FSA has published in the FSA Handbook the Principles, which apply in whole, or in part, to all authorised firms.

3.2 The Principles are a general statement of the fundamental obligations of authorised firms under the regulatory system and reflect the FSA's regulatory objectives. An authorised firm may be liable to disciplinary sanction where it is in breach of the Principles.

3.3 The Principles relevant to this matter are:

(1) Principle 3 which provides that:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems";

(2) Principle 7 which provides that:

"A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading"; and

(3) Principle 9 which provides that:

"A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment."

3.4 The procedures to be followed in relation to the issuance of a public censure and imposition of a financial penalty are set out in sections 207 and 208 of the Act.

**4. Conduct of Business**

4.1 The Conduct of Business Sourcebook ("COBS"), which is part of the FSA Handbook, applied to authorised firms with effect from 1 November 2007.

4.2 All of the provisions of COBS set out below apply in relation to designated investment business.

4.3 COBS 4.2.1R requires an authorised firm to ensure that a communication to a client is fair, clear and not misleading.

4.4 COBS 4.5.2R requires that information provided by an authorised firm to retail clients is accurate and, in particular, does not emphasise any potential benefits of an investment without also giving a fair and prominent indication of any relevant risks.

4.5 COBS 9.2.1R provides that:

"(1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.

(2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:

a. knowledge and experience in the investment field relevant to the specific type of designated investment or service;

b. financial situation; and

c. investment objectives;

so as to enable the firm to make the recommendation, or take the decision, which is suitable for him."

4.6 COBS 9.2.2 R provides that:

"(1) A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:

a. meets his investment objectives;

b. is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

c. is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

(2) The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

(3) The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments."

4.7 COBS 9.2.6R requires that, if an authorised firm does not obtain the necessary information to assess suitability, it must not make a personal recommendation to the client.

4.8 COBS 9.4.7R requires that suitability reports provided to retail clients must at least specify the client's demands and needs; explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and explain any possible disadvantages of the transaction for the client.

## 5. Systems and Controls

5.1 During the relevant period, Chapter 3 of the FSA's Senior Management Arrangements, Systems and Controls sourcebook ("SYSC"), also part of the FSA Handbook, applied to Exclusive.

5.2 SYSC 3.1.1R states that an authorised firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

5.3 SYSC 3.1.2G states, as guidance, that, to enable it to comply with its obligation to maintain appropriate systems and controls, an authorised firm should carry out a regular review of them.

5.4 SYSC 3.1.6R states that an authorised firm must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

5.5 SYSC 3.1.7R states that an authorised firm, when complying with SYSC 3.1.6R, must take into account the nature, scale and complexity of its business and the nature and range of financial services and activities undertaken in the course of that business.

5.6 SYSC 3.2.6R requires 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.

5.7 SYSC 4.1.1R requires that a firm must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

5.8 SYSC 6.1.1R requires that a firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime.

## 6. Training and Competence

6.1 The FSA's Training and Competence sourcebook ("TC") applies to authorised firms such as Exclusive advising on investment products.

6.2 TC 2.1.2R requires that a firm must not allow an employee to carry on an activity in TC Appendix 1 without appropriate supervision, which activities relating to designated investment business carried on for a retail client.

6.3 TC 2.1.3G states that firms should ensure that employees are appropriately supervised at all times. It is expected that the level and intensity of that supervision will be significantly greater in the period before the firm has assessed the employee as competent, than after. A firm should therefore have clear criteria and procedures relating to the specific point at which the employee is assessed as competent in order to be able to demonstrate when and why a reduced level of supervision may be considered appropriate. At all stages firms should consider the level of relevant experience of an employee when determining the level of supervision required.

6.4 TC 2.1.7R(4) requires that a firm must ensure that an employee does not carry on the activity of a pension transfer specialist without first attaining each module of an appropriate qualification.

6.5 TC 2.1.11G stated that firms should ensure that their employees' training needs are assessed at the outset and at regular intervals (including if their role changes). Appropriate training and support should be provided to ensure that any relevant training needs are satisfied. Firms should also review at regular intervals the quality and effectiveness of such training.

6.6 TC 2.1.12R requires that a firm must review on a regular and frequent basis employees' competence and take appropriate action to ensure that they remain competent for their role.

6.7 TC 2.1.13G states, as guidance, that a firm should ensure that maintaining competence for an employee takes into account such matters as:

(1) technical knowledge and its application;

(2) skills and expertise; and

(3) changes in the market and to products, legislation and regulation.