

On 1 February 2005 the Complaints Commissioner issued a final report on complaint GE-L0287 to the complainant and the Financial Services Authority. The introduction and summary to that report is published below.

CONFIDENTIAL

FINAL REPORT ON COMPLAINT GE-L0287

1. Introduction and Summary

- 1.1 This is the report of an investigation by the Complaints Commissioner of complaint reference number GE-L0287 against the Financial Services Authority (FSA). The complaint falls to be considered under the Main Scheme.
- 1.2 The complainant is a firm of Independent Financial Advisors, Company X, which wished to change its legal entity from that of a Partnership to one of a Limited Company for reasons of tax efficiency. After reading the FSA Handbook and relying on SUP 15.5.5R, Mr R, a Partner in Company X wrote to the Monitoring and Notifications Department (MAND) of the FSA on 22 July 2003 informing them of the intention to incorporate with effect from 1 September 2003. The letter explained that the name which the company would like to have used was not available and therefore Mr R would write again when the new name was known. In addition he requested whether any further action was required on the part of the Company.
- 1.3 Over the same period from 3 July 2003 until 17 September 2003, Company X had been in correspondence with the Independent Firms Division of the FSA concerning their inability to obtain compliant professional indemnity insurance (PII). This correspondence concluded on 17 September 2003 when the FSA granted the Partnership a “modification” which allowed it to continue trading.
- 1.4 No response had been received to the letter notifying MAND of the intention to incorporate and Mr R wrote again on 2 September 2003 providing the name for the new company.
- 1.5 On the same day, Officer A from the Independent Firms Division Contact Centre (IFDCC), wrote to Mr R using a ‘standard’ letter. She apologised for the delay in responding and explained that a new application would be required because of the change of legal entity. The complainant was directed towards the website where the application forms could be found and towards the relevant sections in the FSA Handbook.

1.6 On 5 September 2003 Ms W from the Compliance Consultancy retained by Company X telephoned IFDCC to challenge the need for a new authorisation and to request that the fees for the new application should be waived. The call was responded to the following day when IFDCC outlined the requirements of the Financial Services and Markets Act 2000 (FSMA) to Ms W.

1.7 On 9 September 2003, Mr S from Company X formally complained to the FSA as follows:

- *We duly advised the FSA on 22 July 2003 and specifically requested whether any further action was required.*
- *Under the impression that we have done all that is required, we proceeded with our arrangements. As you will appreciate we have already incurred costs in establishing the new company.*
- *We were therefore appalled to receive a letter dated 2 September 2003.....it is only due to a slight delay in our own arrangements that we have not yet actually transferred our operations to the new company.....we would have been trading without authorisation, which is a criminal offence.*
- *SUP 15.5.5 R only states that ‘a firm must give the FSA reasonable advance notice of a proposed change in its legal status which limits the liability of any of its members or partners.’ The guidance at SUP 15.8 G does not mention a new application.*
- *Authorisations Department have verbally agreed that whilst Part 111 of FSMA 2000, S.32 requires a new application from a partnership changing legal status, this is not actually reflected in the Handbook*
- *We therefore request that if we decide to proceed with an application*
 1. *That our case is dealt with as a priority to allow transfer of our business by 1 October 2003; and*
 2. *That the application fee is waved.*

1.8 On 11 September 2003 the complaint was entered into the Complaints Scheme by Officer B and he provided Mr S with a leaflet explaining the Scheme.

1.9 On 15 September 2003 Officer B again wrote to Mr S excluding from the Complaints Scheme the part of the complaint dealing with a “material omission” from the Handbook. The reason for the exclusion was:

“We believe that this is a complaint about the way in which the FSA has exercised its ‘legislative functions’ in regard to making and issuing rules and/or guidance and is therefore excluded from the Scheme. Notwithstanding this, I shall refer the wider issue to the relevant policy department for their consideration”

The part of the complaint relating to administrative errors made by the FSA in dealing with the notification of the change in legal status of company X would be the subject of a Stage 1 investigation. An investigation into this aspect of the complaint was independently conducted by Officer C and a report provided to Officer D who had taken over dealing with the complaint from Officer B.

1.10 On 17 September 2003 a modification was granted to the partnership by IFDCC which allowed Company X to continue trading as a Partnership.

1.11 On 17 November 2003 a substantive response was sent by Officer D addressed to both Mr R and Mr S at Company X. The complaint concerning the delay in responding to the letter dated 22 July 2003 was upheld:

- *“In the light of the above information we uphold your complaint of delay. We would take this opportunity to reaffirm the apology made in the letter dated 2 September 2003. Even though your complaint was upheld the option of an ex-gratia payment is not considered to be appropriate in this case.”*

The response continued:

- *“It is important to note that while there may not be an obvious reference to the requirement for a new authorisation after a change of legal entity within the FSA handbook, there is a requirement under Section 40 of the Financial Services and Markets Act 2000 (FSMA). In addition, it is a firm’s responsibility, not the FSA’s to ensure that any requirements are met.”*

The response concluded:

- *“Your letter of 22 July 2003 stated your ‘intention to incorporate’ to a Limited Company, although the name was yet to be determined. However, your 23 July 2003 letter, responding to our letter concerning Professional Indemnity Insurance (PII), set out in a manner which suggested your business would be continuing as a partnership. We are advised that you have since been granted a PII waiver and have therefore continued to conduct investment business under a partnership entity. As stated above, no application has yet been received in respect of the new Limited Company.”*

1.12 Mr R responded to Officer D on 21 November 2003:

- *“Are you suggesting that whilst the multimillion pound resources of the FSA should not be expected to note a discrepancy between the FSA Handbook and the FSMA, we as a two partner firm are? I find it difficult to conceive of a greater abrogation of responsibility from an entity (the FSA) whose sole reason for existence is to implement and regulate the legislation.”*

- *“I would be grateful if you could please let me know, by return, the process required for us to refer these issues to the Independent Complaints Commissioner.”*

- 1.13 On 24 November 2003 a letter was received by the Complaints Commissioner from Ms W, a compliance consultant retained by Company X. Ms W informed the Commissioner that she had conducted research into the FSA rules on authorisation and that there was no reference in the Handbook to a new application being required in such cases. Indeed, in her view the rules that are in the Handbook state quite the opposite. She provided extracts from the Handbook to illustrate her point.
- 1.14 Ms W stated that she “strongly rejected” the FSA’s assertion in their letter to Company X regarding FSMA. She understood that FSMA applied to all but did not believe that the FSA should abdicate their responsibility in relation to making clear rules and guidance for authorised firms. She mentioned that as a point of fact S40 of FSMA does not deal with a change of legal entity for a firm that is already authorised....S32 deals with authorised partnerships.
- 1.15 Ms W concluded by stating that she had requested a change to SUP 15.5.5R but had been unable to find an avenue via the FSA. They had dismissed their responsibility, ignored her sundry requests for a suitable contact and had not progressed her request for a change to SUP 15.5.5R.
- 1.16 On 2 December 2003 Mr R wrote a letter of complaint to the Complaints Commissioner.
- 1.17 On 27 February 2004 the Commissioner wrote to Company X and confirmed that he was prepared to conduct a stage 2 investigation into the Complaint.

2. Findings and Recommendations

- 2.1 In the course of the investigation, the Complaints Commissioner obtained and has considered written representations from the complainants and from their compliance adviser; and documents and correspondence provided to him by the complainant and by the FSA. The Office of the Commissioner also conducted interviews with relevant personnel at the FSA.

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

- 2.2 The material facts are shown at Appendix A and relevant paragraphs from the FSA Handbook and from the Financial Services and Markets Act 2000 are shown at Appendix B.
- 2.3 The Commissioner has analysed the complaint as having two elements:

- a) *That no response had been received to the initial enquiry resulting in expense to the company which might not have been undertaken had they realised the delays involved in obtaining authorisation; and*
- b) *The FSA Handbook does not state that if a Partnership changes status to that of a Limited Company, that a new application is required.*

2.4 In relation to the first part of the complaint that *no response had been received to the initial enquiry resulting in expense to the company which might not have been undertaken had they realised the delays involved in obtaining authorisation*, in summary, the Commissioner finds as follows:

- (a) Officer C, who conducted the Stage 1 investigation into the complaint, has explained to the Commissioner that it appeared to him that MAND in receiving the letter from Company X dealt with that part of the letter which applied to them, namely the notification of the intention to incorporate and the fact that the new name would be notified at a later date. However, there was a failure to recognise that a speedy response to the question regarding any further action was required from another department. Officer C's report recommended further training of staff in recognising when another department should be involved at an early stage. The Commissioner has no reason to doubt the conclusions which were drawn regarding this aspect of the report. When the letter eventually reached the IFD Contact Centre, on 2 September, Officer A has explained to the Commissioner that she realised that it needed an urgent response and sent the 'standard' letter to the complainants on the same day.
- (b) A delay of this kind was clearly not acceptable particularly in view of the serious consequences which could have resulted in company X trading illegally. However, the FSA has acknowledged this situation and apologised to the complainants. The Commissioner has noted that this company has been in the habit of contacting the FSA on a number of different occasions and the FSA has suggested that Company X should have contacted them when a response was not received to the letter. However, the Commissioner is of the opinion that where a firm has sent a notification of a change of legal entity to the Regulator, it is reasonable for them to have believed that they had fulfilled the requirements placed on them by the Handbook and, therefore, there would not have been a need for further contact.
- c) The Commissioner also notes that at the same time that Company X was considering a change of legal identity, they were also in discussion with another department of the FSA concerning their ability to obtain Professional Indemnity Insurance cover. Consequently there appears to have been a concern within the FSA that the original notification of change of legal entity was undertaken with a view to obtaining compliant professional indemnity cover for the new company rather than for reasons of taxation as stated by Company X. When the Partnership obtained the "modification" to allow it to continue with the business as a Partnership then the change of legal entity was no longer required. However, the

Commissioner has found no evidence to suggest that this was the reasoning behind the notification from Company X. He is aware that there can be tax advantages to a limited liability company and can see no reason to doubt the word of the complainants in this case.

- d) In conclusion, the Commissioner finds that the delays in responding to the letter informing the FSA of the intention to incorporate were not acceptable and therefore this element of the complaint is made out.

2.5 In relation to the second part of the Complaint that ***the FSA Handbook does not state that if a Partnership changes status to that of a Limited Company, that a new application is required***, in summary, the Commissioner finds as follows:

- (a) In considering this element of the complaint, the Commissioner was mindful of COAF 1.4.2G concerning complaints relating to the performance of the FSA's legislative functions under the Act, including making rules and issuing codes and general guidance. While he is of the opinion that the complainants were not querying the rules or rule making powers of the FSA but were instead alleging that the Handbook is not clear and may be wrong in that it does not reflect the Act, may be internally contradictory or misleading, the Commissioner, on reflection accepts the position of the FSA and now takes the clear view that the complaint in that respect is not within the scope of the Scheme.
- b) The Commissioner would add by way of further comment however that he has looked carefully at the **Supervision**, **Authorisation** and **General** Sourcebooks and is of the opinion that only very specific examples of changes of status requiring new authorisation are covered. **Supervision** deals with core information requirements, which involve reasonable advance notification of a change in the firm's name, address or legal status. **Authorisation** 3.11 deals with specific obligations for partnerships or unincorporated associations. **Authorisation** 3.23 deals with applicants that are limited liability partnerships but does not mention Limited Companies. **General** deals with firms seeking initial authorisation. The Handbook does appear to the Commissioner to be silent on whether a new application is required by a partnership or sole trader, already authorised and changing status to that of a limited company.
- c) The Commissioner has also considered the sections of the Financial Services and Markets Act 2000 (FSMA), which have been quoted by the FSA. The FSA have quoted both Sections 32 and 40 as being relevant to the situation where a partnership decides to incorporate. Section 32 deals with Partnerships and unincorporated associations whilst Section 40, which was quoted by Officer D in his response to the complaint, deals with individuals or organisations applying for Authorisation. Neither appears to the Commissioner to cover the situation of a change of legal entity from a Partnership to a Limited Company or to suggest that a new application is required in this situation. In fact, Section 40 appears to suggest that a new

authorisation should not be sought when a valid authorisation already exists.

- d) The Commissioner is aware of an exchange of emails between Officers of the FSA in connection with this complaint and in which it was stated “*the rule seems to limit itself to very particular changes in status.... the obvious examples (sole trader or partnership to limited company) are missing.*” The suggestion was then added that the Handbook should not be regarded as the sole source of material or requirements.
- e) FSA Principle 6 states “a firm must pay due regard to the interests of its customers and treat them fairly.” The Commissioner would suggest that in the same way that the FSA has a requirement that firms have a responsibility to their customers, the FSA also has a responsibility to its customers i.e. the regulated community. It is accepted that the requirements of FSMA apply to everyone but a regulated firm should not be expected to have to research the Act of Parliament because the Handbook is either not clear or is misleading. In fact, as has already been mentioned at c) above, FSMA itself does not appear to mention a new authorisation being required when a firm changes legal entity.

2.6 In the light of these findings the Commissioner recommends as follows:

- a) The FSA has acknowledged the failings in their dealings with the notification of a proposed change of legal entity and has apologised to Company X. Officer C’s report has recommended training of staff in recognising when action is required by different departments in response to letters and his recommendation is welcomed by the Commissioner. There does seem to have been some confusion within the FSA as to exactly what training should be given and the Commissioner would suggest that monitoring of the situation should be undertaken at a senior level to identify what training is actually required and to ensure that the training is appropriate and effective.
- b) In addition, the Commissioner is of the opinion that whilst standard letters can be suitable for the majority of responses, there are occasions, such as in this particular case, where an individual response would have been more appropriate. The Commissioner accepts the view of Company X that expense was incurred because of the delay in receiving a response which might not have been undertaken had they received an earlier and more appropriate response suggesting that a new application was required. Unfortunately, the Commissioner is unable to make an award in this respect and must therefore leave this issue as a matter for the FSA to consider in the light of this report. The Commissioner is of the view that the issue of the PI cover was totally separate and being dealt with by another department within the FSA and has no bearing in the subject of this complaint. Whilst the Commissioner is unable to recommend a payment to compensate for the unnecessary expenditure he does suggest that a sum of £100 should be paid to Company X by the FSA in recognition of the distress and inconvenience caused. The FSA has since

suggested that this amount be increased to £250 and the Commissioner notes that helpful increase.

- c) Principle 11 of “The Principles” states that “a firm must deal with its Regulators in an open and cooperative way and disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.” In complying with SUP 15.5.5 and notifying the FSA of the intention to incorporate, the Commissioner is of the opinion that Company X had behaved reasonably and complied with that Principle.
- d) The Commissioner recommends that the Handbook is re-examined by the FSA and that suitable amendments, in line with the requirements of FSMA, to clarify the requirements on firms, are put forward to the Board for their consideration.

2.7 The Commissioner has decided to publish the Introduction, Summary, Findings and Recommendations to this report.