

4th June 2007

Dear Complainant

Complaint against the Financial Services Authority
Reference Number: 707

I am writing to advise you that I have now completed my investigation into your complaint.

At this stage I think it would be worth explaining my role and powers. Under the Complaints Scheme (Complaints against the FSA - known as COAF) my role is as an independent reviewer of the FSA's handling of complaints. I have no power to enforce any decision or action upon the FSA. My power is limited to setting out my position on your complaint based on its merits and then, if I deem it necessary, I can make recommendations to the FSA. Such recommendations are not binding on the FSA and the FSA is at liberty not to accept them. Full details of Complaint Scheme can be found on the internet at the following website; <http://fsahandbook.info/FSA/html/handbook/COAF>.

From your letters of 13th January and 5th February 2007, I understand your complaint relates to the following points:

1. You believe that the FSA is unwilling to protect UK consumers. You feel the firm you dealt with, Firm A, has not acted appropriately and as a result you have lost around £20,000. You claim that you only dealt with the firm as it indicated it was authorised by the FSA. As a result you are looking to the FSA for compensation.
2. You claim the rules surrounding the 'passporting in' and the 'voluntary passporting in' of firms from other European Economic Area (EEA) States do not give consumers sufficient protection and help unscrupulous companies.
3. Firm A had its licence withdrawn by the German Regulator (BaFIN) in July 2005. You would like to know why its licence was withdrawn and are unhappy that neither the FSA nor BaFIN will provide you with this information.

From your correspondence with the FSA it is clear you believe that as Firm A was authorised by the FSA to carry out regulated activities in the UK. As such you feel you should therefore be covered by the consumer protection offered by the Financial Services and Markets Act 2000 (FSMA).

The firm in question is a German firm which was regulated by the German Financial Services Regulator (BaFIN). Under the EU Investment Services Directive (ISD) a firm's home regulator (in this case BaFIN) authorises a firm. This authorisation has the effect of providing it with an EEA Passport which will allow it to undertake regulated activity in another EEA State (in this case the UK).

Firm A was granted an 'inward services passport' by BaFIN in August 2002. This enabled it to undertake regulated activity in the UK without going through the authorisation process which the FSA requires. The firm is not required to go through the FSA's authorisation process as the home state regulator (in this case BaFIN) had already deemed the firm to be fit and proper.

Whilst BaFIN regulated and approved the firm, the FSA only regulates how the firm conducts its business in the UK. In doing this the FSA expects any firm which has been granted an EEA 'inward services passport' to adopt the same business standards as a firm which it directly authorises.

In your letters to both my office and the FSA you state that the firm did not adhere to the required standards. The FSA has finite resources and operates a risk based approach to regulation. As a result of this it is unable to monitor every communication a firm has with a consumer. Instead, the FSA places the onus on firms (through their individual Compliance Officers) to comply with its rules and relies on spot checks to ensure that the required business standards are being met.

As the firm is based in Germany, and directly authorised by BaFIN, the FSA works with BaFIN to ensure that the firm meets the required regulatory standards in its dealings with UK consumers. Additionally, I should point out that the standards BaFIN require firms to adopt when dealing with consumers (whether in German or the UK) are similar to those required by the FSA.

Although the firm may not have adopted the appropriate standards in its dealings with you, you have not provided any evidence to show that it was that failure that led to you suffering a loss or further that it was the actions, or inactions, of the FSA that resulted in you incurring a loss. The essential reason for your loss was the failure of the shares that you purchased.

I should also add that, from the information you have provided, I believe that as an existing holder of single company shares, you were aware of the risks associated with this type of investment. Additionally, the correspondence suggests that, although you made investments in 2003 and 2004, you did not raise any concerns over the firm's actions or its sales approach until 2005.

You have told me that Firm A made unsolicited approaches to you, and used excitable phrases like "we are very excited about this one" and "we are certain that it is going to take off". Whilst this may have been the case, it is true to comment that as an investor in shares you must have appreciated that relying solely on "cold call" sales tactics is always a dangerous and risky practice. Likewise, as I have not seen any of the research you may have been given, prior to purchasing the shares, I cannot comment on whether this was misleading.

What I can say is that the document you provided to me entitled “Company Updates for Mr X of Firm B”, which although given to you after you purchased the shares, clearly indicates the risks associated with investments of this nature. In the second paragraph on the first page it states:

“As the listing requirements are less stringent than the AMEX, NASDAQ, or NYSE, the securities listed on the OTCBB tend to be riskier investments and more volatile in their price and the number of shares traded”.

Additionally, the third paragraph on the first page states:

“A review of trading and pricing movements indicate that share prices of small and micro cap companies move far more quickly and further (in either direction but especially down) than NYSE, Dow, S&P and NASDAQ National Market stocks and indices. In addition, one must understand that with the relatively low volumes and float in these stocks their price is far more volatile than large cap companies”.

This, in my opinion, clearly indicates that the shares you were purchasing were those of newly floated companies which were extremely volatile in nature. It also indicates that they carried a greater degree of risk than the shares of larger and more established listed companies which are traded on more recognisable markets.

Whilst Firm A should not have made an unsolicited approach to you, the fact that it may have done so, and the fact that you decided to purchase shares through them as a result, is not the fault of the FSA. In a similar way, although you say the potential of the shares was presented to you in an ‘excitable way’ and that the firm withheld material information from you (such as the fact that there was an impending lawsuit against one of the companies it was recommending to you) is also not the fault of the FSA.

Although I do not dispute your recollections of events, there was a delay of almost two years between the firm making its alleged unsolicited approach to you and you notifying the FSA of your concerns. In cases of this nature time is of the essence and without a timely referral and the production of documentary evidence, it is extremely difficult for the FSA (or the home state regulator) to take any action against a firm.

I must also make you aware that a complaint from a single consumer would not indicate to the FSA that was a systemic problem with a firm or indicate that it needs to take immediate action against the firm. Having said this, it may suggest that the FSA (and the home state regulator) should start to monitor the actions of the firm more closely.

It is also clear that you believe both the FSA and the home state regulator (BaFIN) authorise the firm. As the FSA complaint handler explained, the EEA ‘inward services passport’ was given by BaFIN and not by the FSA. The FSA is only required to authorise the firm if it wanted to hold client money in the UK. In this case, as the firm did not apply to hold client money in the UK, the FSA did not need to authorise it.

A firm with an ‘inward services passport’ is able to choose whether it wants to be subject to dispute handling bodies in the UK (such as the Financial Ombudsman Service [FOS]) or in its home country. If a firm decides to use the dispute handling bodies in its home state, then the possible entitlement to UK compensation on a firm which holds an ‘inward services passport’ only applies if the firm has FSA approval to hold client money, and the claim for compensation relates specifically to the holding of client money. In cases where the claim does not relate specifically to the holding of client money in the UK, the firm’s existing dispute handling arrangements would apply.

I appreciate that you feel because of this the EEA Passport arrangements offer UK consumers insufficient protection, but this is incorrect. The aim of the ISD was to allow firms to offer services to consumers in other EEA States; this was only possible if all EEA State regulators adopt similar business standards.

Under the ISD a consumer is given a similar level of protection in which ever EEA country the dispute is considered. Whilst this may mean that a UK investor may not be able to refer the matter to the FOS or to the Financial Services Compensation Scheme (FSCS), it does mean that the dispute can be referred to the equivalent body in the firm’s home country.

From the FSA’s complaint file I understand that you been told by both the FOS and the FSCS that your complaint is outside their respective jurisdiction, and neither can consider your complaint. From the papers presented to me, this is correct as the firm appears to have opted to use the dispute handling bodies in its home state of Germany.

I also understand you have already contacted both BaFIN and the German Ombudsman but they have dismissed your complaint. Whilst I can sympathise with your position, again you have not provided any evidence to show that it was the actions or inactions of the FSA that has resulted in you incurring any loss.

On 13th October 2005, the FSA removed Firm A from its register of firms allowed to conduct business in the UK. The FSA did this as BaFIN informed it that it had withdrawn the firm’s authorisation in July 2005. Section 348 of FSMA imposes upon the FSA, as the regulator, confidentiality in the context of its response or position when acting in the discharge of its function as the relevant regulator. Although you have asked why the firm’s authorisation was withdrawn, I cannot comment further on this due to the confidentiality restrictions set out in Section 348 which prevents the release of sensitive information such as this.

You also raised concerns over Firm B, as you believe this is a “phoenix” firm of Firm A. I know you have been told that the FSA is concerned over this firm, but have been told that the concerns relate to different issues to those raised by you.

I can understand your frustration at not being told the exact reasons for the FSA’s interest, but again, the statutory confidentiality restrictions set out in Section 348 of FSMA apply. Although I cannot comment further on the FSA’s specific concerns about Firm B, what I can say is that the FSA have been in contact with BaFIN.

In your last letter to my office you also stated that a number of the people who used to work for Firm B are now working for different companies based in the UK. Whilst this may be the case, unless these individuals are undertaking Controlled Functions for these companies (which require approval from the FSA prior to their appointment), the FSA is unable to prevent these individuals from taking alternative positions with these new firms. I would also add that for the FSA to withhold its approval, the individual would have to be proven to have breached the FSA's rules or principles. My understanding is that, whilst you are unhappy with the conduct of these individuals, it has not been proven that any of them have breached any of the FSA's rules or principles.

I appreciate that you will be disappointed with my findings but, from the papers that I have examined there is no evidence which demonstrates any breach of the rules or its duties by the FSA. Therefore your complaint cannot be upheld.

Yours sincerely,

Sir Anthony Holland
Complaints Commissioner