

## **FINAL REPORT AND FINDINGS**

### **1. My Position as Independent Investigator**

- 1.1 Under the provisions of the Complaints against the FSA Scheme (Amendment No. 2) Instrument 2005, the FSA, having been informed of a conflict of interest on the part of the Complaints Commissioner, requested the President of the Law Society to nominate a Solicitor to act as Independent Investigator. I was so nominated by the President on 1 November 2005. My nomination being approved by the Treasury it now falls to me to carry out the functions conferred on the Complaints Commissioner by the Complaint Scheme, which is established in accordance with Paragraph 7 of Schedule 1 to the Financial Services and Markets Act 2000 and generally referred to as Complaints against the FSA [COAF]. I am required in so doing to adopt the methodology of the Complaints Commission.

### **2. The Scope of my Investigation**

- 2.1 COAF provides for a two stage investigation into complaints against the FSA; Stage 1 being an in house investigation and report by a suitably senior member of staff who has not previously been involved in the matter, with a Stage 2 investigation and report being undertaken by the Complaints Commissioner or, in this case, an Independent Investigator only if the complainant is dissatisfied with the Stage 1 report or the FSA has refused or neglected to undertake a Stage 1 investigation.
- 2.2 In this case there was a Stage 1 investigation and report carried out by Officer A, a complaints officer in the Company Secretariat of the FSA, which was sent to the complainants by letter dated 12 September 2005. The complainants were dissatisfied with that report and wrote to the Complaints Commissioner, an undated letter but received on 15 September 2005, requesting a further investigation into their complaint. A conflict of interest was identified and the complaint is accordingly referred to me.

### **3. Background**

- 3.1 The complainants, Mr and Mrs X, had invested money with an individual, Mr Y, (along with some 8,500 others), in what they described as a *club* comprising of family and friends of Mr Y. As a consequence of the FSA's investigation into the activities of Mr Y in early February 2004, the complainants allege that they (and others) have been deprived not only of the promised returns on those funds but the majority of their initial investment.
- 3.2 Following information received from the police and banking institutions, the FSA had commenced civil proceedings on or around 4

February 2004 in respect of what it believed to be a very large and fraudulent collective investment/deposit-taking scheme or schemes being operated by Mr Y without him being so authorised under the Financial Services & Markets Act 2000 [FSMA].

- 3.3 The FSA was successful in its court action and a Restraint and Freezing Order was granted on 16 March 2004, which, in essence, prevented Mr Y from continuing his investment activities, in that all of his and his investors' funds were frozen. The sequence of events that then followed concluded in the FSA petitioning the court for the bankruptcy of Mr Y, which was granted on 4 July 2005. During this period of time between the granting of the Restraint and Freezing Order and the Bankruptcy Order Mr Y opposed the proceedings at each appropriate stage, seeking extensions of time that were granted, and also proposed, as an alternative to bankruptcy, that he would enter into an Individual Voluntary Arrangement [IVA], which the FSA opposed. However, when eventually the bankruptcy proceedings took place on 4 July 2005, Mr Y did not oppose them. It is understood that although an appeal was lodged against those proceedings, Mr Y failed to support this application properly with the required information and, therefore, his application was dismissed by the Court of Appeal.
- 3.4 The complainants have emphasised that no individual member of the club complained about the actions of Mr Y nor did they require the protection of the FSA. They, and others, allege that by placing Mr Y into bankruptcy the FSA has caused severe financial hardship, in that any return of their money will only amount to a few pence in the pound.

#### 4. The Complaint

- 4.1 The letter of complaint received by the Office of the Complaints Commissioner on 15 September 2005 was from Mrs X and was based on a template model, being identical to others received on or around that time. The embolden words contained within the letter are those of this and other complainants. The letter stated -

*"Dear Sir/Madam,*

*I am a member of the (name of Mr Y's operation), a club for some 9,000 **invited** members only. Members comprise family and friends looking after their own best interests and the best interests of their own local community throughout the UK.*

*In February 2004 the FSA took it upon themselves to investigate our founder member Mr Y, for being an **alleged** Collective Investment Scheme (CIS). This allegation has **yet** to be proven!*

*This, despite the fact that up until February 2004, **no** member had made any complaint against the (name of Mr Y's operation) **nor** had the (name of Mr Y's operation) failed to make a return on due members monies at the designated time!*

*Many months down the line the FSA succeeded, on 4<sup>th</sup> July, in making Mr Y bankrupt, **not** on behalf of his 'creditors' (members) but supposedly in the 'wider Public interest'?  
(An appeal against this judgment was lodged on 18<sup>th</sup> July.)*

*At no time has the FSA bothered to consult with the members of the (name of Mr Y's operation), whose interests they arrogantly profess to protect.*

*Perhaps because we neither sought nor asked for either their involvement or protection in the first place?*

*It is my belief that the FSA have acted outside of their own remit and in 'bad faith'.*

*It is my opinion that the FSA have conducted a pernicious vendetta against Mr Y and consequently us, the members, orchestrated by a Mr (name of Officer D in the Enforcement Division of the FSA).*

*Indeed, there is a question as to their locus standi in the whole action?*

*An action that has caused great distress and suffering too (sic) many members, such as the loss of homes due to re-possession, the cancellation of urgently needed private surgery and numerous cases of well documented hardship- many of which were notified to the FSA!*

*This from a body that is supposed to protect the Public interest? God help us!*

*As such, I would request that you investigate the case of the FSA versus Mr Y to ensure that the FSA have **not** acted outside of their remit and/or in bad faith?*

*Yours sincerely, "*

- 4.2 The Office of the Complaints Commissioner acknowledged this correspondence on 3 October 2005 and explained what would be my role (please see paragraph 1.1 above).
- 4.3 On my appointment, I wrote to Mr and Mrs X asking for their confirmation that they had received the FSA's Stage 1 report and analysing what I understood to be their complaint. Further correspondence was received from Mr and Mrs X by letter dated 14 November 2005 confirming my understanding and including a further component to their complaint. I acknowledged this on 24 November 2005 and confirmed that I would undertake a Stage 2 investigation.
- 4.4 In summary, I have analysed the complaint into four components, namely that -
  - (a) The FSA acted in bad faith;
  - (b) The FSA acted outside its authority;
  - (c) Being a person(s) interested in matters under investigation the complainants were not consulted;

- (d) The actions of the FSA have caused the complainants and others loss.

The complainants in the final paragraph of their letter raised the issue of bias on the part of the FSA in the preparation of its report. This is a new matter which under the terms of COAF must be referred to the FSA direct for consideration and report. I only have jurisdiction to consider this complaint if either the complainants are dissatisfied with such report or if the FSA refuses or neglects to undertake a Stage 1 investigation.

## **5. The Investigation**

5.1 In carrying out my investigation I have had the benefit of the following documents –

- (a) Documents and correspondence provided to me by the FSA;
- (b) The Financial Services and Markets Act 2000 [FSMA], access to the FSA Handbook on regulation and literature on how complaints are handled both by the FSA and the Office of the Complaints Commissioner in line with paragraph 1 of Schedule 7 of FSMA; and
- (c) Correspondence from the complainants.

5.2 The FSA has provided the information and documents asked for during this investigation. No information has been withheld by the FSA for reasons of confidentiality.

## **6. The Findings**

6.1 In making my findings I adopt *the balance of probabilities* (i.e. the normal civil standard) as the standard of proof and regard the burden of proof as being neutral between the FSA and the complainants. I am bound by the Rule 1.5.15 of COAF to accept as conclusive any findings of fact made by a Court as defined in such rule. This Rule states -

*“In the investigation of a complaint by either the FSA or the Complaints Commissioner, any finding of fact of:*

*(1) a court of competent jurisdiction (whether in the United Kingdom or elsewhere); or*

*(2) the Tribunal; or*

*(3) any other tribunal established by legislative authority (whether in the United Kingdom or elsewhere);*

*(4) any independent tribunal charged with responsibility for hearing a final appeal from the regulatory decisions of PIA, IMRO or SFA;*

*which has not been set aside on appeal or otherwise, shall be conclusive evidence of the facts so found, and any decision of that court or tribunal shall be conclusive.”*

I set out below my findings on each component of the complaint referred to in paragraph 4.4 above.

## 6.2 ***The FSA acted in bad faith.***

- (a) The FSA is an independent body set up by Parliament to regulate the financial services industry in the UK. It has four statutory objectives: namely, maintaining confidence in the financial system; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; and reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime. The FSA cannot abrogate its duties nor delegate them to a third party, it has however a discretion as to how to discharge its functions and direct its resources in the most effective and efficient way. Scrutiny of the FSA by Parliamentary Committees may focus on how it achieves its objectives. The FSA is under a duty to show how the rules that it makes and publish relate to those statutory objectives. However, if it interprets the objectives incorrectly, or fails to consider them, it can be challenged in the courts by judicial review. I note that the complainants have not taken this route.
- (b) One of the responsibilities of the FSA is to police the perimeter of the financial services industry, that is, to ensure that all businesses operating within the UK are correctly authorised if they come within the definition of undertaking a *regulated activity* as defined by the FSMA. I attach at Appendix A the FSA's definition of *regulated activity*.
- (c) Having been alerted by the banking transactions of Mr Y and due to his lack of co-operation in assisting them with their enquiries, the FSA then had to obtain sufficient evidence to show that the business operated by Mr Y was an activity that fell within the definition of a *regulated activity* and should, therefore, be authorised under the FSA. The FSA was, therefore, acting in accordance with its statutory objectives and functions in instigating proceedings against Mr Y.
- (d) In view of your concerns, I have asked the FSA for information on other “perimeter” cases whereby it has had to respond urgently to ensure that an activity was operating within the correct authorisation. I am satisfied that the action it took in this case was in line with their normal practice. This particular problem arose because Mr Y either did not realise that he required authorisation, or did not wish to obtain authorisation. The result either way would have been the same. The FSA has properly pursued its statutory obligations in intervening and, from other examples of their policing the perimeter that I have seen, this case was not exceptional.

- (e) I, therefore, do not uphold this component of the complaint.

**6.3 *The FSA acted outside its authority.***

- (a) As I have outlined above, the FSA has a duty to operate within its statutory authority. It has a wide range of powers to assist it in achieving its objectives. From the documentation I have seen, the FSA has consistently operated within those powers. In order to gain the Restraint and Freezing Orders, the Statutory Demand and the Bankruptcy Order, the FSA was required to demonstrate to the Court not only that it had the powers to do so but also that it was fair and reasonable in undertaking such action. The Court has upheld their submissions.
- (b) I have seen no evidence to indicate that the FSA was acting outside its authority and, therefore, I do not uphold this component of the complaint.

**6.4 *Being a person(s) interested in matters under investigation the complainants were not consulted;***

- (a) Mr and Mrs X have indicated that Mr Y was operating a club for members which comprised family and friends and, therefore, it was not a business and as such should not have come under FSA authorisation. They emphasise that no “member” had made a complaint against Mr Y. Therefore, it is their view that they should have been consulted as to whether they (and others) wished to have the protection offered by the FSA.
- (b) The FSA has discretion to choose how to act in a situation once it has established that the activities come within the definition of a *regulated activity*. It has the responsibility to enforce the Act for the protection of consumers, now and in the future. It has powers to consult with an individual or a group of individuals to seek their views as to how it should proceed even when those persons have not raised a complaint. In this case, it presented evidence to the Court to show that Mr Y was operating, as a business undertaking, an activity which fell within the definition of a *regulated activity*, and that in so doing he had breached the requirements of FSMA. The Court upheld this view.
- (c) The FSA did, however, keep the complainants (and others) informed of its actions by issuing statements on its web site. Some eighteen statements were made between February 2004 and 21 July 2005. Included in the statements were examples of frequently asked questions and answers to assist those investors (or would be investors) to understand the situation as it unfolded. The FSA also wrote to each individual investor

who raised concerns with it and alerted them to the information that could be obtained from its web site.

(d) I, therefore, do not uphold this component of the complaint.

**6.5 *The actions of the FSA have caused the complainants and others financial loss.***

(a) In view of the Bankruptcy Order issued in July 2005, which followed proceedings before the court that indicated that Mr Y did not have the funds either to pay to investors their promised returns or their original investments, I have to accept that it is very likely that the complainants (and others) will lose the greater part of their money but this will be as a direct result of Mr Y operating illegally a collective investment scheme, not because of the subsequent actions of the FSA. As I understand it, Mr Y did not oppose the Bankruptcy Order although he did subsequently lodge an appeal against it. However, he failed to support his application for leave to appeal properly with the information as ordered by the Court of Appeal, and his application was therefore dismissed.

(b) For this reason, I do not uphold this component of the complaint.

**7. My Decision**

For the reasons given I conclude that the complainants' complaint is not well founded and I, therefore, dismiss it.

**8. Publication**

this report may be published in full as neither party has made representations to the contrary.

### **The FSA's Definition of *Regulated Activity***

(In accordance with section 22 of the Act (The classes of activity and categories of investment)) any of the following activities specified in Part II of the *Regulated Activities Order* (Specific Activities):

- (a) accepting deposits (article 5);
- (aa) issuing electronic money (article (B));
- (b) effecting contracts of insurance (article 10(1));
- (c) carrying out contracts of insurance (article 10(2));
- (d) dealing in investments as principal (article 14);
- (e) dealing in investments as agent (article 21);
- (f) arranging (bringing about) deals in investments (article 25(1));
- (g) making arrangements with a view to transactions in investments (article 25(2));
- (ga) arranging (bringing about) regulated mortgage contracts (article 25A(1));
- (gb) making arrangements with a view to regulated mortgage contracts (article 25A(2));
- (h) managing investments (article 37);
- (i) safeguarding and administering investments (article 40); for the purposes of the permission regime, this is sub-divided into:
  - (i) safeguarding and administration of assets (without arranging);
  - (ii) arranging safeguarding and administration of assets;
- (j) sending dematerialised instructions (article 45(1));
- (ha) assisting in the administration and performance of a contract of insurance (article 39A);
- (k) causing dematerialised instructions to be sent (article 45(2));
- (l) establishing, operating or winding up a collective investment scheme (article 51(1)(a)); for the purposes of the permission regime, this is sub-divided into:
  - (i) establishing, operating or winding up a regulated collective investment scheme;
  - (ii) establishing, operating or winding up an unregulated collective investment scheme;

- (m) acting as trustee of an authorised unit trust scheme (article 51(1)(b));
- (n) acting as the depository or sole director of an open-ended investment company (article 51(1)(c));
- (o) establishing, operating or winding up a stakeholder pension scheme (article 52);
- (oa) providing basic advice on a stakeholder product (article 52B);
- (p) advising on investments (article 53); for the purposes of the permission regime, this is sub-divided into:
  - (i) advising on investments (except pension transfers and pension opt-outs);
  - (ii) advising on pension transfers and pension opt-outs;
- (pa) advising on regulated mortgage contracts (article 53A);
- (q) advising on syndicate participation at Lloyd's (article 56)
- (r) managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's (article 57);
- (s) arranging deals in contracts of insurance written at Lloyd's (article 58);
- (sa) entering into a regulated mortgage contract (article 61(1));
- (sb) administering a regulated mortgage contract (article 61(2));
- (t) entering a provider into a funeral plan contract (article 59);
- (u) agreeing to carry on a regulated activity (article 64);

which is carried on by way of business and relates to a specified investment applicable to that activity or, in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind.

February 2006