
FINAL NOTICE

To: David Welsby

**To: Pritchard Stockbrokers Limited
(In Special Administration)**

IRN: DAW01124

FRN: 124257

Date of Birth: 16 October 1957

Date: 9 October 2014

ACTION

1. For the reasons given in this notice, the Authority hereby:
 - a) imposes on David Welsby a financial penalty of £14,000 for breaches of Statement of Principle 1, pursuant to section 66 of the Act;
 - b) withdraws the approval given to Mr Welsby to perform controlled function of CF1 Director at Pritchard, pursuant to section 63 of the Act; and

- c) makes an order prohibiting Mr Welsby from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm, pursuant to section 56 of the Act.
2. Mr Welsby agreed to settle at an early stage of the Authority's investigation. He therefore qualified for a 30% discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £20,100 on him.
3. Mr Welsby has provided verifiable evidence of serious financial hardship. Had it not been for his reduced financial circumstances, the Authority would have imposed a financial penalty of £72,000 (or £50,400 adjusted for a 30% discount, if settled early).

SUMMARY OF REASONS

4. Mr Welsby breached Statement of Principle 1 during the Relevant Period by failing to act with integrity in that he recklessly failed to provide adequate protection for client monies for which Pritchard Stockbrokers Limited was responsible. Mr Welsby was personally culpable as he recklessly relied upon the existence of an undocumented Offshore Facility in attempting to correct a deficit which Pritchard had incurred in its client money resource. He wrongfully included the Offshore Facility as an available client money resource when reconciling the amount of client money that needed to be segregated by Pritchard. This failure to ensure the appropriate segregation of client money by Pritchard throughout the Relevant Period contributed to a loss of approximately £3 million to Pritchard's clients by the time Pritchard entered into Special Administration.
5. Mr Welsby's fellow director, David Gillespie, was the Managing Director and (for the final three months of the Relevant Period), the CF10a holder at Pritchard. Mr Gillespie had primary contact with the overseas company providing the Offshore Facility. He provided verbal assurances to Mr Welsby regarding the existence and availability of the Offshore Facility. However, as Finance Director Mr Welsby was assigned responsibility for accounting and performing the internal reconciliation of client money at Pritchard. It was incumbent upon him, particularly in light of the financial difficulties experienced by Pritchard, to seek verification of the Offshore Facility's existence, its drawdown and appropriate inclusion in the client money resource, beyond Mr Gillespie's assurances. However, Mr Welsby failed to verify

the existence of the Offshore Facility, or to ensure contractual paperwork existed to support that facility.

6. As a consequence of Mr Welsby's failings as set out in paragraphs 4 and 5 above:
 - a) client money was wrongly used to pay business expenses;
 - b) Pritchard failed to routinely pay sufficient funds into its client bank account to cover shortfalls in client money, in breach of the Client Money Rules;
 - c) Pritchard placed reliance upon the Offshore Facility when calculating the client money resource for inclusion within Pritchard's internal reconciliation of client money despite the fact that such a facility was not permitted to be included in the client money resource in accordance with the Client Money Rules; and
 - d) the Authority was not informed when a shortfall in client money occurred which could not be rectified by the firm, notably when the shortfall exceeded even the purported £2 million available under the Offshore Facility which Pritchard relied erroneously upon when calculating the client money resource included within the internal reconciliation of client money.
7. Consequently, Mr Welsby as Finance Director failed to provide adequate protection for client money for which he had responsibility, both in respect of accounting and internal reconciliation functions.
8. The Authority is not alleging or implying that Mr Welsby acted dishonestly when it uses the term 'reckless' in relation to the failings detailed in this notice. The Authority considers Mr Welsby's failings to be serious for the following reasons:
 - a) these failings resulted in significant consumer detriment, including contributing to a loss of approximately £3 million of client money;
 - b) the failures directly led to Pritchard breaching the Client Money Rules and Principle 10 throughout the Relevant Period;
 - c) the failures resulted in the FSCS having to compensate clients; and
 - d) the failures led to Pritchard's books and records being inaccurate and therefore increased the cost of the Special Administration.

9. This action supports the Authority's operational objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

DEFINITIONS

10. The definitions below are used in this Final Notice:

"the Act" means the Financial Services and Markets Act 2000;

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

"CASS" means the Client Assets Sourcebook contained in the Authority's Handbook;

"Client Money Rules" means Chapter 7 of CASS (as defined above);

"CF10a" means an individual approved by the Authority (as defined above) for the CASS operational oversight function;

"DEPP" means the Authority's Decision Procedure & Penalties Manual;

"EG" means the Enforcement Guide;

"FSCS" means Financial Services Compensation Scheme;

"the Offshore Facility" means the undocumented £2 million overdraft facility purportedly provided by an offshore company;

"Principle 10" means Principle 10 of the Authority's Principles for Businesses;

"Pritchard" means Pritchard Stockbrokers Limited;

"Relevant Period" means 1 July 2010 to 8 February 2012;

"Statements of Principle" means the Statements of Principle for Approved Persons;

"Special Administration/ Special Administrators" refers to the regime governed by the Investment Bank Special Administration Regulations 2011; and

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

FACTS AND MATTERS

Background

11. Pritchard was incorporated in England and Wales on 14 April 1986 and authorised on 1 December 2001 to carry on designated investment business. Mr Welsby was approved as a Director (CF1) of the firm at its authorisation and was its Finance Director throughout the Relevant Period. Mr Welsby's fellow director and the Managing Director, Mr Gillespie, has accepted that he was ultimately responsible for the firm, including the CASS breaches, throughout the Relevant Period and held the CF3 Chief Executive function from 11 November 2011 until 6 March 2012. Mr Gillespie was also the CF10a of Pritchard for the final three months of the Relevant Period, and the person at Pritchard who had primary contact with the overseas company which provided the Offshore Facility.
12. Pritchard's annual accounts for 2010 described its principal activities as that of "providing securities and financial advice and providing securities and dealing facilities on an agency basis." The structure of its business required it to be able to hold client money. It was authorised to do so in relation to the business it conducted through its headquarters in Bournemouth and 10 ancillary offices.
13. Pritchard had been experiencing financial problems since 2009. These financial problems put pressure on Pritchard's capital adequacy and client money positions. Gillespie claims that he sought support from a trading counterparty of Pritchard via an offshore company, which purportedly offered an undocumented £2 million Offshore Facility to support Pritchard's client money position.
14. On 10 February 2012, due to concerns about Pritchard's holding of client money, the Authority secured Pritchard's assets and imposed a requirement on it to close out transactions it had already commenced.
15. On 9 March 2012, Pritchard entered Special Administration. It is estimated that Pritchard should have held an estimated £26.5 million in client money, approximately £3 million of which was represented by guarantees and the Offshore Facility purportedly provided by third parties that were irrecoverable or unenforceable, which caused the shortfall.

Internal reconciliation of client money

16. Mr Welsby had responsibility for the maintenance of Pritchard's accounts. This included responsibility for the production of Pritchard's internal reconciliations.

17. Pritchard followed what is known as the standard method of internal reconciliation of client money. This is set out at Annex 1 to the Client Money Rules and requires, on each business day, a firm to conduct a reconciliation to check whether its client money resource was at least equal to its client money requirement at the close of the previous business day in order to ensure that it has sufficient client money to repay what it owes its clients. In the event that the client money resource is insufficient to meet the requirement, the firm is obliged to transfer funds from its own resources to its client bank account to cover any shortfall on the same day. If for any reason a firm cannot do this it is obliged to inform the Authority in writing, without delay.
18. The internal reconciliation of client money was carried out at Pritchard on a daily basis in line with the guidance in Annex 1 to the Client Money Rules. Practically, the task of producing the reconciliations was undertaken by a small back office team. Mr Welsby delegated the task of producing the reconciliations to a staff member who reported directly to him.
19. On days where Pritchard did not have adequate financial resources in its own account to cover the shortfall in the client account identified by the internal reconciliation of client money, a note was kept of the sum outstanding. These amounts were initially recorded in manuscript, and then latterly electronically, in daily diaries, but no transfers from the firm's own resources were made to make good the client shortfall during the Relevant Period.
20. In the course of the relevant period these daily diaries showed, with the exception of two days, client money shortfalls ranging between £198,000 and £2,676,252. Mr Welsby was made aware of the shortfalls by a staff member who regarded Mr Welsby as responsible for Pritchard CASS matters, including, specifically, client money. Mr Welsby took no further action as he wrongly thought that the shortfall was appropriately covered by the Offshore Facility.
21. Pritchard, in breach of its regulatory duty, did not at any time in the Relevant Period make good the shortfalls in its client money nor did it inform the Authority of those breaches. As the Finance Director with specific responsibility for the accounts and Client Money, Mr Welsby should have ensured that Pritchard notified the Authority either via (in the last three months of the Relevant Period) its CF10a, or personally.
22. Mr Welsby said in interview that he believed that there was financial support in place from a third party, the overseas company which provided the Offshore

Facility, to cover the shortfall in the client money position. He described the support as being like an overdraft facility to the value of £2 million and held with a UK law firm in an escrow account on behalf of the overseas company. The facility, Mr Welsby believed, was available to Pritchard on demand and free of lien. Pritchard's client money deficit exceeded £2million on at least nine occasions during the Relevant Period and Mr Welsby accepted in interview that these shortfalls should have been reported to the Authority at the time.

Steps taken by Mr Welsby to safeguard Pritchard's client money: the Offshore Facility

23. The Client Money Rules do not recognise escrow accounts with law firms as being accounts in which client money can be deposited. Therefore, even if money had been ring-fenced in such an account, and there is no evidence that was the case, it could not have been designated as client money by Pritchard when calculating its client money resource in accordance with the Client Money Rules.
24. Mr Gillespie had the primary contact with the overseas company providing the Offshore Facility. He conducted negotiations with the contacts responsible for the Offshore Facility, principally through telephone calls and meetings, of which there is no documentary evidence. Mr Gillespie nevertheless assured Mr Welsby of the existence of the Offshore Facility.
25. Neither Mr Welsby nor Pritchard's other officers, staff or professional advisers have been able to provide any credible evidence of the existence of the Offshore Facility.
26. Mr Welsby failed to obtain or put in place any contractual documents which would have enabled Pritchard to evidence or confirm the Offshore Facility, nor did he take any steps to satisfy himself that others were putting in place the necessary documentation. Mr Welsby relied on the assurances of Mr Gillespie and failed to satisfy himself that the necessary contractual documentation was put in place to evidence or confirm the Offshore Facility. The steps he took during the Relevant Period to validate the Offshore Facility were inadequate and he inappropriately included this as client money.
27. The Offshore Facility was, according to Mr Welsby, agreed between the overseas company and Mr Gillespie, and Mr Gillespie convinced Mr Welsby of its existence. Mr Welsby did not, between 2009 (when he thought the Facility was agreed) and 2011, request from Mr Gillespie any evidence of the Offshore Facility. It was, he

said, "quite frankly beyond belief" that Mr Gillespie would not have obtained documentary evidence of the Offshore Facility. Notwithstanding that, his own failure to ensure the existence and availability of the Offshore Facility and his reliance on its purported availability to support significant shortfalls in Pritchard's client money account was reckless.

The failure to call upon the facility

28. Mr Welsby failed to call upon the Offshore Facility to make good the shortfall in Pritchard's client money. That shortfall existed throughout the Relevant Period, albeit in various degrees of gravity. Mr Welsby stated that he took comfort from the fact that the offshore company had a trading account with Pritchard holding significant trading funds throughout the Relevant Period, which he believed indicated the offshore company's financial strength and ability to assist Pritchard, if the Offshore Facility was called upon.
29. As the client money shortfall rose intermittently above £2 million towards the end of 2011, Mr Welsby pressed Mr Gillespie for documentation regarding the facility. In November 2011, when it was not forthcoming, he tendered his resignation, only agreeing to withdraw it upon receiving a categorical assurance from Mr Gillespie that a genuine facility existed and that "client assets weren't at risk and it was nothing to worry about."

Events surrounding the Authority's meeting with Pritchard of 8 February 2012 and Mr Welsby's actions thereafter

30. On 8 February 2012, the Authority attended Pritchard's office on a pre-announced visit.
31. Ahead of the Authority's visit to Pritchard, Mr Gillespie sought further assurances from the overseas company who provided the Offshore Facility that the £2 million resided in an account held by a UK law firm and was exclusively for the benefit of Pritchard clients. An email exchange followed between Mr Gillespie and the overseas company providing confirmation that a letter in relation to the facility would be sent.
32. Mr Gillespie provided Mr Welsby with emails from the overseas company, and verbally assured him that the Offshore Facility "properly" qualified as client money. The verbal assurances from Mr Gillespie and the overseas company's

email led Mr Welsby to accept that he had received confirmation of the Offshore Facility's existence and the fact it could qualify as client money.

33. On 8 February 2012, upon receipt of the email confirmation, Mr Welsby instructed a staff member to insert an entry into Pritchard's accounts to show that the firm had £2million to cover any client money shortfall. At that point, the staff member requested a written instruction to this effect. Mr Welsby agreed and made a manuscript addition to a printout of an email of 7 February 2012 between the overseas company and Mr Gillespie. That manuscript note was to confirm, for the staff member's benefit, that the overseas company had "put £2 million into its solicitors' client account that was to support the Pritchard client cash position + capital." The staff member then inserted an entry into the Pritchard bank reconciliation and included the funds as client money resource when performing the internal reconciliation of client money.
34. After the Relevant Period and following the cessation of Pritchard's business, Mr Welsby was involved in both negotiating the sale of Pritchard's trade and managing the transfer of its assets to another broker. During that process he liaised and co-operated with the Authority and the Special Administrators.
35. The actions of Mr Welsby and the reliance he placed on assurances made to him throughout the Relevant Period, without seeing verification or evidence to support those assurances, demonstrate recklessness by Mr Welsby. There are no documents which credibly suggest that the Offshore Facility, as understood by Mr Welsby, existed and there is no credible evidence that anything communicated to Pritchard's directors could have been construed as an offer to provide one.

Mr Welsby's appreciation of client money issues

36. On 20 March 2009, the Authority sent a letter to compliance officers of all firms with permission to hold client money, including Pritchard. This letter made clear the Authority's concerns about firms' CASS compliance and set out the Authority's expectations of firms when arranging adequate protection for clients' assets and money.
37. On 19 January 2010, the Authority sent letters to the Chief Executive Officers of all relevant firms with permission to hold client money, including Pritchard. These letters emphasised that the Authority was giving a higher priority "to achieving compliance with client asset requirements" because it was concerned that firms were "not always achieving an adequate level of protection". The letters enclosed

reports which noted that the Authority considered compliance with the Client Money Rules to be poor across the financial services industry. At the commencement and throughout the Relevant Period, the senior management at Pritchard including Mr Welsby had or should have had a heightened awareness of the importance of affording adequate protection to client money and the concerns of the Authority in this respect. The onus was on Mr Welsby as a Finance Director and as someone who was responsible for issues regarding client money to ensure that Pritchard paid heed to the Authority's concerns and acted upon them.

38. Individuals with approval to perform controlled functions or any other functions in relation to the carrying on of a regulated activity, and in particular those involving the exercise of significant influence, must ensure that they understand their regulatory obligations in order to be able to discharge them adequately and thereby ensure the safe and compliant operation of the firm for which they are responsible. This is necessary to safeguard the interests of consumers and the market generally. Mr Welsby failed in these requirements in relation to his responsibilities as Finance Director and his functions in relation to CASS Compliance.

FAILINGS

39. Based on the facts and matters described above, the Authority considers that in the Relevant Period Mr Welsby failed to act with integrity in breach of Statement of Principle 1. The regulatory provisions relevant to this Final Notice are referred to in the Annex.

Statement of Principle 1

40. Mr Welsby breached Statement of Principle 1 by failing to act with integrity in that he recklessly failed to provide adequate protection for client monies for which Pritchard was responsible. This contributed to a loss of approximately £3 million of Pritchard's client money by the time Pritchard entered into Special Administration. As a consequence of Mr Welsby's failings in relation to the Offshore Facility:
- a) client money was wrongly used to pay business expenses;
 - b) Pritchard failed to pay sufficient funds into its client bank account to cover shortfalls in client money, in breach of the Client Money Rules;

- c) Pritchard placed reliance upon the Offshore Facility when calculating the client money resource for inclusion within Pritchard's internal reconciliation of client money despite the fact that such a facility was not permitted to be included in the client money resource in accordance with the Client Money Rules; and
- d) the Authority was not informed when a shortfall in client money occurred which could not be rectified by the firm, notably when the shortfall exceeded even the purported £2 million available under the Offshore Facility which Pritchard relied erroneously upon when calculating the client money resource included within the internal reconciliation of client money.

SANCTION

Financial penalty

- 41. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5B sets out the details of the five-step framework that applies in respect of financial penalties imposed on individuals in non-market abuse cases.

Step 1: disgorgement

- 42. Pursuant to DEPP 6.5B.1G, at Step 1 the Authority seeks to deprive an individual of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 43. The Authority has not identified any financial benefit that Mr Welsby derived directly from the breach.
- 44. Step 1 is therefore **£0**.

Step 2: the seriousness of the breach

- 45. Pursuant to DEPP 6.5B.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. That figure is based on a percentage of the individual's relevant income. The individual's relevant income is the gross amount of all benefits received by the individual from the employment in connection with which the breach occurred, and for the period of the breach.

46. The period of Mr Welsby's breach was from 1 July 2010 to 8 February 2012. The Authority considers Mr Welsby's relevant income for this period to be £120,000.

47. In deciding on the percentage of the relevant income that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 40%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on individuals in non-market abuse cases there are the following five levels:

Level 1 – 0%

Level 2 – 10%

Level 3 – 20%

Level 4 – 30%

Level 5 – 40%

48. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5B.2G(12) lists factors likely to be considered 'level 4 or 5 factors'. Of these, the Authority considers the following factors to be relevant:

- a) Mr Welsby was reckless in relying on an undocumented facility; and
- b) Mr Welsby's failure to protect adequately client monies contributed to a £3,021,660 loss of Pritchard's client money.

49. The Authority also considers that the following factors are relevant:

- a) The loss outlined above was suffered by consumers, at least some of whom were individual (i.e. non institutional) investors. The Financial Services Compensation Scheme ("FSCS") has confirmed that there are a number of consumers who have not been fully compensated due to their investments being for amounts higher than the FSCS £50,000 claim payment threshold; and

- b) Detriment has been caused to consumers as Pritchard remains in Special Administration and distributions to creditors, including claimants through the FSCS, have yet to be completed.

50. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 30% of £120,000.

51. Step 2 is therefore **£36,000**.

Step 3: mitigating and aggravating factors

52. Pursuant to DEPP 6.5B.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

53. The Authority considers that there are no mitigating or aggravating features.

54. Step 3 is therefore **£36,000**.

Step 4: adjustment for deterrence

55. Pursuant to DEPP 6.5B.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.

56. The Authority does consider the penalty against Mr Welsby to be insufficient and therefore increases the penalty at Step 4 by way of an uplift of 100%. In so doing the Authority has paid regard to the following concerns:

- a) The detriment and inconvenience to customers of Pritchard; and
- b) Welsby's reckless behaviour contributed to the loss of £3 million of Pritchard's client money.

57. The step 4 figure is therefore **£72,000**.

Serious financial hardship

58. Pursuant to DEPP 6.5D.2G, (text of guidance provided in Annex) the Authority will consider reducing the amount of a penalty if an individual will suffer serious financial hardship as a result of having to pay the entire penalty. The Authority

accepts that the payment of a penalty of £72,000 would cause Mr Welsby serious financial hardship. Mr Welsby has provided verifiable evidence of serious financial hardship. The Authority has therefore reduced the penalty to **£20,100**.

Step 5: settlement discount

59. The Authority and Mr Welsby reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.
60. The Step 5 figure is therefore **£14,000**.

Proposed penalty

61. The Authority therefore proposes to impose a total financial penalty of **£14,000**.

PROCEDURAL MATTERS

Decision maker

62. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.
63. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for Payment

64. The financial penalty must be paid in full by Mr Welsby to the Authority by no later than 23 October 2014.

If the financial penalty is not paid

65. If all or any of the financial penalty is outstanding on 24 October 2014, the Authority may recover the outstanding amount as a debt owed by Mr Welsby and due to the Authority.

Publicity

66. 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 Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the

Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

Authority contacts

68. For more information concerning this matter generally, contact Paul Howick (direct line: 020 7066 7954 /email: paul.howick@fca.org.uk) of the Enforcement and Financial Crime Division of the Authority.

Megan Forbes

Financial Conduct Authority, Enforcement and Financial Crime Division

ANNEX

RELEVANT STATUTORY AND REGULATORY PROVISIONS

RELEVANT STATUTORY PROVISIONS

- a. The Authority's statutory objectives, set out in section 1B(3) of the Act, include the consumer protection objective and the integrity objective.

Disciplinary Powers

- b. Section 66 of the Act provides that the Authority may take action against a person if it appears to the Authority that he is guilty of misconduct and the Authority is satisfied that it is appropriate in all the circumstances to take action against him. A person is guilty of misconduct if, while an approved person, he has failed to comply with a statement of principle issued under section 64 of the Act, or has been knowingly concerned in a contravention by a relevant authorised person of a relevant requirement imposed on that authorised person.

Prohibition Order

- c. Section 56 of the Act provides that the Authority may make an order prohibiting an individual from performing a specified function, any function falling within a specified description or any function, if it appears to the Authority that that individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person, exempt person or a person to whom, as a result of Part 20, the general prohibition does not apply in relation to that activity. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated activities.

Imposition of financial penalty

- d. Section 206(1) of the Act provides:

"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."

RELEVANT REGULATORY PROVISIONS

Statements of Principle and Code of Practice for Approved Persons

- e. The Authority's Statements of Principle and Code of Practice for Approved Persons ("APER") have been issued under section 64 of the Act.
- f. Statement of Principle 1 states:

"An approved person must act with integrity in carrying out his accountable functions."
- g. The Code of Practice for Approved Persons sets out descriptions of conduct which, in the opinion of the Authority, do not comply with a Statement of Principle. It also sets out factors which, in the Authority's opinion, are to be taken into account in determining whether an approved person's conduct complies with a Statement of Principle.

The Fit and Proper Test for Approved Persons

- h. The part of the Authority's Handbook entitled "The Fit and Proper Test for Approved Persons" ("FIT") sets out the criteria that the Authority will consider when assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.
- i. FIT 1.3.1G states that the Authority will have regard to a number of factors when assessing the fitness and propriety of a person. The most important considerations will be the person's honesty, integrity and reputation, competence and capability and financial soundness.

The Enforcement Guide

- j. The Enforcement Guide ("EG") sets out the Authority's approach to exercising its main enforcement powers under the Act.
- k. Chapter 7 of the EG sets out the Authority's approach to exercising its power to impose a financial penalty.
- l. Chapter 9 of EG sets out the Authority's policy in relation to prohibition orders.
- m. EG 9.1 states that the Authority may exercise this power where it considers that, to achieve any of its regulatory objectives, it is appropriate either to prevent an

individual from performing any functions in relation to regulated activities or to restrict the functions which he may perform.

DEPP

n. Chapter 6 of DEPP sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act.

o. DEPP 6.5D.2G states that:

(1) In assessing whether a penalty would cause an individual serious financial hardship, the FCA will consider the individual's ability to pay the penalty over a reasonable period (normally no greater than three years). The FCA's starting point is that an individual will suffer serious financial hardship only if during that period his net annual income will fall below £14,000 and his capital will fall below £16,000 as a result of payment of the penalty. Unless the FCA believes that both the individual's income and capital will fall below these respective thresholds as a result of payment of the penalty, the FCA is unlikely to be satisfied that the penalty will result in serious financial hardship.

(2) The FCA will consider all relevant circumstances in determining whether the income and capital threshold levels should be increased in a particular case.

(3) The FCA will consider agreeing to payment of the penalty by instalments where the individual requires time to realise his assets, for example by waiting for payment of a salary or by selling property.

(4) For the purposes of considering whether an individual will suffer serious financial hardship, the FCA will consider as capital anything that could provide the individual with a source of income, including savings, property (including personal possessions), investments and land. The FCA will normally consider as capital the equity that an individual has in the home in which he lives, but will consider any representations by the individual about this; for example, as to the exceptionally severe impact a sale of the property might have upon other occupants of the property or the impracticability of re-mortgaging or selling the property within a reasonable period.

(5) The FCA may also consider the extent to which the individual has access to other means of financial support in determining whether he is able to pay the penalty without being caused serious financial hardship.

- (6) Where a penalty is reduced it will be reduced to an amount which the individual can pay without going below the threshold levels that apply in that case. If an individual has no income, any reduction in the penalty will be to an amount that the individual can pay without going below the capital threshold.
- (7) There may be cases where, even though the individual has satisfied the FCA that payment of the financial penalty would cause him serious financial hardship, the FCA considers the breach to be so serious that it is not appropriate to reduce the penalty. The FCA will consider all the circumstances of the case in determining whether this course of action is appropriate, including whether:
- (a) the individual directly derived a financial benefit from the breach and, if so, the extent of that financial benefit;
 - (b) the individual acted fraudulently or dishonestly with a view to personal gain;
 - (c) previous FCA action in respect of similar breaches has failed to improve industry standards; or
 - (d) the individual has spent money or dissipated assets in anticipation of FCA or other enforcement action with a view to frustrating or limiting the impact of action taken by the FCA or other authorities.

Client Money Rules

- p. The Client Assets section of the Authority's Handbook ("CASS") sets out the requirements relating to holding client assets and client money.
- q. Set out below are relevant extracts from CASS 7.4 and 7.6:

CASS 7.4.1

"A firm, on receiving any client money, must promptly place this money into one or more accounts opened with any of the following:

- (1) a central bank;
- (2) a CRD credit institution;
- (3) a bank authorised in a third country;
- (4) a qualifying money market fund."

CASS 7.6.1

"A firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money."

CASS 7.6.2

"A firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients."

CASS 7.6.5

"A firm should ensure that it makes proper records, sufficient to show and explain the firm's transactions and commitments in respect of its client money."

CASS 7.6.6

"(1) Carrying out internal reconciliations of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds in client bank accounts and client transaction accounts should be one of the steps a firm takes to satisfy its obligations under CASS 7.6.2 R, and where relevant SYSC 4.1.1 R and SYSC 6.1.1 R.

(2) A firm should perform such internal reconciliations:

(a) as often as is necessary; and

(b) as soon as reasonably practicable after the date to which the reconciliation relates;

to ensure the accuracy of the firm's records and accounts.

(3) The standard method of internal client money reconciliation sets out a method of reconciliation of client money balances that the FCA believes should be one of the steps that a firm takes when carrying out internal reconciliations of client money."

CASS 7.6.10

"(1) A firm should perform the required reconciliation of client money balances with external records:

(a) as regularly as is necessary; and

(b) as soon as reasonably practicable after the date to which the reconciliation relates;

to ensure the accuracy of its internal accounts and records against those of third parties by whom client money is held.

(2) In determining whether the frequency is adequate, the firm should consider the risks which the business is exposed, such as the nature, volume and complexity of the business, and where and with whom the client money is held."

CASS 7.6.13

"When any discrepancy arises as a result of a firm's internal reconciliations, the firm must identify the reason for the discrepancy and ensure that:

(1) any shortfall is paid into a client bank account by the close of business on the day that the reconciliation is performed; or

(2) any excess is withdrawn within the same time period (but see CASS 7.4.20 G and CASS 7.4.21 R)."

CASS 7.6.16

"A firm must inform the FCA in writing without delay:

(1) if it has not complied with, or is unable, in any material respect, to comply with the requirements in CASS 7.6.1 R, CASS 7.6.2 R or CASS 7.6.9 R;

(2) if having carried out a reconciliation it has not complied with, or is unable, in any material respect, to comply with CASS 7.6.13 R to CASS 7.6.15 R."