

5th June 2008

Dear Complainant

Thank you for your letter of 18th September 2007, which details the elements of your (the complainant) complaint against the Financial Services Authority (FSA). This letter sets out my final decision on the complaints you have raised.

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>

Background

This complaint concerns the regulation of a firm by the FSA and its directors over a substantial period, during which the complainant was an employee of the firm. The firm in question is AB & Co. Ltd (the Firm) whose directors were a Mr A and a Mr B and from 2002 onward Mr C. The Firm's permissions were cancelled on the 1st June 2007 and it is this firm, and its regulation, which is the centre of this complaint. On 15th May 2007 Mr C was prohibited by the FSA from performing any function in relation to any regulated activity. The regulatory history of the Firm is that it had joined the Financial Intermediaries, Managers, and Brokers Regulatory Association (FIMBRA) prior to the introduction of regulation in 1988 and it joined the Personal Investment Authority (PIA) in 1994 and was "grandfathered" across into the FSA on the 1st December 2001. It was not expelled by the PIA.

It is of note that some time ago there was a sister firm AB & Co (H) Ltd (the sister firm) which had the aforesaid Messrs A and B as directors along with Mr D. The sister firm was the subject of disciplinary action and Mr D was, according to the FSA, "found guilty of misappropriating client money". He was expelled as a registered individual and the firm was expelled by the PIA on 16th January 2001. Messrs A and B were not subject to disciplinary action.

The FSA was responsible for the conduct of investment business of the Firm from the 1st December 2001 onwards. It should be noted that the FSA was not responsible for the regulation of the mortgage business of the Firm until 31st October 2004 (the FSA also regulated general insurance from 14th January 2005). Before the 31st October 2004 the General Insurance Standards Council (GISC), a non statutory body, had been responsible for regulating the mortgage business of the Firm. Between 1st December 2001 and 31st October

2004 the FSA was responsible for the approval of persons wishing to perform a controlled function of firms such as that in question. One of the areas of importance to me in my investigation is the transition of regulator status from GISC to the FSA and how the FSA used information available to it from GISC in its decision making about how to regulate the Firm.

The key dates

- 1st January 2002 Mr C becomes a director of the Firm (known as controlled function 1 or CF1).
- 3rd May 2002 Mr C applies to become the compliance manager (CF10) of the firm.
- 11th June 2002 the FSA rejects Mr C's application to become CF10.
- 1st October 2003 the complainant becomes an employee of the Firm.
- 14th and 18th October 2004 telephone and emailed whistle-blowing contact with the FSA with regard to the Firm.
- 26th October 2004 GISC visit the Firm.
- 17th February 2005 the FSA receive the Firm's annual questionnaire for the period up to the 31st December 2003.
- 8th and 12th October 2005 whistleblowing emails about the Firm received by the FSA.
- 12th December 2005 a further whistleblowing email is received by the FSA.
- 22nd June 2006 FSA letter sent to the Firm regarding possible rule breaches in relation to its completion of RMAR reporting.
- 18th August 2006 a further whistleblowing call is made.
- 5th September 2006 the complainant makes a whistleblowing call.
- 16th September 2006 the police email the FSA about the Firm.
- 29th September 2006 the complainant leaves employment of the Firm.
- 30th September 2006 is the date of an FSA visit to the Firm which notes that the accounts are to be qualified and issues regarding complaint handling are mentioned.
- 1st June 2007 the Firm's permissions are cancelled.

The Complaint to the FSA

On the 20th February 2007 the complainant wrote to the FSA asking for details on how his complaint could be forwarded to the Office of the Complaints Commissioner. This letter contained a "statement of facts" which set out the basis for the complaint. This included the following statements;

- "It is my belief that, had the FSA acted promptly, or at all, this situation would not have arisen, or to that extent and I would not be disadvantaged financially."
- "The FSA failed in its duty to actively protect all those affected by the activities of the Firm during its existence, thus leaving the industry with further damage to its reputation and its regulator with further damage to its cause".

The complainant set out figures for redress he believed that he was owed by the FSA for losses he suffered due to the Firm becoming insolvent. He alleges that the FSA are liable for these losses because it had been “negligent”.

The Complaint to the Office of the Complaint Commissioner

In the complaint letter (18th September 2007) the complainant made a number of comments in support of his complaint including that the FSA regulation of the firm was “clearly negligent”, that the impact on “the local community, staff and clients (of the Firm) has been very significant” and that;

“The Final Notice quite properly details the shortcomings found. It also highlights the severity of his (Mr C) misdemeanours. Given that the findings resulted in a Prohibition Order it defies belief that our allegations (which in hindsight were found to be completely substantiated) were given no more than cursory examination.”

The FSA Position

The FSA wrote to the complainant on the 19th June 2007 with its decision on the complaint (the decision letter). It stated that the FSA understood the complaint to be;

“You allege that the FSA failed to take regulatory action against the Firm (now in administration), despite allegations being made on several occasions by the firm’s staff and by members of the public concerning the actions of the Managing Director.

With reference to our rules, we defined your complaint as an allegation of lack of care on the part of the FSA.”

It is my view that this “understanding” does not provide a complete explanation of the complaint. The complaint covers a variety of issues and by reducing the scope of the complaint it is arguable that the complaint made is not answered in full in this decision letter. It is my view that the complainant wishes the FSA’s regulation of the Firm to be reviewed in the whole and not merely as to whether or not the FSA took action against the Firm. It is of note that the first part of the allegation (that is “regulatory action”) as worded by the FSA is not directly answered in the FSA decision letter. Nor in fact is the element concerning “lack of care”.

COAF 1.4.1 states;

“(1) The complaints scheme provides a procedure for enquiring into and, if necessary, addressing allegations of misconduct by the FSA arising from the way in which it has carried out or failed to carry out its functions. The complaints scheme covers complaints about the way in which the FSA has acted or omitted to act, including complaints alleging:

(a) mistakes and lack of care;

(b) unreasonable delay;

(c) unprofessional behaviour;

(d) bias; and

(e) lack of integrity.

(2) I[deleted]

(3) To be eligible to make a complaint under the complaints scheme, a person (see COAF 1.2.1 G) must be seeking a remedy (which for this purpose may include an apology, see COAF 1.5.5 G) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the FSA's actions or inaction."

Having regard to the detail identified in the papers I have seen, I have considered this matter taking into account all those details in the light of COAF 1.4.1 a) that I have reproduced above.

I should add, on past occasions, I have explained to the FSA that by trying to condense the issues raised by complainants into a sentence or two, as in this case, it can lead to a different complaint being answered to that made. This does not always aid complainants' views of how the FSA handles complaints. In this instance I would have welcomed the specific issue of a "lack of care" being answered. I fully accept that it is often the case, as it was here, that a complainant agrees with the FSA's understanding of the complaint but nevertheless caution should be exercised when initially condensing the issues raised by complainants. I recommend that in future the FSA always endeavours to give an accurate and precise explanation of the complainant's issues as set out in the original complaint.

The decision letter sets out how whistleblowing correspondence with the FSA was dealt with;

"What I can tell you is that the Small Firms Division (SFD) opened a case based on allegations that had been raised about the Firm in May, October and December 2005. The allegations were risk assessed, and the SFD recognised the nature of these allegations related to matters that had already been raised. A copy of the firm's audited accounts that had previously been received disproved the allegations and as such, they were filed accordingly."

I shall comment on the merits of this point in the section of this letter called "my investigation".

The decision letter concludes;

"When an allegation is raised with the FSA about an authorised firm, the firm's supervision team (in this case, the SFD) can only reasonably analyse a situation based on the information that it has available at the time the allegation is made. The allegations that were raised about AB & Co/ Mr C were not supported by the financial accounts that the SFD had received."

Later;

“As can be seen by this case, it is always a possibility that allegations against a firm which contain no factual evidence, and which are deemed at the time of receipt to be unproven or unreliable are later proved to be substantiated. However, from my investigation I am satisfied that the SFD’s actions were reasonable and appropriate considering the fact that the allegations were not supported by the information received from the firm.”

The decision letter then notes that the complaint has not been upheld and gives the complainant the option of bringing his complaint to my attention.

My Investigation

Having reviewed the evidence I put some questions over a period of time to the FSA. To indicate the difficulties the FSA had, I shall quote the relevant passages.

I raised concerns about a whistle-blowing email dated 8th October 2005 with the FSA and it responded on this point in its letter 15th January 2008 by saying;

“No action was taken by the SFD; it was noted that the content of the email was vague hearsay regarding alleged inappropriate use of client money during the GISC regime and that the workforce at the Firm were at breaking point. The complaint was rejected because the issue had been looked into before and the Firm had provided evidence (by way of its 2003 accounts) which countered the allegations made against it. It was concluded that there were no concerns.”

In my letter 28th January 2008 I stated in response to the above;

“This statement concerns me as it appears that both the original SFD team and the current complaint investigators appear not to have grasped that the whistleblower is referring to such misappropriations taking place in 2005 repeating what was done in 2003. Clearly 2003 accounts have no bearing on the alleged misappropriation in 2005. I would welcome the FSA’s comments on this issue.”

On record is a file note dated 30th November 2004 recording a conversation between the FSA and GISC regarding the sum of one hundred thousand pounds having been removed from the Insurance bank account of the Firm. On the 26th October 2004 GISC had visited the Firm and as a result the money was put back into the account. In this note Mr C is noted as the “MD” or managing director. He is said to have claimed to be new to the business and not fully conversant with the requirements. Such requirements, it could be observed, might be considered to be elementary.

The FSA responded to this point in its letter dated 22nd February 2008

“The FSA was aware of the fact that the anonymous whistleblowing allegation made on 8th October 2005 referred to incidents that allegedly occurred in 2004 and that were purported to have happened again in 2005. At the time of receiving the allegation SFD only had the 2003 AQ (annual questionnaire) to refer to and this did not support the allegation

made. Additionally, the whistleblowers failed to provide evidence to support their assertions”.

Clearly the 2003 AQ has no relevance to events in 2005 so referring to it has no relevance either. I would note that allocating weight of argument to the point that the whistleblowers failed to provide evidence to support their assertions is also unhelpful. The email was from an account which appears it could not be replied to and thus the whistleblowers could not be asked to give evidence to support their allegations. However from the content of the email it appears that the whistleblower was an employee. So the FSA comment in the email dated 15th December 2005 that “this was *very vague hearsay* (my emphasis) information alleging inappropriate use of client money during the GISC regime and the fact that the workforce were at breaking point.” is mistaken on two counts, namely that it was particularly relevant evidence given apparently by a serving employee, and the alleged misappropriation was not during the GISC regime, it was in 2005 under the current FSA regime. It did however demonstrate a pattern of behaviour which must concern any objective reviewer.

I raised this point with the FSA and asked for contemporaneous evidence that demonstrated that the FSA understood that the alleged misappropriation was in 2005. It responded in a letter dated 6th March 2008 and refers to an email of 10th October 2005;

“The sender mentions that he/she is aware of previous disclosure made to the FSA regarding AB and its Managing Director. Our systems show that a previous anonymous Whistleblower contacted the WB line in October 2004.”

We feel that the sentence structure demonstrates awareness of the alleged allegations in 2005 whilst also making reference to incidents that allegedly occurred in 2004.”

My view is that this assertion by the FSA only demonstrates that it was aware of the allegation made in 2005 and that there had been previous allegations made. It does not, in my view, evidence appreciation that this allegation referred to events in 2005 as well as the allegation being made in 2005. It is clear from the record that this 8th October 2005 whistleblowing email was not taken further for a number of reasons, including the erroneous view about the 2003 AQ, apparently in isolation, which in my view should have had no bearing on the FSA view of the validity of this email.

Furthermore, bearing in mind the FSA risk based approach and need for effective and efficient use of its resources it does not seem unreasonable to expect the FSA to use information it already has in its possession. The FSA shares this view and states in its letter of 6th March 2008;

“All information that is received in SFD is viewed alongside any previous correspondence and all regulatory reporting received by the Firm. Using a risk based approach an informed decision is then made on the new information received”.

Bearing in mind the FSA’s stated position on this issue I have noted in the course of my investigations that the following information about the Firm and Mr C was in the FSA’s possession at the time that the email of the 8th December 2005 was analysed and “closed”.

- That Mr C had been refused CF10 status by the FSA on the 11th June 2002. Clearly this demonstrates that the FSA had concerns about Mr C being fit and proper to hold CF10 status.
- That Mr C was acting as Managing Director of the Firm (File note 30th November 2004) although he had been refused CF10 status.
- That the Firm had breached, and was in breach, of rules concerning notification of controlled function status. Such breaches are liable to disciplinary action. This was inadvertently demonstrated to the FSA by the Firm in the 2003 AQ where Mrs C is noted as being a director and the (apparent) only shareholder. The post of Director is a controlled function (CF1) and the Firm is required to ensure that the candidate does not perform this function without prior approval from the FSA (SUP 10.12.1).
- That the sister firm had been expelled by the PIA for misappropriation of funds.

In an internal email of 15th December 2005 it notes, in relation to a yet further whistleblowing email of 12th December 2005 that it had provided “checkable” information. It goes on in that internal email to state that;

(Alleging that our) “records are incorrect with Mr E resigning in 2004, Mr F in 2003 and Mr B leaving in 2002. *This information is verified by Companies House records* (my emphasis). Tardis (records management system) probably needs amending.”

It is of concern that the information available from the Companies House does not appear to have been considered alongside the information possessed by the FSA at that point. It is of note that the author of this email appears to indicate his concern about the solvency of the firm to SFD based on the financial accounts of the firm not having been properly filed with Companies House at that time.

The FSA on looking at this information firstly would have had reasonable suspicion that the Firm was not informing the FSA of changes in its controlled persons and secondly, and more importantly, it would have realised that Mr C was in effect the managing director of the firm and consequently would have had complete control of the running of the Firm. Bearing in mind the FSA’s refusal of his application of CF10 status earlier this should have lead to action being taken by the FSA to ascertain the facts. However it was not until after the response by the Firm to the FSA letter of 22nd June 2006 and the FSA concerns regarding RMAR reporting and the further whistleblowing events and the FSA visit (29th September 2006) to the Firm that the FSA took substantial action in relation to its investigation of the Firm (shortly before the complainant left the firm).

Those are the relevant somewhat truncated facts arising out of my investigation. It is my view that it is reasonable to have expected the FSA to have reviewed all the information that was available to it in October 2005 and especially December 2005. I would have expected, and continue to expect, to see a management decision as to how information that is received is rated based on the information available to the FSA. Such a management decision would either be by the team manager or if individual Firms are allocated to individual FSA staff on a permanent basis, by that particular member of staff. It appears to me that in this case the responsibility for this firm has been shared between too many FSA staff and as a result

pertinent information from various sources has not been pulled together to reach an informed decision.

It is my opinion that any FSA staff member aware of the sister firm's past, Mr C's issue with being fit and proper, and aware of the discrepancies with who were directors of the firm, as well as taking into account the numerous whistleblowing reports would have been likely to have initiated some form of information gathering exercise no matter how limited to establish the facts of the matter in relation to the whistleblowing email of 8th October 2005 in October 2005 and no later than the whistleblowing email of 12th December 2005 and not ignoring the sequential story when considering the detail of the whistleblowing report of 18th October 2004.

I fully accept that the FSA operates, and is entitled to do so, on a risk based basis but at some point it must pay regard to the totality of information being fed to it, delays in regulatory information being forthcoming and extraneous sources such as whistleblowers. It must then provide for a system to capture that totality and monitor it as a collection of information. I feel that in this case it failed to do so and that all that occurred can be defined as "too little too late".

I turn now to the issue of the claim made for recompense by the complainant. Let me at once say that I reject that for two reasons. The first is that the complainant was, and must have been, aware of the precarious financial position of the firm and yet remained with it despite that awareness. I do appreciate that the complainant's personal circumstances did, in that context, limit his options but nevertheless I must look at the matter objectively. Further more in remaining with the firm allowed himself to be compensated by way of salary and commission earned. He must therefore be deemed to have accepted, although without enthusiasm, the risks that that acceptance of such a compensatory package posed to him. Secondly and perhaps more importantly a direct causal link has not been substantiated by the complainant. He has alleged that if the FSA had regulated the Firm properly he would not have sustained the loss he did sustain. It is clear from the actions taken by the FSA when the Firm had its permissions cancelled that the finances of the firm were being misused and had been misused for some time. Consequently my view is, at this time, even if the FSA had acted some time before it did, that it does not necessarily follow that the complainant would have received the monies that he claims that he was owed. Ultimately Mr C admitted to knowingly and deliberately using client money to cover the Firm's running costs (Final Notice 15th May 2007). As a consequence of these two reasons I do not consider the FSA liable for the loss that the complainant suffered.

With regard to the FSA decision letter of 19th June 2007 it is my view that the decision's erroneous conclusions were the result of a limited investigation coupled with a poor understanding of what the FSA should expect of how information is analysed in relation to a Firm. From the moment that the Firm came under the regulation of the FSA it is arguable that given the events referred to earlier greater care might be needed to supervise it. The lateness of its submissions to the FSA, the lack of clarity of the Directorships and the whistleblowing to the FSA should have all led to the FSA considering the information that it

had *in the round* (my emphasis) and making an informed decision with regard to how to treat the Firm in late 2005. I have not seen sufficient evidence which demonstrates that all of these factors were considered together in late 2005 and certainly not before.

The conclusions of the decision letter and that I had to approach the FSA on four occasions for further information or clarification give me cause for concern about the handling of this particular complaint. It seems to me that throughout the investigation process the FSA has taken an unnecessarily defensive position and has not made any admission of being able to have dealt with the Firm or the complaint any better than has transpired. It seems to me that the FSA should have had concerns about how it has handled both the Firm originally and the complaint. I would have welcomed as I remarked earlier in this preliminary decision a specific reference to a lack of care. I feel that the FSA has not met the standards that a complainant to the Complaints Scheme is entitled to expect.

Conclusion

My conclusion is that if the FSA had properly considered the totality of all the information available to it in late 2005 it would have taken a more pro-active stance than it did. I do not feel that this would have necessarily altered the final outcome due to the admitted guilt of Mr C, although it may have brought the issues of the Firm and the behaviour of Mr C to a head earlier. This however, may not have happened and even if it had happened it does not necessarily follow that the finances of the firm would have been any better than as they later transpired to be. I do however feel that had the FSA taken such a pro-active stance based on the information available to it, and was to do so in any similar cases now and in the future, it would avoid the criticism I now make.

This matter has not been well handled by the FSA either (a) in relation to the substantive issue raised by the complainant or (b) in the investigation that it gave rise to. My reasons are as to both (a) and (b) I now set out.

- a)
 - i) There were sufficient numbers of emails to give rise to concerns by the 8th October 2005.
 - ii) The fact that the directors included the wife of Mr C which the FSA knew about but in respect of which the FSA took no action.
 - iii) The delay in the continued late filing of regulatory information (always a cause for concern in itself).
 - iv) The failure to collate items i), ii) and iii) together to be considered in their totality primarily it is said because the FSA operates on a risk based approach. Such an approach is not valid however when there is a sufficient amount of information which can be collected together and which should give rise to concern about a firm, as appears to be the case in this instance.

- b)
 - i) I was supplied on what I can only describe as an erratic basis the entire information I needed in this instance to carry out my investigation thereby unnecessarily prolonging it.

- ii) There is a failure in the decision letter to stand back and to consider objectively whether what was uncovered in this investigation could be considered to amount in all to a lack of care by the FSA in what it did between 2004 and 2006.
- iii) Whether that should have entailed an upholding of the complainant's complaint given all the relevant circumstances.

In the light of my conclusions the issue that arises as to what the FSA should now do. An apology to the complainant can be proffered which can be accompanied by an *ex-gratia* award. I shall address the latter issue first. *Ex-gratia* payments from the FSA come from funds provided by the Financial Services Industry itself. The complainant is a member of that industry. He took part in the whistleblowing that occurred and in doing so can be considered to have acted responsibly. He feels, and felt, that the FSA by its approach in this entire matter is at fault and I can sympathise with that view. On the other hand having acted responsibly is he then also entitled to an *ex-gratia* award funded by the industry? He has suffered financial loss which may (and I can put it no higher than that) have been partially mitigated had the FSA acted sooner but I have already explained why I do not believe that that issue is one that is a matter for the FSA. There only remains therefore what my final views are in this area. On the former issue-that of making an apology I believe that in the circumstances that I have identified that is reasonable.

I **recommend** that the FSA should apologise to the complainant for the matters set out in a) i) to iv). It should further as recognition of at least the inconvenience and concern that the complainant has been put to unnecessarily, make an *ex-gratia* award of £250.

Responses to my Preliminary Decision

The FSA, in its response, has very frankly accepted the points made above and has agreed to make the *ex-gratia* payment of £250. It has also instituted a number of initiatives and corrective actions in light of this investigation. I am pleased that the FSA have taken such a pro-active stance on the matter. I feel confident that these changes will improve the functioning of the FSA in these areas.

The complainant also provided a detailed response on the matter. Some of this took the form of observations which provided insight into the goings-on in the Firm at the time. The complainant also raised two specific points which I will deal with now.

- 1) The complainant alleged that financial information supplied by the Firm to the FSA during the period in question would be found to be "identical" which would then, through inference, suggest that insufficient comparison had been made by the FSA at the time. On review of these documents it is clear that they were not identical, nor close to being so. Consequently the complainant's allegation on this point is not upheld.
- 2) The complainant also requests a review of my decision with regard to his compensation. Unfortunately for the complainant my view is unchanged. Furthermore the complainant has inadvertently provided a further reason for his wish not to be granted by stating;

“The only reason that I lost out as badly as I did was that I was on holiday when the firm folded and could not, therefore, present my final pay cheque in adequate time before the company’s funds ran out-all the other members of staff got theirs paid in just in time.”

Clearly it is not the fault of the FSA that the complainant was on holiday at the pertinent time and consequently this point adds to the other reasons already stated in my decision as to why the FSA should not recompense the complainant for his loss of earnings as stated in his claim.

This decision brings this matter to a close and once this decision is published I will close my file on the matter.

Yours sincerely

Sir Anthony Holland
Complaints Commissioner