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## FINAL NOTICE

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To: **Meenaz Pravin Mehta**  
Of: **337 City Road**  
**London**  
**EC1V 1LJ**  
IRN: **MPM01055**

Date: **14 April 2010**

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London, E14 5HS ("the FSA") gives you final notice about a requirement to pay a financial penalty:**

### **1. THE PENALTY**

1.1. The FSA gave Mr Meenaz Pravin Mehta ("Mr Mehta") a Decision Notice on 24 February 2010 which notified Mr Mehta that pursuant to sections 56, 63 and 66 of the Financial Services and Markets Act 2000 ("FSMA"), the FSA had decided to take the following action:

- (1) to make a prohibition order prohibiting Mr Mehta from performing any significant influence function (as defined in the FSA Handbook) at any authorised or exempt person or exempt professional firm which undertakes any regulated activity with a view to transactions in penny shares<sup>1</sup> in relation to retail customers save that the prohibition shall not extend to the performance of such functions at any such firm whose activity in relation to

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<sup>1</sup> A 'penny share' is defined in the FSA Handbook as a readily realisable security in relation to which the bid-offer spread is 10 per cent or more of the offer price, but not (a) a government and public security; or (b) a share in a company quoted on The Financial Times Stock Exchange 100 Index; or (c) a security issued by a company which, at the time that the firm deals or recommends to the client to deal in the investment, has a market capitalisation of £100 million or more (or its equivalent in any other currency at the relevant time).

penny shares is restricted to executing instructions from existing customers for disposal of existing holdings on an execution only basis (the “prohibition order”); and

(2) to impose a financial penalty of £35,000 on Mr Mehta.

- 1.2. Mr Mehta has confirmed that he would not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below, the FSA imposes a financial penalty and the prohibition order on Mr Mehta.
- 1.4. The prohibition order has effect from the date of this Final Notice.

## **2. REASONS FOR THE ACTION**

- 2.1. This Notice is issued to Mr Mehta for breaches of the FSA’s Statements of Principle for Approved Persons in his role as director of Hythe Securities Limited (“Hythe”) between 1 June 2006 and 21 May 2008 (“the Relevant Period”) by failing, as an approved person performing significant influence functions, to take reasonable steps to ensure that the business of one of Hythe’s business units, for which he was responsible in accordance with his controlled functions, complied with the relevant requirements and standards of the regulatory system, in contravention of Statement of Principle 7.
- 2.2. During the Relevant Period, Mr Mehta held Controlled Functions CF1 (Director), CF10 (Compliance Oversight) and CF11 (Money Laundering Reporting). CF1, CF10 and CF11 are significant influence functions. He also held CF21 (Investment Adviser) to 31 October 2007 and CF30 (Customer) from 1 November 2007.
- 2.3. Notwithstanding the fact that Mr Mehta did not hold the CF3 (Chief Executive) function (which was held by another director of Hythe), Mr Mehta acted as Chief Executive and senior manager of Hythe during the Relevant Period. Mr Mehta was the senior manager responsible for the overall operation of all Hythe’s business, including its compliance with regulatory requirements.
- 2.4. During the Relevant Period, amongst other business activities, one of Hythe’s business units advised on and arranged the sale of higher risk securities to customers. The business unit dealt primarily with small capitalisation shares (“small cap shares”) (including penny shares) on the Alternative Investment Market and PLUS markets, and Contracts for Difference, and was called the “Retail Group”.
- 2.5. During the Relevant Period, in relation to the Retail Group, Mr Mehta’s conduct fell short of the FSA’s prescribed regulatory standards for approved persons because he failed to take reasonable steps to implement adequate systems and controls to ensure that the business of the firm for which he was responsible complied with the relevant requirements and standards of the regulatory system. In particular:

- (1) Mr Mehta failed to take reasonable steps to ensure that responsibilities were adequately apportioned amongst staff and that staff were properly registered with the FSA;
- (2) Mr Mehta failed to take reasonable steps to implement appropriate compliance policies and processes at Hythe;
- (3) Mr Mehta failed to take reasonable steps to ensure that there was a robust and appropriate training and competence regime in place;
- (4) Mr Mehta failed to take reasonable steps to properly mitigate the adverse effects of an inappropriate remuneration and reward system;
- (5) Mr Mehta failed to take reasonable steps to ensure that Hythe's customers were appropriately classified;
- (6) Mr Mehta failed to take reasonable steps to ensure that essential information, including any mark-ups payable to Hythe, were disclosed to Private customers;
- (7) Mr Mehta failed to take reasonable steps to ensure that information provided to customers was clear, fair and not misleading or to record the basis for the price forecasts he produced and communicated to advisers;
- (8) Mr Mehta failed to take reasonable steps to ensure that an adequate record was maintained of Hythe's advice to customers; and
- (9) Mr Mehta failed to take reasonable steps to ensure that appropriate money laundering checks were carried out.

2.6. The following considerations are relevant to the seriousness with which the FSA views Mr Mehta's failings:

- (1) Mr Mehta knew that advisers' sales conduct during telephone calls could pose a risk to customers, particularly because the sale of higher risk securities requires robust systems and controls;
- (2) the way in which Hythe's business was structured, with Retail Group advisers being employed by a separate unregulated company, presented extra challenges to Hythe and Mr Mehta in ensuring that appropriate systems and controls were implemented and maintained;
- (3) Hythe's customers were exposed to a risk of financial detriment, because there was a risk that they would be recommended stocks which were potentially unsuitable for them and Hythe could not establish or demonstrate whether such sales were suitable;

- (4) there was a significant risk that some customers were classified incorrectly, with the result that they would not have been aware of, and/or accorded, the rights to which they were entitled; and
  - (5) the deficiencies in anti-money laundering checks relating to customers meant that Hythe could not adequately counter the risk that it might be used in connection with financial crime.
- 2.7. By virtue of the matters referred to above, the FSA has concluded that, in all the circumstances, it is appropriate to impose a financial penalty on Mr Mehta and to make the prohibition order in the terms set out at paragraphs 1.1 above.

### **3. RELEVANT STATUTORY PROVISIONS**

- 3.1. The FSA's statutory objectives are set out in Section 2(2) of FSMA. The relevant objectives for the purpose of this case are the protection of consumers and maintaining confidence in the financial system.
- 3.2. The FSA has the power pursuant to section 56 of FSMA to 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 FSA that the individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by any authorised person, exempt person, or exempt professional person.
- 3.3. Section 66 of FSMA provides:
- “(1) The Authority [The FSA] may take action against a person under this section if-*
- (a) it appears to the Authority that he is guilty of misconduct; and*
  - (b) the Authority is satisfied that it is appropriate in the circumstances to take action against him.*
- (2) A person is guilty of misconduct if, while an approved person –*
- (a) he has failed to comply with a statement of principle issued under section 64.....*
- (3) If the Authority is entitled to take action under this section against a person, it may –*
- (a) impose a penalty on him of such amount as it considers appropriate...”*
- 3.4. The FSA issued statements of principle under section 64 of FSMA to codify the conduct expected of approved persons.
- 3.5. Statement of Principle 7 provides that an approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

- 3.6. The FSA’s general approach to determining whether to impose a financial penalty and the appropriate level of any such penalty is set out in the Decision Procedures and Penalties Manual (“DEPP”), which is part of the FSA Handbook.
- 3.7. As set out in DEPP 6.1.2G the principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating, generally, to firms and approved persons, the benefit of compliant behaviour.
- 3.8. DEPP 6.5.2G sets out a non-exhaustive list of thirteen factors that may be relevant to determining the appropriate level of financial penalty. In considering whether to impose a financial penalty and the amount of the penalty to impose, the FSA has also had regard to the provisions of the Enforcement Manual (“ENF”) which were also in force during the Relevant Period.
- 3.9. Guidance relating to prohibition orders is contained in the Enforcement Guide (“EG”) at EG 9. EG 9.1 provides that the FSA may exercise its power to prohibit individuals where it considers that, to achieve any of its regulatory objectives, it is appropriate either to prevent an individual from performing any function in relation to regulated activities or to restrict the functions which he may perform.
- 3.10. EG 9.9 provides that in deciding whether to make a prohibition order the FSA will consider all the relevant circumstances including whether other enforcement action should be taken” (EG 9.3). A non-exhaustive list of nine relevant circumstances is given, including:

...

“(2) *whether the individual is fit and proper to perform functions in relation to regulated activities. The criteria for assessing the fitness and propriety of approved persons are set out in FIT 2.1 (Honesty, integrity and reputation); FIT 2.2 (Competence and capability) and FIT 2.3 (Financial soundness);*

(3) *whether and to what extent the approved person has:*

*(a) failed to comply with the Statements of Principle issued by the FSA with respect to the conduct of approved persons;*

...

(5) *The relevance and materiality of any matters indicating unfitness;*

...

(7) *The particular controlled functions the approved person is (or was) performing, the nature and activities of the firm concerned and the*

*markets in which he operates; and*

(8) *The severity of the risk which the individual poses to consumers and to confidence in the financial system”.*

3.11. EG 9.5 provides that the scope of a prohibition order will depend on the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk which he poses to consumers or the market generally.

3.12. The FSA has also had regard to the provisions of ENF which were in force during the Relevant Period.

3.13. The FSA Handbook also sets out rules and guidance relating to the Fit and Proper Test for Approved Persons (“FIT”). FIT 1.3.1 G and 1.3.2 G provide as follows:

*“The FSA will have regard to a number of factors when assessing the fitness and propriety of a person to perform a particular controlled function. The most important considerations will be the person’s:*

*(1) honesty, integrity and reputation;*

*(2) competence and capability; and*

*(3) financial soundness”.* (FIT 1.3.1 G)”

*“In assessing fitness and propriety, the FSA will also take account of the activities of the firm for which the controlled function is or is to be performed, the permission held by that firm and the markets within which it operates.”* (FIT 1.3.2 G)

3.14. FIT 2.2.1 G provides that in determining a person’s competence and capability, the FSA will have regard to all relevant matters including but not limited to whether the person has demonstrated by experience and training that he is able to perform the controlled function.

#### **4. FACTS AND MATTERS RELIED ON**

4.1. During the Relevant Period, Mr Mehta was responsible for compliance oversight and acted as the Money Laundering Reporting Officer at Hythe (holding the CF10 and CF11 functions). He was a Director (CF1) at Hythe and although there were several other executive and non-executive directors of Hythe, he was responsible for the day-to-day running of Hythe. He had the duties and responsibilities of a Chief Executive, even though he was not registered as such with the FSA.

4.2. In June 2006, Mr Mehta expanded Hythe’s business by recruiting the Retail Group. Members of the Retail Group were employed by a separate, unregulated company, which entered into a service agreement with Hythe specifically for the trading of

small cap shares (including penny shares). Under the terms of the service agreement, Hythe shared revenues generated by the Retail Group and Hythe undertook to supervise the members of the Retail Group from a compliance and regulatory perspective. All contracts for business were concluded directly between Hythe and the customer. Hythe provided back office and compliance services to the Retail Group, including the processing of payments, settlement of trades and compliance monitoring. The service agreement did not expressly give Hythe any control, or right of consultation, over the remuneration of, and payment of commissions to, the Retail Group's sales advisers. These were set and paid by the separate company which employed them.

- 4.3. The Retail Group made its recommendations primarily through telephone contact with its customers. Most of its customers were private individuals.
- 4.4. The managers of the Retail Group, Hythe's compliance manager and Hythe's administration manager all reported directly to Mr Mehta. Mr Mehta's job description as Chief Executive and Compliance Officer included, but was not limited to, providing high-level supervision of all business lines; setting the requirements for senior management systems and controls in order to provide appropriate and adequate management information; providing the regulatory framework in which Hythe operated; and maintaining compliance procedures consistent with the regulatory rules for the business being undertaken by Hythe. Mr Mehta did not personally make recommendations to Retail Group customers; however, he was involved in the research, analysis and approval of the stocks recommended by them.
- 4.5. The Retail Group is no longer operating at Hythe and Hythe is no longer advising retail customers on the purchase of penny shares. Hythe does, however, arrange, deal in and make arrangements with a view to transactions in penny shares on an execution only basis for existing retail customers who wish to sell their shares.
- 4.6. The FSA has reviewed a random sample of 32 recommendations in small cap shares made by the Retail Group in 2007 and has reviewed 32 customer files, most of which were connected with the 32 recommendations.

#### ***Identification of risk by Mr Mehta***

- 4.7. On recruiting and establishing the Retail Group, Mr Mehta recognised that the Retail Group business model posed a risk to customers because its advisers sold higher risk stocks to customers over the telephone on a commission basis. He therefore recognised that sales conduct was a key issue.
- 4.8. However, notwithstanding his concerns, Mr Mehta failed to take reasonable steps to implement adequate systems and controls to mitigate the risks he had identified. These failures are set out below.

#### ***Apportionment of responsibilities***

- 4.9. Mr Mehta failed to take reasonable steps to ensure that responsibilities were adequately apportioned amongst Hythe/Retail Group staff.

- 4.10. Hythe did not have clear and appropriate apportionment of significant responsibilities amongst senior management so that the business and affairs of the Retail Group could be adequately monitored and controlled. The apportionment of responsibilities and duties amongst senior management was unclear and there was no formal, or clearly understood, division of duties. Senior managers were unable to demonstrate a complete understanding of their roles and responsibilities, there were no accepted job descriptions, and employees' registrations with the FSA did not always reflect their position at Hythe. For instance, the CF3 (Chief Executive) function was not held by Mr Mehta, who acted as Chief Executive and senior manager of Hythe during the Relevant Period, but by another director of Hythe (see paragraph 2.3 above).
- 4.11. In his capacities as CF1 and CF10, Mr Mehta was aware, or should have been aware, of the failure to ensure that responsibilities were properly apportioned amongst staff.

### ***Compliance policies and procedures***

#### ***Compliance monitoring***

- 4.12. Despite his identification of the risk that the Retail Group business posed to customers (see paragraphs 4.7 and 4.8 above), Mr Mehta failed to take reasonable steps to implement sufficient compliance monitoring procedures and resources to mitigate the risk he had identified.
- 4.13. There was no formal compliance plan for Hythe, nor was there any evidence of compliance monitoring results being reported to, or discussed by, the Board of Directors.
- 4.14. The compliance resource dedicated to the Retail Group's activities was, in general, insufficient. A compliance consultant was employed as a compliance manager in January 2007 in order to establish a more formal compliance monitoring regime. However, the compliance manager typically worked only four half days a week, which was inadequate given the number of customers, transactions and issues relating to the Retail Group's business and a documented compliance monitoring policy was not established until September 2007.
- 4.15. The monitoring of advisers' telephone calls was inadequate in both its extent and its effectiveness. Despite the fact that Mr Mehta identified advisers' telephone calls as a risk when the Retail Group joined Hythe, no independent monitoring of the calls took place until January 2007. After that, some improvements were made because some recommendation, administration and promotional calls were monitored. However, this was insufficient, in part due to Hythe's failure to apply sufficient resources to the monitoring of Retail Group calls, particularly in the period to September 2007.
- 4.16. Until September 2007, calls were monitored by one person only; a member of staff who was insufficiently experienced and who was not a dedicated call monitor, and who was also performing other roles within Hythe. In the eight months to September 2007 only 35 calls were recorded as having been monitored, with the Retail Group having no records of any call monitoring for two months of 2007. Nine out of these 35 calls had non-compliant elements to them. This level of call monitoring was



insufficient given that in the same period the Retail Group recorded 2,383 transactions.

- 4.17. There was no record of the actions taken to resolve issues identified in non-compliant calls, nor any formal record of how the results of the monitoring were communicated to senior management.
- 4.18. Mr Mehta did attempt to increase and improve the resource for the compliance monitoring function, and increase its scope at the end of 2007 and the beginning of 2008. After September 2007, and during the early part of 2008, new Compliance Assistants were recruited, the compliance monitoring checklist was improved and, from September 2007 to December 2007, the level of compliance monitoring increased, to an average of 19 calls per month. However, this level of monitoring was still inadequate given that the number of trades was, on average, 270 per month. In addition, although it was Hythe's stated policy that there would be a review of five calls per month for each adviser, in practice no adviser appears to have had five calls a month monitored. Nor was there any increased monitoring of advisers previously identified as non-compliant.
- 4.19. Significant further improvements were not made until February 2008, when more calls were monitored and the monitoring checklist was enhanced.
- 4.20. There is no record that Mr Mehta sought or received any information on compliance monitoring results prior to September 2007.
- 4.21. Furthermore, Mr Mehta failed to take reasonable steps to ensure that the staff who were carrying out compliance monitoring were sufficiently experienced and trained, particularly with regard to the requirements of the FSA's Conduct of Business Rules or other FSA requirements.
- 4.22. The failures in relation to compliance monitoring procedures were Mr Mehta's responsibility, because in his capacity as CF10 it was his responsibility to maintain compliance procedures consistent with the regulatory rules for the business and to provide the regulatory framework in which Hythe operated. Mr Mehta was a senior board member and acted as the Chief Executive Officer, holding the controlled function CF1. He was fully aware that he was not receiving formal feedback concerning the results of compliance monitoring and that Hythe had no formal compliance work programme or monitoring plan.
- 4.23. The failures in this regard are particularly serious because the lack of sufficient compliance monitoring meant that inappropriate sales practices, and the provision of inadequate, misleading or incomplete information to customers, were not detected and that unsuitable sales were therefore not identified and remedied.

#### *Managerial oversight*

- 4.24. There is no indication that during 2006 and 2007 Mr Mehta sought or received formal reports documenting the results of the compliance monitoring and highlighting any issues.

- 4.25. In the eight months to September 2007, the issues identified as a result of call monitoring were serious and 9 of the 35 (over 25%) calls reviewed were found to have compliance issues. However, Mr Mehta claims that he was not made aware of any issues which gave him cause for concern about the activities of the Retail Group.
- 4.26. Mr Mehta's failure to take reasonable steps to ensure that sufficient formal reporting procedures were put in place meant that there was a risk that Mr Mehta and other members of the Hythe Board could not identify and control regulatory risks arising from Hythe's business model, particularly those which related to the fair treatment and protection of the Retail Group's customers.

### ***Training and Competence***

- 4.27. Notwithstanding the risks he had identified on the recruitment and establishment of the Retail Group (see paragraphs 4.7 and 4.8), Mr Mehta did not take reasonable steps to implement a formal induction programme. He also did not ensure that new advisers were made aware of, or asked to assess, their individual training needs upon joining the Retail Group.
- 4.28. The limited training provided to advisers consisted mainly of informal adviser meetings that were unstructured and orientated primarily towards sales techniques. Although a Training and Competence Register was kept, there was no formal internal training that sufficiently focused on regulatory and compliance requirements during the Relevant Period. There was no evidence to confirm that an appropriate assessment of competence had been undertaken when individuals applied to become an FSA Approved Person, nor were there adequate records to demonstrate that those in customer facing roles maintained competence.
- 4.29. Mr Mehta was responsible for these failings as, in his capacity as CF10, it was his responsibility to provide an appropriate structure for the training and competence of all regulated personnel.

### ***Reward and remuneration systems***

- 4.30. The contractual arrangements between Hythe and the unregulated company that employed the advisers gave Hythe no influence over advisers' remuneration. However, the Retail Group established a remuneration and reward system which, combined with a pressurised sales environment, encouraged and incentivised its advisers to sell shares without having appropriate regard to the suitability of the recommendations and advice given.
- 4.31. The Retail Group set its advisers sales targets. Pressure was applied by the Retail Group on advisers to meet these figures and advisers who were not able to meet targets regularly were disciplined. This pressure risked focussing advisers on meeting targets rather than on recommending what was suitable for their customers.
- 4.32. Retail Group advisers were paid a relatively low base salary, with the majority of their remuneration coming from monthly commissions of between 0.5% and 5% of the value of the shares they had sold. These commissions were set by Retail Group

management, and Mr Mehta and other Hythe senior management did not have any input into, and were unable to influence, them. Advisers were therefore incentivised to sell as many shares as possible. However, there were limited formal incentives for advisers to act compliantly. In 2006 and 2007, there were no financial sanctions on advisers who acted non-compliantly.

- 4.33. Internal pressure and incentives to sell led to the risk of unfair treatment of customers by Retail Group advisers. However, Mr Mehta did not take reasonable steps to introduce sufficient countervailing compliance controls to adequately mitigate this risk.
- 4.34. In his capacities as CF1 and CF10, Mr Mehta was responsible for the failure to introduce adequate systems to countervail the risks of the Retail Group's commission and incentive structure and introduce a penalty system for advisers who did not treat customers fairly. Mr Mehta's failure to take reasonable steps to do so heightened the risk of unsuitable sales being made to customers. This risk was particularly serious given that the Retail Group's monitoring procedures were inadequate.

#### *Customer classification*

- 4.35. Prior to November 2007, Hythe did not have a clear procedure with regard to its approach to the classification of Retail Group customers. Until January 2007, Retail Group customers were automatically classified as "Intermediate" customers, even though they may more appropriately have been classified as "Private" customers. From January 2007, when a compliance manager was hired, customers continued to be automatically initially classified as Intermediate customers but some were changed to Private customers upon review by the compliance manager.
- 4.36. There was therefore a risk that customers were not appropriately classified throughout their relationship with Hythe. This is further demonstrated by the fact that instances were noted where customers were classified as Intermediate yet there was evidence that the customer did not have sufficient experience or understanding of small cap shares to warrant such a classification. This included advisers recording that a customer "*doesn't know a lot on market*" or that a customer's trading was "*infrequent*", but still retaining the Intermediate customer classification.
- 4.37. The result of failing to assess customers adequately was that many customers were incorrectly informed that they were Intermediate customers, and therefore lost the rights associated with being a Private customer, such as recourse to the FOS and the Financial Services Compensation Scheme. In contrast, there is no evidence that all those who were reclassified as Private customers were informed of this. Therefore, a number of the Retail Group's customers would have been unaware that they had the protections associated with being a Private customer. Furthermore, Hythe could not properly assess what protections were required and did not, in practice, treat its Private and Intermediate customers differently. It failed to provide to all its customers, even when they may have been Private customers, adequate disclosures about the mark-ups it received (as set out in paragraphs 4.39 to 4.44 of this notice) and the risks of the investments recommended.

- 4.38. In his capacities as CF1 and CF10, Mr Mehta had responsibility for the correct classification of customers but he failed to take adequate steps to ensure that the Retail Group's customers were correctly classified.

***Disclosure of commission and charges***

- 4.39. Mr Mehta failed to take reasonable steps to ensure that a process was in place for ensuring that customers were provided with sufficient information about the mark-up Hythe may have been receiving on the recommended stock.
- 4.40. During the Relevant Period, Hythe derived income from a combination of flat fees charged to customers on trades (typically £20 per trade); from inducements paid by third parties to sell the shares (such inducements coming from either the companies whose shares were being sold or from existing shareholders); or, for trades in which Hythe was acting as a principal to the transaction, the difference between the price that Hythe bought the shares and the price which it sold the shares to its customers. For such principal trades, Hythe would typically agree a series of trades with its customers and send out requests for payment, before collating these agreements and buying the stock from a counterparty. It therefore took customer orders and then took principal positions so as to fulfil the customers' orders, with the difference between price charged to the customer and that charged by the counterparty being known as a "mark-up". In doing this, Hythe acquired shares from companies at below the market rate and then sold them to its Retail Group customers at the prevailing market rate.
- 4.41. The existence of the £20 flat fee was disclosed to customers in Hythe's account opening information and was included in the contract notes sent to customers. The possible existence of fees from third parties and of a margin being earned on the difference between the buy and sell price on principal trades was mentioned to a limited extent in Hythe's terms of business. However, no specific disclosure was made to Retail Group Private customers by Hythe as to the actual existence or size of any mark-up in the post-trade documentation.
- 4.42. These mark-ups could be substantial. During its review, the FSA noted mark-ups of between 67% and 139%. However, because Hythe obtained shares at a discount to the prevailing market prices, its customers eventually paid a price within the prevailing bid-offer market price range.
- 4.43. In all of the relevant transactions reviewed, Hythe failed to disclose the full amount of its mark-up in the subsequent contract notes and therefore failed promptly to provide to customers essential details of transactions.
- 4.44. Mr Mehta was aware of the nature and amount of these mark-ups and yet he failed to take reasonable steps to ensure that they were disclosed to Private customers.

***Providing information to customers and recording the basis for the price forecasts***

- 4.45. Mr Mehta failed to take steps to ensure that information provided to customers was clear, fair and not misleading. Retail Group advisers provided customers with selective information about the previous performance of earlier recommendations by

Hythe, as well as providing unsubstantiated forecasts about the growth potential of the stocks they were recommending.

- 4.46. Mr Mehta produced the price forecasts for the stocks being recommended. Mr Mehta produced these forecasts and then informally communicated them to the advisers. Furthermore, Mr Mehta maintained no formal record of these forecasts or the basis for them.
- 4.47. The FSA has identified a number of resulting failures to treat customers fairly. In 18 out of 32 Retail Group recommendations reviewed, advisers then gave unsubstantiated indications of how they expected the stock to perform.
- 4.48. In several of the transactions reviewed, inconsistent performance predictions were also provided to customers with different returns being predicted in different recommendations of the same share. As a result of this, customers could have been provided with unsupported or unrealistic expectations about the potential performance of the recommended shares which they might, as a result of the representations, reasonably have believed were achievable.

#### ***Record keeping***

- 4.49. Mr Mehta failed to take reasonable steps to ensure that Hythe had systems in place to ensure that an adequate record was maintained of the advice given to Retail Group customers on the telephone.
- 4.50. Although Hythe had a call recording system, it was not reliable, as evidenced by Hythe being able to locate only approximately 50% of the call recordings required by the FSA. In failing to adequately store all telephone calls, Hythe had to rely on contemporaneous notes of advice given to Retail Group customers. However, Retail Group advisers failed to properly record their recommendations to ensure an adequate record of advice was kept. This was despite Mr Mehta being aware of failings in its call recording system.
- 4.51. Consequently, Hythe failed to maintain an adequate record of advice given to Retail Group customers. This could adversely affect customers if they wished to complain about the advice they received.
- 4.52. Mr Mehta was aware of deficiencies in the recording of sales calls. In his capacities as CF1 and CF10, Mr Mehta was responsible for Hythe's failings in implementing adequate record keeping systems in relation to the Retail Group.

#### ***Customer identification and anti-money laundering procedures***

- 4.53. Mr Mehta failed to take reasonable steps to ensure that appropriate money laundering checks were carried out. Hythe required new Retail Group customers to provide proof of identification for the purpose of anti-money laundering controls. The Firm's policy was that original documents had to be provided or that, if copies were provided, they should be certified by a professional. However, no procedures were put in place to ensure that this policy was adhered to. Notwithstanding this policy, in

seven of the 32 files reviewed, advisers had requested photocopies of documents, without specifying that they needed to be certified, and in four of these files the advisers had then themselves certified the copies as true copies of the originals, even though it appears that they had never seen the originals or met the customer in person. This indicates that, when Retail Group customers sent uncertified copies of their identification documents to Hythe, the Retail Group advisers would themselves certify them to be a true likeness of the original and that, given that the advisers had not always seen the original documents and had not always met the customer in person, their certifications may have been false or incorrect.

- 4.54. By relying on photocopied and uncorroborated photographic documents, and by certifying copies as originals when the originals had not been seen and the adviser had not met the customer face to face, Hythe exposed itself to the risk of the firm being used as a vehicle for financial crime by third parties. Such practices could have exposed the firm to the risk of being utilised for money laundering, for example. Mr Mehta was aware from at least September 2007 that advisers were certifying client identification documents as being a true likeness of the original when they had not met the client face to face.
- 4.55. Mr Mehta was responsible for these failings as he held Controlled Function CF11 and as such either was, or should have been, aware of these failings.

## **5. ANALYSIS OF BREACHES**

- 5.1. The failures summarised above represent a failure by Mr Mehta to comply with Statement of Principle 7 for Approved Persons while he performed significant influence controlled functions at Hythe, because he did not take reasonable steps to ensure that the business of Hythe for which he was responsible in his controlled functions complied with the relevant requirements and standards of the regulatory system.
- 5.2. In concluding that Mr Mehta failed to comply with Statement of Principle 7 for Approved Persons, the FSA considers that his conduct fell well below the standard expected of approved persons performing significant influence functions. Mr Mehta's failure to take reasonable steps to establish adequate record keeping systems and compliance monitoring procedures meant that there was a risk that unsuitable sales to customers were not being identified and remedied.
- 5.3. Mr Mehta's failures in this regard are particularly serious given that he had identified that advisers' sales conduct on telephone calls could pose a risk to customers. In addition, the deficiencies which were revealed by the FSA's review of a random sample of 32 transactions and client files indicate that there have been instances of Hythe:
  - (1) failing to treat customers fairly;
  - (2) failing to communicate information to customers in a way which is clear, fair and not misleading; and

- (3) failing to take reasonable care to ensure the suitability of advice.

## **6. ANALYSIS OF SANCTIONS**

- 6.1. For the reasons set out above, Mr Mehta did not meet the degree of competence prescribed under the regulatory system in carrying out his significant influence controlled functions in relation to the business conducted by the Retail Group. Such failings seriously undermined the protection and fair treatment of customers and confidence in the financial services industry. Accordingly, the FSA considered whether it is appropriate to:
  - (a) make a prohibition order; and
  - (b) to impose a financial penalty.
- 6.2. For the avoidance of doubt, although Mr Mehta's conduct has raised serious concerns in relation to his competence and capability, the FSA has not identified concerns in relation to his honesty or integrity.

### ***Prohibition***

- 6.3. As set out in section 3 above, in considering whether to impose a prohibition, the FSA had regard to the provisions of EG and ENF. The FSA also took into account the representations made by Mr Mehta that it was not necessary to impose a prohibition on him and that formal undertakings combined with a private warning would be sufficient to address the FSA's concerns. Mr Mehta submitted that he had no intention of undertaking any regulated activities in relation to penny shares for retail customers.
- 6.4. The FSA considered that in breaching Statement of Principle 7 for Approved Persons in the manner described, Mr Mehta had demonstrated a serious lack of competence in relation to the performance of his significant influence controlled functions in relation to the activities of the Retail Group. However, the FSA recognised that the failures identified by the FSA arose only in the context of the Retail Group's advice on and arrangements for the sale of higher risk securities to customers. The FSA had not identified any deficiencies in the performance of Mr Mehta's significant influence functions in relation to Hythe's current regulated activities.
- 6.5. Having regard to the provisions of FIT, the FSA has concluded that Mr Mehta is not a fit and proper person to perform any significant influence functions in relation to any authorised or exempt person or exempt professional firm which undertakes any regulated activity with a view to transactions in penny shares in relation to retail customers, unless such activity is restricted to executing instructions from existing customers for disposal of existing holdings on an execution only basis.
- 6.6. The FSA considered whether its regulatory objectives, which include the need to maintain confidence in the financial system and to secure the appropriate degree of protection for consumers, can be adequately achieved by the imposition of disciplinary sanctions other than a prohibition. However, the FSA concluded that, in

all the circumstances, including the serious lack of competence identified, and given the extent of Mr Mehta's relatively recent failure to comply with Statement of Principle 7, the relevance and materiality of those matters and Mr Mehta's continued performance of controlled functions, it is appropriate to impose a prohibition order in the terms set out at paragraph 1.1 above.

- 6.7. In deciding to impose a prohibition order, the FSA is not required to establish that Mr Mehta intends to carry on the functions to be prohibited by the order. Section 56 of FSMA is available in cases of past misconduct, enabling the FSA to make a prohibition order to afford the necessary future protection to the public. The fact that Mr Mehta appears to be unfit to perform significant influence activities in relation to certain activities is sufficient to justify the making of a prohibition order and his assertions that he will undertake not to perform such activities are not an adequate alternative. Given the risks that his past conduct has posed to consumers, the FSA takes the view that a prohibition order is necessary and proportionate will advance its statutory objectives.

#### *Financial penalty*

- 6.8. In considering whether to impose a financial penalty and the appropriate level of penalty, the FSA has had regard to the representations made by Mr Mehta that a financial penalty would not be proportionate, and to the provisions of DEPP and ENF which set out the factors that may be of particular relevance in determining whether, and at what level, it is appropriate to impose a financial penalty. The criteria are not exhaustive and all the relevant circumstances of the case have been taken into consideration. The FSA considers that the following factors are particularly relevant in this case:

#### *Deterrence*

- 6.9. The FSA considers that a financial penalty will be most effective in deterring Mr Mehta from further breaches of regulatory rules and Principles and in deterring other senior managers from committing similar breaches. Equally, the FSA considers that it will assist in promoting a message to the industry that the FSA expects senior managers to maintain high standards of regulatory conduct, thereby advancing the FSA's regulatory objectives.

#### *The nature, seriousness and impact of the breach*

- 6.10. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the duration and frequency of the breaches, whether the breaches revealed serious or systematic failings in Hythe's systems and controls and the number of customers who were affected and/or placed at risk of loss.
- 6.11. For the reasons set out at paragraph 2.6 above, the FSA considers that the breaches in this case are of a serious nature, particularly given the serious risk of loss to customers. In the period from January 2007 to May 2008, Hythe completed 3,230 sales to approximately 1,111 customers and, even on Mr Mehta's case, his failures



took place over a period of more than one year between September 2006 and December 2007. The FSA recognises that Mr Mehta did take some steps to improve Hythe's systems and controls and has taken these into account. However, the FSA does not consider such steps to have been sufficient because the failings identified were widespread. Furthermore, the FSA does not accept that the Retail Group client base posed a low money laundering risk and considers that Mr Mehta's failures regarding money laundering checks created a risk that Hythe might be used as a vehicle for financial crime.

*The extent to which the breach was deliberate or reckless*

6.12. The FSA has considered the extent to which Mr Mehta's actions were reckless or deliberate. Mr Mehta submitted that his conduct had, save for the failures regarding the provision of information to customers and customer identification procedures, not facilitated financial crime, and that in terms of money-laundering, the business was not high risk. He also submitted that there had been no proven loss to customers and that not all of the breaches had posed a risk of loss to customers. The FSA has concluded that the contraventions made by Mr Mehta were not deliberate. However, the FSA considers that in some respects Mr Mehta was reckless because he gave no apparent consideration to the consequences of his behaviour and the extent of the risks to customers, particularly with regard to:

- (1) the failures to implement adequate compliance monitoring and reporting procedures, notwithstanding that some improvements were made during the Relevant Period;
- (2) the failures in relation to customer classification; and
- (3) the failures in relation to the provision of price forecasts.

*Financial resources and other circumstances of the individual and the amount of benefit gained*

6.13. The FSA has been mindful of Mr Mehta's representations regarding the potential impact of a public sanction. Mr Mehta represented that it would not be proportionate to hold him personally culpable for all the failings identified and that any form of public punishment would have completely destructive and disproportionate consequences for him, his business and his employees.

6.14. The FSA has also taken into account the fact that Mr Mehta committed serious breaches whilst performing significant influence controlled functions and the need to achieve effective deterrence, particularly against the misconduct of senior management. The FSA has also taken into account the remuneration Mr Mehta received, his stakeholding in Hythe and the fact that he has chosen not to make representations regarding personal financial hardship.

*Conduct following the breach*

- 6.15. The FSA has taken into account that there is no longer a Retail Group operating at Hythe and that Hythe has not been active in selling small cap shares since 2008.

*Disciplinary record and compliance history*

- 6.16. Mr Mehta has not previously been the subject of disciplinary action by the FSA.

*Other action taken by the FSA*

- 6.17. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour and Mr Mehta's representations in relation to these. Mr Mehta represented that any financial penalty should be proportionate to those imposed on other individuals. Mr Mehta highlighted some factors which he submitted distinguished him from those on whom sanctions had previously been imposed, including the following:

- (a) the FSA had not identified any concerns with Mr Mehta's honesty or integrity and none of his breaches was deliberate;
- (b) Mr Mehta had only been found to be in breach of Statement of Principle 7;
- (c) Mr Mehta had not personally given any advice to retail customers in relation to penny shares;
- (d) Mr Mehta's responsibilities related solely to Hythe and not a large network;
- (e) Mr Mehta's failings did not take place against a backdrop of FSA communications regarding small cap shares. When final notices were issued to other firms which related to the sale of small cap shares, Hythe reacted by making changes to its systems and controls prior to the referral to enforcement;
- (f) Mr Mehta had a high degree of involvement in all matters relevant to the Retail Group and had a "hands-on" approach;
- (g) his failings took place over a relatively short period of time. The Retail Group started trading in September 2008 and investigators were appointed in May 2008. Mr Mehta closed the Retail Group in Summer 2008. Furthermore, Mr Mehta submitted that Hythe was compliant by December 2007.

## **7. CONCLUSIONS**

- 7.1. In light of the matters set out above, the FSA concluded that it could not be satisfied that Mr Mehta was competent and capable to perform significant influence controlled functions for a business whose activities in relation to penny shares go beyond the execution of instructions from existing customers for disposal of existing holdings on an execution only basis.

- 7.2. The FSA concluded that Mr Mehta breached Principle 7 of the FSA's Statements of Principle for Approved Persons by failing, as an approved person performing significant influence controlled functions, to take reasonable steps to ensure that the business of the Retail Group at Hythe, for which he was responsible in this capacity, complied with the relevant requirements and standards of the regulatory system.
- 7.3. Taking into account all the relevant circumstances and the representations made by Mr Mehta, the FSA decided to impose on Mr Mehta:
- (a) a prohibition order in the terms set out in paragraph 1.1 above; and
  - (b) a financial penalty of £35,000.

## **8. DECISION MAKERS**

- 8.1. The decision which gave rise to the obligation to give this Final Notice was made by the Regulatory Decisions Committee.

## **9. IMPORTANT**

- 9.1. This Final Notice is given to you under sections 57 and 207 of the Act and in accordance with section 390 of the Act.

### **Manner of and time for Payment**

- 9.2. The financial penalty must be paid in full by Mr Mehta to the FSA by no later than 12 May 2010, 28 days from the date of the Final Notice.

### **If the financial penalty is not paid**

- 9.3. If all or any of the financial penalty is outstanding on 13 May 2010, the FSA may recover the outstanding amount as a debt owed by Mr Mehta and due to the FSA.

### **Publicity**

- 9.4. 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 FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.
- 9.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

**FSA contacts**

- 9.6. For more information concerning this matter generally, you should contact Stephen Robinson (direct line: 020 7066 1338) of the Enforcement and Financial Crime Division of the FSA.

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**Georgina Philippou**

**FSA Enforcement and Financial Crime Division**