# FINAL NOTICE

To: Scotts Private Client Services Limited

Of: 3 Rubislaw Terrace
Aberdeen
AB10 1XE

Date: 9 June 2004

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") has taken the following action**

## THE PENALTY

1. The FSA gave you a Decision Notice dated 22 April 2004 which notified you that pursuant to Section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a penalty of £25,000 on Scotts Private Client Services Limited ("Scotts") for breaches of the FSA's Principles for Businesses. The FSA would have imposed a much more substantial financial penalty, were it not for Scotts' very limited financial resources and the desire of the FSA that those be used substantially to assist in obtaining restitution for investors.

2. You have not referred the matter to the Financial Services and Markets Tribunal within 28 days of the date on which the Decision Notice was given to you.

3. Accordingly, for the reasons set out below the FSA hereby imposes a financial penalty on you in the amount of £25,000 ("the Penalty").

## REASONS FOR PENALTY

4. The FSA has concluded, on the basis of the facts and matters described below that Scotts, by its failure to exercise due skill, care and diligence, to have proper systems and

controls in respect of its business, to pay due regard to investors' information needs and to ensure (where appropriate) the suitability of its advice, introduced US $9.7m[1] of investors' funds into what the FSA considers was an unauthorised and apparently unlawful investment scheme.

**Relevant Statutory Provisions and Rules**

5. The FSA's regulatory objectives, which are set out in Section 2(2) of the Act, are market confidence, public awareness, the protection of consumers and the reduction of financial crime.

6. Section 41 of the Act with Schedule 6 sets out the threshold conditions which authorised persons must satisfy and continue to satisfy as a condition of authorisation ("the Threshold Conditions").

7. Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to it to be necessary or expedient for the purpose of protecting the interests of consumers.

8. Under the FSA's rule-making powers the FSA has published the part of the Handbook titled Principles for Businesses ("PRIN"). Of those Principles ("the Principles"), the following are relevant in this case:

- Principle 2 – Skill, Care and Diligence

  *A firm must conduct its business with due skill, care and diligence.*

- Principle 3 - Management Control

  *A firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk and management systems.*

- Principle 7 – Communications with Clients

  *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.*

- Principle 9 – Customers: Relationship of Trust

  *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 judgement.*

9. Section 206 of the Act provides that, if the FSA considers that an authorised person has contravened a requirement imposed by or under the Act it may impose a penalty, in respect of that contravention, of such amount as it considers appropriate.

[1] The Sterling equivalent figure is £6.7m based on the exchange rate at the time the funds were placed in the scheme.

**Relevant Guidance**

10. In considering the exercise of its powers in relation to the imposition of a financial penalty the FSA has had regard to the guidance published in the Handbook, including PRIN.

11. PRIN 1.1.2 provides that the Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect its regulatory objectives.

12. PRIN 1.1.4 provides that, in substance, the Principles express the main dimensions of the "fit and proper" standard set for firms in Threshold Condition 5 (Suitability), although they do not derive their authority from that standard or exhaust its implications.

13. PRIN 1.1.7 provides that breaching a Principle makes a firm liable to disciplinary sanctions.

**Summary**

14. Scotts is a firm of Chartered Accountants, incorporated in Scotland with limited liability, the main business of which is tax advice. Scotts was authorised to conduct investment business up to 30 November 2001 by the Institute of Chartered Accountants of Scotland and since then has been an authorised person under the Act.

15. In 2001 Scotts' Managing Director, John Dryburgh, first met with Dobb White & Co ("Dobb White") in relation to Scotts' main business of tax advice. At this meeting Mr Dryburgh was told about an investment scheme where those placing funds with Dobb White were offered high returns at low risk ("the Scheme").

16. Mr Dryburgh initially invested US $1.2m of his own funds in the Scheme. In the course of carrying on its main business, Scotts communicated details of the Scheme to a small number of its direct clients and to four other authorised persons. Subsequently six direct clients invested US $3.1m, and investors introduced to Scotts by four other authorised persons invested US $6.6m, by transferring funds to Scotts for onward transmission to Dobb White. Scotts were to receive a share of any return if the return exceeded 15%.

17. In early October 2002 Scotts unsuccessfully requested the return of the remaining funds transmitted by Scotts for investment in the Scheme. In total some US $7.5m of the funds originally invested in the Scheme remains outstanding. On 22 October 2002 the FSA obtained a freezing order against Dobb White and it appears that there may be a substantial shortfall.

18. Although Mr Dryburgh and Scotts carried out due diligence into the Scheme, this was inadequate in relation to the regulatory status of Dobb White and the Scheme and in

relation to the Scheme generally. Scotts should have concluded that this was an unauthorised regulated activity. As a result Scotts acted in breach of Principle 2.

19. The FSA considers that Scotts also failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, in breach of Principle 3.

20. Further Scotts failed to pay due regard to investors' information needs and to ensure the suitability of the Scheme for investors in breach of Principles 7 and 9.

21. The FSA accepts that Scotts did not deliberately mislead consumers or wilfully engage in this misconduct. Were it not for these matters and for the steps Scotts has since taken to improve the structure and organisation of its business, the FSA would have taken action to cancel Scotts' permission under Part IV of the Act to carry on regulated activities. Instead the FSA has decided to discipline Scotts for breaches of the Principles by imposing a financial penalty on Scotts, while fixing the amount of the proposed penalty with regard both to the fact that Scotts' financial resources are very limited and also the FSA's desire that those financial resources be used substantially to assist in obtaining restitution for investors.

**Facts and Matters Relied On**

Background

22. Scotts was incorporated on 27 January 2000. Mr Dryburgh and Ms Hazel Gray are the two directors of Scotts and own 70% and 30% respectively of the equity. Scotts was authorised for the purpose of investment business by the Institute of Chartered Accountants of Scotland ("ICAS") from 18 May 2001 until 30 November 2001. On 1 December 2001 Scotts became an authorised person under the Act.

23. Mr Dryburgh is approved under the Act to perform the controlled functions of Director, Chief Executive Officer and Apportionment and Oversight for Scotts.

24. Ms Gray is approved under the Act to perform the controlled functions of Director, Compliance Oversight, Money Laundering Reporting, Investment Adviser and Investment Management for Scotts. Two other approved persons are employed by Scotts at its London office.

25. Scotts operates from three offices; Aberdeen, Edinburgh and London. The Aberdeen and London offices are concerned with the provision of tax advice which is Scotts' main business. The Aberdeen office was, during the relevant period, staffed by Mr Dryburgh, Ms Gray and three other members of staff.

26. The FSA's investigation of Scotts began on 22 January 2003. This was in respect of Scotts' dealings with other parties connected to unauthorised investment schemes operated by those other parties and the openness and accuracy of Scotts' dealings with its clients and other authorised firms regarding these matters. The FSA's investigation was not therefore concerned with the totality of Scotts' business nor, in particular, its

unregulated core business including specialist tax advice for which Scotts is regulated by its professional body, ICAS.

Dobb White

27. Dobb White is, or was at the relevant time, a firm of accountants with two partners based in Nottingham.

28. Neither Dobb White nor the individual partners have been authorised or exempted from authorisation to undertake regulated activities under the Act. Nor were they authorised or exempt persons under any predecessor legislation such as the Financial Services Act 1986 or the Banking Act 1987.

29. In 1998 the FSA alleged unauthorised deposit taking by Dobb White and obtained interim restraint and freezing orders against it and the individual partners. As a result of this action Dobb White, while disputing any unlawful deposit taking, consented to a court order to repay in excess of US $15m to depositors and to provide undertakings to the Court to not in future accept deposits in breach of the Banking Act 1987 or make misleading statements in breach of the Banking Act 1987.

30. In 2000 there was a second FSA investigation into Dobb White in respect of suspected unauthorised deposit taking. One of Dobb White's partners pleaded guilty at Thames Magistrates' Court to two criminal offences of failing to provide information and documents to the FSA. He was fined £7,000. Both matters were published in the FSA press releases on 4 November 1999 and 14 August 2000 respectively and were (at the relevant time) available to the public on the FSA website.

31. In or about October 2002, the FSA began a further investigation into whether Dobb White, its partners and another entity might have undertaken unauthorised investment business in the UK in contravention of the Act. The FSA alleged that they had run an unlawful investment scheme that had received many millions of US dollars from members of the public in the United Kingdom and abroad.

32. A number of authorised persons had become directly and indirectly involved with the investment scheme apparently without, it appears, knowledge of its exact status. The FSA understands that compared to other authorised persons Scotts introduced the largest amount of investors' funds.

33. The FSA brought proceedings under the Act against Dobb White and its partners on the basis that it appeared to be carrying on unauthorised regulated activities. Interim injunctions were granted by the High Court on 22 and 29 October 2002 to restrain certain activities of Dobb White and others and to freeze assets worldwide under their control. The restraint order has now been made permanent and the interim freezing injunction remains in place. On 2 December 2003 the FSA obtained in the High Court a winding up order against Dobb White and bankruptcy orders against the individual partners.

The Scheme

34. Mr Dryburgh first met Dobb White in or about August 2001 to discuss Scotts' specialist tax business, with the intention of Scotts providing services to Dobb White's clients. At that meeting one of Dobb White's partners described to Mr Dryburgh the Scheme in which those placing funds with Dobb White were offered high returns at low risk. At this initial stage, Mr Dryburgh was interested in the Scheme only in a personal capacity.

35. The FSA understands that it was further represented to Mr Dryburgh that money invested in the Scheme was deposited offshore with minimum AA rated banks. High rates of return could potentially be achieved by the use of the money on the overnight money markets and/or by the purchase of corporate bonds with a minimum A+ rated status. A further use represented was "balance sheet support" for banking institutions to aid their dealings in the bond market where it was represented that institutions might be required to show an availability of funds to transact such business. Although investors' money was never to be put at risk, a fee would be payable by the banking institution. Scotts understood that funds could not be moved from these banking institutions without its consent.

36. Between August 2001 and October 2002 at meetings in the course of its specialist tax business, Scotts communicated details of the Scheme to four other authorised persons. This included arranging a meeting in November 2001 with Dobb White for one of them. This authorised person later introduced 22 of its clients to Scotts for the purpose of their participation in the Scheme with a total investment of US $5.4m. In similar circumstances, Scotts also informed a small percentage of its existing clients and arranged for six to invest in the Scheme.

37. Mr Dryburgh, through his investment vehicle, Scotts Investment Company Limited ("SICL"), placed US $100,000 personally with Dobb White on 10 October 2001. Further funds were placed and by September 2002 US $1.2m of Mr Dryburgh's money was held by Dobb White through SICL.

38. On 11 October 2001, at the request of an authorised person introduced to Dobb White by Scotts with a view to confirming details of the Scheme before any funds were invested, Scotts prepared a draft reasons why or suitability letter entitled: *Offshore Money Market Deposit Account*. This was used by that and subsequently other authorised persons when introducing individuals to the Scheme. The letter was used by these authorised persons as their own document when dealing with their clients.

39. The reasons why or suitability letter contained an explanation of the Scheme and made a number of statements as follows:

- "*the potential to achieve a much higher return where the US Dollar principal is protected and the risks are identifiable…*"
- *"… during the last four years these particular accounts have enjoyed total returns well in excess of bank deposit rates*"

- *"… such monies are placed with a branch of one of the major UK clearing banks or a bank of a similar standing and credit quality…"*
- *"All monies are paid into dedicated bank accounts of which the bank is custodian"*
- *"Professional Indemnity Insurance is in place…protecting up to £5 mn for any one individual claim"*
- *"This is a low risk alternative to an ordinary cash account offering considerably higher returns…"*

40. Scotts agreed to arrange for investor funds to be placed in the Scheme. In this regard it accepted funds from six of its existing clients and 28 clients of various other authorised persons, a total of 34 investors.

41. For the purposes of investing funds in the Scheme, Scotts adopted the standard documentation provided by Dobb White (similar documentation was also used by Mr Dryburgh for his personal investments in the Scheme). The standard documentation included a letter of appointment in which the investor stated to Scotts as follows:

*"I , the undersigned hereby confirm that following an introduction to your firm by …, I would like to appoint your firm to act on my behalf in connection with certain of my affairs in Europe.*

*I understand that your firm is not a licensed broker or securities trader and [is] not authorised to give specific investment advice. I confirm that you have not solicited me in any way, and that I am requesting your firm to act for me of my own choice and free will.*

*I will be issuing specific instructions as to how any funds I transfer to your current account should be applied. I look forward to your early reply."*

42. In response Scotts would send a letter of undertaking which stated as follows:

*"Thank you for your letter of appointment and client information form dated ….*

*We are pleased to confirm our willingness to act for you and receive any funds you wish us to hold pending your further instructions.*

*We confirm that any funds you remit to our account will accrue interest at the prevailing bank deposit rates. We will be responsible for returning the principal together with accrued interest, within 30 days of receipt your written instructions.*

*We confirm that the Company carries professional indemnity insurance up to the value of £5m per claim. If you require any further information please do not hesitate to contact us."*

43. Subsequently a further letter was received by Scotts from the investor which stated as follows:

*"With reference to the £ … transferred to your client account to be held to my order, I hereby authorise [you], subject to the funds being cleared, to transfer those funds to the offshore US dollar account as discussed.*

*These funds are to be held to your order pending my further instruction."*

44. Scotts subsequently transferred an investor's funds by telegraphic transfer on the instructions of Dobb White to one of seven companies controlled by Dobb White. These funds were to be held to Scotts' order. None of the investors knew the specific company or account in which their funds were placed.

45. The standard documentation detailed the arrangements between Scotts and the investors. On occasion the documentation between Scotts and the investors went via an authorised person. None of the 34 investors addressed their correspondence to or had any contact with Dobb White.

46. The FSA has formed the view that the Scheme constituted a regulated activity, and in particular (but without prejudice to other possible regulated activities), a collective investment scheme within the meaning of Section 235 of the Act pursuant to Article 51 of the Regulated Activities Order ("the RAO"), where Dobb White acted as the Scheme operator. To do so Dobb White required authorisation under the Act.

47. The FSA has further concluded that Scotts carried on regulated activities in relation to the Scheme. The FSA accepts that at the time Scotts did not appreciate that it was undertaking such regulated activities.

The Profit Sharing Arrangements

48. Until May 2002 Scotts estimated that the funds in the Scheme might achieve a return of 28% per annum. A schedule received from Dobb White in March 2002 indicated such a rate of return. At that time Scotts allocated 15% to those individuals who had placed money in the Scheme via Scotts to be shared where agreed with the relevant authorised person, 2% to the individual who introduced Scotts to the Dobb White and the remaining balance split between Scotts and its employees in accordance with an agreed formula.

49. Until May 2002 Scotts' directors and employees envisaged high returns and therefore significant payments to themselves. However, in May 2002 Scotts understood that the potential rate of return had reduced to approximately 14%. The FSA has calculated the actual sums allocated to Mr Dryburgh, Ms Gray and Scotts' employees and these were: US $20,298, US $5,094 and US $70,298 respectively. Of the US $70,298 allocated to Scotts' employees, only US $6,310 of the funds were actually paid to the employees. The rest was retained in the Scheme in the employees' names.

The US Dollar currency hedge

50. The reasons why or suitability letter identified as a risk of investment in the Scheme a US Dollar / Sterling foreign exchange rate risk if and when any monies were converted back to Sterling. In or about December 2001 one of the authorised persons enquired of a Scotts' London office employee whether funds paid into the Scheme by investors introduced by them might use a currency hedge to reduce this risk. This was a condition of their participation in the Scheme.

51. The London office employee made enquiries about how a currency hedge might be effected and offered by Scotts. This included obtaining information from a major UK bank. However, the London office employee was told by Scotts' management based in Aberdeen that Scotts should not itself offer any currency hedge.

52. Despite this (and the FSA understands without the knowledge of Scotts' management), the London office employee purported to offer the authorised person's clients a US dollar currency hedge. As a consequence between 18 January 2002 and 5 August 2002 US $4.2m was transferred by 20 investors to Scotts for investment in the Scheme in the belief that the monies were subject to a currency hedge.

53. Statements produced by Scotts' London office employee and sent to the 20 investors were to the effect that there was a currency hedge stating that "*the initial cash deposit is hedged at a charge of 1% p.a. at the exchange rate of …".* In fact, at no time was there a currency hedge in place.

54. In June and July 2002, four individuals requested Scotts to withdraw their funds from the Scheme. Due to exchange rate movements since making their investments and, in the absence of a hedge, there was a shortfall of £9,000 in the sum to be repaid from the Scheme. This shortfall was made good by the London office employee personally, less a purported administration charge of 1% as noted above.

55. In July 2002 the authorised person who had introduced these investors to the Scheme was informed by the London office employee that a currency hedge would not be available on any further sums invested. In fact none of the funds in the Scheme had ever been hedged. Further, the London office employee misrepresented that existing funds continued to benefit from a currency hedge. The FSA understands that on both occasions Scotts' management was unaware of these statements made on its behalf and it was not until November 2002 that they became aware of the position.

The End of the Scheme

56. During the period of Scotts' involvement with the Scheme it received occasional requests from investors to withdraw all or part of their funds. These were made within the agreed notice period for withdrawal. This was initially 30 days but was increased in Spring 2002 to 60 days by Dobb White.

57. In August 2002 one investor requested Scotts to return his funds within the 60 day notice period. On 6 October 2002 one of the other authorised persons involved

recommended withdrawal to all of its 22 clients that remained in the Scheme, a number of whom immediately requested the return of their funds from Scotts.

58. On 10 October 2002 Scotts requested Dobb White on behalf of all investors the return of the remaining funds in the Scheme. In total US $7.5m of the original capital invested in the Scheme remains outstanding. These funds have not been repaid by Dobb White to Scotts and Scotts has not, to date, repaid any funds to investors.

59. Since 22 October 2002 all monies under the control of Dobb White have been subject to the worldwide freezing order obtained by the FSA. There may be a significant shortfall in assets to meet creditors' claims.

**Issue 1 – the failure to exercise due skill, care and diligence with regard to assessing Dobb White and the Scheme as an appropriate and low risk investment in breach of Principle 2**

60. Scotts' due diligence in respect of Dobb White, the Scheme and the Scheme's regulatory status consisted principally of the following:

- Mr Dryburgh met with Dobb White on a number of occasions from August 2001 to November 2002 when he was briefed, initially in respect of his own personal investments, about the Scheme;

- Scotts confirmed Dobb White's professional status as accountants;

- Dobb White provided a letter dated 28 December 2000 from the FSA to Dobb White ("the FSA letter") stating that the FSA had concluded an investigation of Dobb White in respect of suspected unauthorised deposit taking activities;

- Dobb White provided a letter dated 1 May 2000 from Dobb White's solicitors addressed to "to whom it may concern" ("the Solicitors' letter") referring to its having been instructed by Dobb White in relation to two investigations by the FSA into breaches of Sections 3 and 35 of the Banking Act 1987 concerning suspected unauthorised deposit taking. The letter stated that the FSA's investigations had concluded without any evidence of unauthorised deposit taking and that therefore, despite inferences appearing in certain publications, there had been no findings of any breach of the Banking Act 1987; and

- Scotts made enquiries about the availability of Dobb White's professional indemnity insurance.

61. The FSA considers that Scotts' due diligence was seriously inadequate. In view of the regulatory background of Dobb White, the fact that Dobb White had previously given undertakings to the High Court not to accept deposits and certain features of the Scheme (such as the high potential rate of return but apparently low risk), it was incumbent on Scotts to exercise particular skill, care and diligence with regard to assessing the

suitability of Dobb White and the Scheme for investment and whether the Scheme constituted a regulated activity

62. In the light of the FSA's press releases dated 4 November 1999 and 14 August 2000 referred to above at paragraph 30 (which were known to Scotts), enquiries should have been made of the FSA.

63. The extent of Scotts' reliance on the FSA's letter and the Solicitors' letter was unreasonable. Scotts should have drawn a number of conclusions from these letters in conjunction with the FSA's press releases: first, that Dobb White was not authorised to accept deposits (this, in the context of the undertakings not to accept deposits); secondly, that, in view of the similarities between the Scheme and previous alleged unlawful deposit taking, it should have questioned whether the Scheme did in fact constitute a regulated activity; and, finally, that further enquiries and independent verification of the exact nature of the Scheme should have been obtained before Scotts participated and involved others.

64. Scotts failed to obtain any documentary evidence whatsoever about the Scheme. Furthermore, Scotts failed to carry out any, or any adequate, due diligence on the oral representations about the Scheme in order:

- to substantiate how profits or returns were generated;
- to explain or justify the potential high rate of return, and whether it was compatible with the description of the Scheme as low risk;
- to obtain and verify any information about the bank accounts and companies through which funds were channelled and held and, in particular, to obtain company searches to confirm ownership and control; and
- to obtain confirmation from Dobb White's professional indemnity insurers that cover was available as regards the Scheme to cover the loss of monies invested in the event of misappropriation or other default.

65. The reasons why or suitability letter prepared by Scotts, and subsequently made available to other authorised firms and an existing Scotts' client, contained statements about the Scheme, including performance and risk, for which inadequate due diligence had been carried out and which therefore could not be substantiated by Scotts.

66. Scotts also failed to have proper and/or adequate procedures in place to ensure ongoing due diligence and monitoring of the Scheme.

67. The FSA considers that Scotts failed, including by failing to take legal advice, adequately to assess and analyse the Scheme's nature., and in consequence Scotts similarly failed to appreciate that by its involvement it would itself also carry on a regulated activity in relation to the Scheme.

68. Scotts failed to ensure that it had the necessary permissions under Part IV of the Act to permit it to undertake the regulated activities referred to in paragraph 47. The FSA therefore considers that Scotts acted outside the scope of its Part IV permissions, for instance, by receiving client money for the purposes of investment through its bank accounts.

69. The FSA has therefore concluded that by its misconduct described above Scotts acted in breach of Principle 2.

**Issue 2 – the failure to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in breach of Principle 3.**

70. Scotts' management failed to exercise adequate control of its London office and, in particular, failed to carry out and ensure adequate supervision of London based employees. In this respect the FSA notes that a London office employee was able (without the knowledge of Scotts' management) to purport to offer a US dollar currency hedge for the benefit of 20 investors who invested a total of US $4.2m in the Scheme. These individuals may not otherwise have invested.

71. Some withdrawals of capital from the Scheme suffered shortfalls arising from adverse US dollar and sterling exchange rate movements over the period of investment. In the absence of the purported currency hedge the London office employee personally made up the shortfall without the knowledge of Scotts' directors. In this respect by October 2002 the potential aggregate shortfall to investors' funds was significant. Scotts' management had no knowledge of these facts.

72. London office employees also disseminated the reasons why or suitability letter to other authorised persons without the full knowledge and consent of Scotts' management in Aberdeen. Scotts' management therefore had an incomplete knowledge of what business was conducted in Scotts' name at the London office.

73. Scotts failed to have proper and/or adequate procedures to ensure that investment products and any related documentation were subject to the appropriate degree of due diligence and verification. In this regard reference is made to the standard documentation and, more particularly, the reasons why or suitability letter as exemplified by the failures identified in paragraphs 60 to 66.

74. An authorised person must take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that it is clear who has which responsibilities and that its business and affairs can be adequately monitored and controlled by its directors and senior managers.

75. The FSA has therefore concluded that by its misconduct described above Scotts also acted in breach of Principle 3.

**Issue 3 – the failure to pay due regard to investors' information needs and to ensure the suitability of the scheme for investment in breach of Principles 7 and 9.**

76. The standard documentation used by Scotts failed to give investors proper and adequate information about the Scheme. In particular:

- the fact that the return from the Scheme was at one stage potentially up to 28% per annum and was not limited to "the much higher return" than deposit account rates represented by Scotts. The FSA considers that the failure to disclose the full potential return to investors had the effect of misrepresenting the nature of the investment and, on the basis that risk and reward are related, the risk profile of the Scheme was misrepresented as low;

- the amount of profit share received by Scotts' directors and others. The FSA considers that it is a fundamental rule of transparency that there should be written disclosure so that an investor knows whether, and what amount of, remuneration has been received;

- the failure to state clearly that funds would be transferred by Scotts to other entities under the purported control of Dobb White and to which financial institutions. The FSA considers that the standard documentation was ambiguous in this regard and that it was incumbent on Scotts to communicate information about the Scheme in a way which was clear and fair and not misleading. In this regard, the FSA notes the use of the phrase "I would like to appoint [Scotts] to act on our behalf in connection with certain of our affairs in Europe", which does not appear to reflect even the purported nature of the Scheme;

- the degree of comfort stated to be provided by professional indemnity insurance in the case of default; the FSA considers that this may have overstated the position and may therefore have been misleading.

77. The statements and representations in the reasons why or suitability letter prepared by Scotts at the request of one of the other authorised persons involved for the use of its clients were not properly verified by Scotts. As Scotts had failed to carry out proper and/or adequate due diligence as detailed above, it was not able to confirm the accuracy of these statements and representations. As a consequence the other authorised persons involved and their clients placed undue reliance on its contents.

78. Having failed to carry out adequate due diligence into the Scheme, Scotts was not able to ensure the suitability of its advice regarding the merits of the Scheme in relation to the participation of its six existing clients.

79. The failure of Scotts to organise and control its affairs as set out above meant that Scotts' management was unaware that a London office employee in the name of Scotts had misled one of the other authorised persons involved and 20 investors over a period of approximately nine months about the existence of a US dollar currency hedge in

respect of their funds in the Scheme as more particularly set out at paragraphs 50 to 55. If the Scheme had continued then, given the exchange rate currency movements over the period, these investors might have been significantly prejudiced.

80. The FSA has therefore further concluded that by its misconduct described above Scotts acted in breach of Principles 7 and 9.

**Conclusions**

81. Scotts failed to carry out adequate enquiries into Dobb White and its regulatory status, it failed to carry out adequate due diligence into the nature and basis of the Scheme and it failed to consider the legal and regulatory status of the Scheme. In consequence, during the relevant period Scotts' conduct of regulated investment business fell below the standards required by the Principles such as to cause the risk of substantial loss to consumers.

**Relevant Guidance on Sanctions**

82. Paragraph 5.1.5 in the part of the Handbook titled Enforcement Manual ("ENF") states that the FSA will consider cancelling a firm's Part IV permission in circumstances where it has very serious concerns about the firm or the way its business has been conducted. Examples of these circumstances are set out in ENF 3.3.2 and include circumstances where it appears to the FSA that a firm is failing to satisfy the Threshold Conditions in relation to its regulated activities and where it appears to the FSA that it is desirable in order to protect the interests of consumers or potential consumers in relation to those regulated activities.

83. In view of Scotts' conduct detailed above the FSA has given serious consideration to whether it merited the cancellation of Scotts' permission under Part IV of the Act. However, for the reasons stated below, the FSA considers that cancellation is not appropriate or proportionate in this case to achieve the FSA's statutory objectives and that, in all the circumstances, discipline is more appropriate.

84. The FSA's criteria for determining the level of financial penalty are listed in ENF 13. The FSA regards the imposition of a financial penalty as a serious sanction, the principal purpose of which is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally the benefits of compliant behaviour. The FSA has considered the above-mentioned breaches by Scotts and the imposition of the proposed penalty with this purpose in mind.

85. The FSA has considered all relevant circumstances of the breaches when deciding to impose a financial penalty and its level.

86. The FSA considers that the following circumstances are relevant.

**The Seriousness of the Misconduct**

87. Breaches of the Principles are always serious. They constitute a general statement of the fundamental obligations of authorised persons under the regulatory system. Scotts' failures facilitated investments into an unauthorised and apparently unlawful investment scheme, the risks of which it did not understand and which may give rise to significant investor losses. The FSA recognises that Scotts was not the only authorised firm to have placed investors' funds into the Scheme.

88. The duration of Scotts' breaches of the Principles is referable to a period from December 2001 until October 2002. During this time funds were received by Scotts from investors and transferred by Scotts into the Scheme. Scotts sought to recover all investors' funds by requesting their return on 10 October 2002, shortly before the FSA obtained a worldwide freezing order.

89. The FSA considers that the breaches revealed a serious weakness of management and internal controls at Scotts in relation to the Scheme. Scotts' management failed to carry out adequate due diligence into the Scheme and/or to supervise the staff in its London office properly so as to prevent an employee there from purporting to offer a US dollar currency hedge to investors. However, in disciplining Scotts (rather than cancelling its permission under Part IV of the Act), the FSA notes the improvements to Scotts' systems detailed at paragraphs 98 and 99.

90. The FSA considers that the impact of Scotts' misconduct was significant in terms of the public's future willingness to invest and to deal with authorised persons. However, this must be seen in the context of the size of Scotts. This has been taken into account by the FSA when evaluating the impact of the breaches on consumers on the basis that misconduct by a larger firm could impact on a much larger number of consumers.

91. Scotts' actions may contribute along with others to a loss to 32 investors of up to US $7.5m of their original capital, which is both collectively and individually significant. Also, while recognising that undetermined sums may yet be recovered from Dobb White, other parties and professional indemnity insurances, the FSA notes that this is likely to be a long and uncertain process. This will have a detrimental impact on investors.

**The Extent to which the Breach was Deliberate or Reckless**

92. In all the circumstances, and having taken into account all the facts and representations by Scotts, the FSA considers that the breaches, while neither deliberate nor reckless, did arise out of serious failings during the relevant period to exercise due skill, care and diligence, to have adequate risk and management systems, to communicate fairly and, where appropriate, to ensure the suitability of its advice. The steps taken by Scotts were seriously inadequate in terms of what was professionally required to protect investors' interests.

**Size and Financial Resources of Scotts**

93. In fixing the amount of the penalty, the FSA has also taken into account the size of Scotts in relation to its financial and other resources. It is a small firm of accountants which, despite being incorporated with limited liability, is effectively a partnership of two individuals who have provided the necessary working capital and financial support. Scotts has around ten employees. In common with many professional firms it has few assets apart from work in progress and debtors.

94. The FSA has had particular regard to the financial resources available to Scotts in respect of which Scotts has provided verifiable evidence. Scotts has stated that it does not have the resources to pay a substantial financial penalty, having referred the FSA in particular to its poor financial performance over the last 12 months coupled with high litigation and regulatory costs. The FSA accepts this, in part, although it is mindful that in the circumstances of this case it is likely that financial resources available to Scotts could in practice extend to those of its directors and connected companies.

95. However, in this regard the FSA has also taken into account that Scotts' principal shareholder, Mr Dryburgh, may suffer a substantial loss from his own investment in the Scheme so that his ability to assist Scotts financially may be correspondingly diminished.

**The Amount of Profits Accrued**

96. The FSA may have regard to the amount of profits accrued as a result of Scotts' contraventions on the basis that a person should not benefit from his misconduct. It appears to the FSA that, except for one occasion when three commission payments totalling some US $31,000 were made to Mr Dryburgh, Ms Gray and another employee and notwithstanding the hopes of those concerned that they would benefit from profit-sharing, none of Scotts, its directors and its employees benefited financially from its involvement in the Scheme.

97. Scotts has informed the FSA that it considers that it has no claim, and will make no claim, in respect of commission or profit sharing, on any part of the money remaining in the Scheme which is now subject to freezing orders.

**Conduct Following the Contravention**

98. The FSA accepts that, since becoming an authorised person under the Act, Scotts has taken considerable steps to improve the structure and organisation of its business, including its compliance culture, drawing on the lessons learnt from this episode. The events in issue occurred shortly after Scotts had been grandfathered into the new regime under the Act on 1 December 2001. In part, the failings which occurred may have been caused by a failure to be sufficiently prepared and/or to have had in place proper systems and controls for carrying on regulated activities.

99. Scotts has now obtained specialist advice on the conduct of regulated activities from external advisers and has retained a financial services consultant. The benefit has manifested itself in the review of and improvement and revision of its procedures for the verification of documents for external use and also in respect of Scotts' internal procedures.

100. As part of the above review, Scotts made a voluntary application for a variation of its Part IV permission limiting its permission to arranging deals in investments with other authorised persons which was granted by the FSA on 22 December 2003. On 23 February 2004 Scotts made a further application to the FSA to cancel its remaining Part IV permission, on the basis that it no longer undertook any activities which would require authorisation.

101. Scotts issued civil proceedings in the High Court for restitution against Dobb White and others in 2003 on behalf of investors in the Scheme and obtained an order for default judgment against Dobb White. In taking these and related steps Scotts has incurred significant legal costs which are being met from its own financial resources.

**Disciplinary Records and Compliance History**

102. Scotts has not been the subject of previous disciplinary action by the FSA.

**Conclusion**

103. The FSA has concluded that, in view of the seriousness of Scotts' breaches of the Principles and their consequences, both actual and potential, for consumers, the imposition of a financial penalty is appropriate. The FSA has also concluded that it is proportionate in all the circumstances, taking into account particularly Scotts' very limited financial resources and the desire of the FSA that these be used substantially to assist in obtaining restitution for investors, to set the level of that penalty at £25,000.

**IMPORTANT**

104. This Final Notice is given to you in accordance with Section 390 of the Act.

**Manner of payment**

105. The Penalty must be paid to the FSA within 14 days beginning with the date on which this notice is given to you.

**If the Penalty is not paid**

106. If all or any of the Penalty is outstanding after 14 days, the FSA may recover the outstanding amounts as a debt owed by you to the FSA.

**Publicity**

107. 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.

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

**Third Party Rights**

109. The FSA gave a copy of the Decision Notice to John Dryburgh and Hazel Gray. Accordingly, the FSA must also give them a copy of this notice.

**FSA contacts**

110. For more information concerning this matter, please contact John Tutt at the FSA (direct line: 020 7066 1240).

**Peter Willsher**
**Manager, Retail Selling**
**FSA Enforcement Division**