
FINAL NOTICE

To: **Blake Independent Financial Services Limited**

Of: **Cockerham Hall
17 Huddersfield Road
Barnsley
S70 2LT**

Date: **19 March 2008**

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 Blake Independent Financial Services Limited ("BIFS") a Decision Notice on 18 March 2008 which notified BIFS that pursuant to section 206 of the Financial Services and Markets Act 2000 (the "Act"), the FSA had decided to impose a financial penalty on BIFS in respect of breaches of Principle 2 (Due skill, care and diligence), Principle 4, (Financial prudence) and Principle 11 (Relations with regulators) of the FSA's Principles for Businesses (the "Principles").

- 1.2 BIFS confirmed on 6 March 2008 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3 Accordingly, for the reasons set out below and having agreed with BIFS the facts and matters relied on, the FSA imposes a financial penalty on BIFS in the amount of £31,500.
- 1.4 BIFS agreed to settle this matter at an early stage of the proceedings. It therefore qualified for a 30% reduction in penalty pursuant to the FSA's executive settlement procedures. Were it not for this discount the FSA would have imposed a financial penalty of £45,000 on BIFS.

2. REASONS FOR THE ACTION

- 2.1 The FSA has decided to impose a financial penalty on BIFS for breaches of the Principles referred to paragraph 1.1. These breaches, which are described in more detail at Section 4 below, relate to BIFS failure to maintain adequate capital resources, its failure to put in place subordinated loans as agreed with the FSA and its provision to the FSA of false subordinated loan agreements.
- 2.2 In summary, the FSA has made the following findings:

- (1) BIFS failed to put in place two subordinated loans totalling £27,000 required by the FSA prior to authorisation in order to satisfy the FSA that the Firm met its capital resources requirement, and on the basis of which authorisation was granted. BIFS also failed to put in place a subordinated loan for £180,000 in July 2005, which was required by the FSA in order to rectify a capital resources shortfall, which had been identified by the FSA. Subsequently, BIFS made claims to have misunderstood the nature of a subordinated loan which were, in the opinion of the FSA, unreasonable. BIFS therefore failed to conduct its business with due skill, care and diligence (in breach of Principle 2);

- (2) BIFS failed to ensure that it maintained adequate financial resources from the date of authorisation on 29 October 2003 until July 2007. During this period, BIFS was failing to meet its capital resources requirement as set out in IPRU-INV 13.10.2 R (in breach of Principle 4 and Threshold Condition 4); and
- (3) BIFS erroneously submitted FSA regulatory returns which indicated that BIFS had the required subordinated loans in place. During the FSA's initial inquiries BIFS was required to provide the FSA with copies of all subordinated loan agreements entered into. BIFS furnished the FSA with false agreements which did not match those countersigned and held on file by the FSA. BIFS therefore failed to deal with the FSA in an open and cooperative way (in breach of Principle 11).

3. RELEVANT STATUTORY PROVISIONS

3.1 Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to be necessary or expedient for the purpose of protecting the interests of consumers.

3.2 Section 206 of the Act provides:

"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such an amount as it considers appropriate."

3.3 Under the FSA's rule-making powers, the FSA has published in the FSA Handbook the "Principles for Businesses" which apply either in whole, or in part, to all authorised persons. These Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the FSA's regulatory objectives. Breaching a Principle makes a firm liable to disciplinary action.

3.4 The Principles and Rules which are relevant to this matter are set out below.

The FSA's Rules

- 3.5 **IPRU-INV 13.1.4 E (10)(a)(i)** provides that, in relation to a firm's PII policy, the policy should not:

"make provision for payment by the firm of an excess on any claim of more than £5,000. (This does not apply to the extent that the firm holds additional own funds in a readily realisable form, in accordance with 13.1.4(12))"

- 3.6 **IPRU-INV 13.1.4 E (12)** provides that:

"The amount of additional own funds in 13.1.4(10)(a)(i) should be calculated by referring to the firm's relevant income and excess"

and provides a table to be used in calculating the additional own funds required.

- 3.7 **IPRU-INV 13.10.1 R** provides that:

"A Category B firm's own funds must at all times be at least £10,000."

- 3.8 **IPRU-INV 13.10.2 R** provides that:

"A Category B firm's own funds must be calculated in accordance with table 13.10(2)."

The FSA's Principles for Businesses

- 3.9 **Principle 2** (skill, care and diligence) provides that:

"A firm must conduct its business with due skill, care and diligence."

- 3.10 **Principle 4** (financial prudence) provides that:

"A firm must maintain adequate financial resources."

3.11 **Principle 11** (relations with regulators) provides that:

"A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice."

The Threshold Conditions

3.12 Threshold Condition 4 (adequate resources) provides that:

"The resources of the person concerned must, in the opinion of the [FSA], be adequate in relation to the regulated activities that he seeks to carry on, or carries on."

4. FACTS AND MATTERS RELIED ON

4.1 BIFS is mid-sized financial advisory firm whose main business is non-investment insurance, retail investments and regulated mortgage contracts. BIFS has been authorised by the FSA since 29 October 2003. Its authorised business includes advising on and arranging regulated mortgage contracts and arranging deals in investments.

BIFS' Application for Authorisation

4.2 On 28 January 2003, the FSA received an application for authorisation from BIFS, in connection with a change in legal status from a partnership to a limited company. Following an initial review of the application, the FSA requested clarification from BIFS on how it would meet its regulatory capital resources requirement as this was not clear from the information provided. The FSA suggested that one solution would be for BIFS to:

"make a director's loan to the company for an amount, which will enable it to meet the £10,000 requirement at all times. This loan will need to be subordinated."

- 4.3 BIFS responded to the FSA on 31 March 2003, stating that the regulatory capital resources requirement would be met by means of a director's loan for £10,000 and that a bank account was being processed which would show evidence of the £10,000 loan. BIFS subsequently provided the FSA with a bank statement in the name of "Blake Independent Financial Ltd" which showed a balance of £10,000 as at 25 April 2003.
- 4.4 A subordinated loan agreement for £10,000 was submitted to the FSA by BIFS on 20 May. Under the heading "LOAN", the agreement stated:
- "The Borrower hereby acknowledges its indebtedness to the Lender in the sum of [ten thousand pounds (£10,000)] as an unsecured loan upon and subject to the terms and conditions of this Agreement."
- 4.5 The agreement was subsequently signed by the FSA and dated 5 June 2003.
- 4.6 On 21 October 2003, BIFS submitted a Professional Indemnity Insurance Self-Certification Form in which it calculated that due to an excess of £10,000 on its PII policy it required, to comply with IPRU-INV 13.1.4E (10)(a)(i), an additional £17,000 of "readily realisable funds". BIFS stated that this requirement would be met by way of a subordinated loan of £17,000, and BIFS attached to its letter a subordinated loan agreement. This agreement was countersigned by the FSA and dated 27 October 2003.
- 4.7 BIFS became an authorised person on 29 October 2003.

Capital Resources Deficit

- 4.8 The FSA subsequently identified, and notified BIFS of, a capital resources deficit of £179,873 in May 2005. BIFS informed the FSA that it intended to rectify the breach by putting in place a subordinated loan agreement for £180,000 and, on 1 July 2005, BIFS emailed the FSA to confirm that such an agreement had been put in place.

- 4.9 In its RMAR for the period ended 30 November 2005 BIFS reported that it met the base capital resources requirement of £10,000 exactly, after relying on subordinated loans of £150,633. In its RMAR for the period ended 31 May 2006, BIFS reported that it exceeded the base capital resources requirement of £10,000, again relying on subordinated loans of £150,633.
- 4.10 The FSA informed BIFS that, on the basis of the information in the May 2006 RMAR, it did not demonstrate the minimum level of capital resources required, as it had not taken account of the additional funds required by IPRU-INV 13.1.4E (12). The FSA stated that on this basis it considered BIFS to be in breach of Principle 4. BIFS maintained that it did not have a capital resources deficit.

False Subordinated Loan Agreements

- 4.11 Following a request from the FSA, BIFS emailed the FSA copies of two subordinated loan agreements between BIFS and Mr Blake. The first agreement was dated 3 February 2003 to the value of £27,000, and the second agreement was dated 24 June 2005 to the value of £180,000. Both agreements were one page documents, identically worded apart from the dates and amounts, but not in the FSA approved format. The agreements stated that the borrower (BIFS) acknowledged its "indebtedness" to the lender, that the loan would be "repaid over a period of 5 years", and that Mr Blake would accept no repayment should repayment cause the Firm's capital resources to fall below the FSA's capital resources requirement. In its email, BIFS confirmed that no repayment of the subordinated loans had taken place.
- 4.12 On 16 January, BIFS submitted its RMAR to the FSA for the period ended 30 November 2006. In section D2 of the RMAR, BIFS reported an own funds surplus, based on an incorrect requirement of £10,000 and after relying on subordinated loans of £127,677. In section D1 of the RMAR, BIFS reported a capital resources deficit after relying on subordinated loans of £101,677. These subordinated loan amounts did not appear in the balance sheet as at 30 November 2006, and neither of the subordinated loan figures reported in the November 2006 RMAR was consistent with the amount of subordinated loans previously advised to the FSA which totalled £207,000. The FSA asked that BIFS explain these discrepancies.

- 4.13 In subsequent correspondence with the FSA, BIFS claimed that it had been advised by its former accountant that subordinated loan agreements could be treated as a "personal guarantee" from Mr Blake to BIFS. These loans had not been drawn down or repaid, and thus had not been reflected in BIFS' accounts. BIFS also claimed that the varying subordinated loan amounts reported in the RMARs reflected the improving financial position of BIFS, and thus the lower level of "personal guarantee" required to meet the capital resources requirement.
- 4.14 On 3 May 2007, the FSA wrote to BIFS stating that there were discrepancies between the FSA's records of the subordinated loan agreements entered into by BIFS in 2003, and those provided by BIFS to the FSA on 11 December 2006. The FSA's records showed that, as detailed in paragraphs 4.4 and 4.6 above, BIFS entered into two subordinated loan agreements in 2003 prior to authorisation. Those agreements were dated 5 June and 27 October 2003 and were for £10,000 and £17,000 respectively. The subordinated loan agreement supplied to the FSA by the Firm on 11 December 2006 was dated 3 February 2003 for £27,000. This agreement was not in the FSA approved format and had not been countersigned by the FSA as would have been required at the time.
- 4.15 The FSA began an investigation into BIFS' capital adequacy provisions and disclosures to the regulator on 12 June 2007. On 10 July 2007, the FSA wrote to BIFS setting out its concerns in relation to the matters set out above, and stating that, on the basis of these concerns it would be recommending that BIFS' permission should be cancelled.
- 4.16 BIFS responded stating that the fact that a subordinated loan agreement must be based on an underlying loan only became clear to it on 3 May 2007. The letter outlined the steps taken by BIFS since that date, including the fact that completion of future RMARs would be overseen by a compliance consultancy and an accountancy firm, and that BIFS' Head of Compliance had been replaced. The letter also stated that BIFS had replaced its accountants in 2006, and that it was now in a position to ensure there was no recurrence of the past problems.

4.17 On 22 July 2007, BIFS provided evidence to the FSA that:

- (1) Mr Blake had injected £95,000 into BIFS' account;
- (2) £75,000 of the Director's Loan Account was being capitalised; and
- (3) BIFS had entered a subordinated loan agreement dated 20 July 2007 between Mr Blake and BIFS in the amount of £51,569.

4.18 On 6 August 2007, BIFS provided the FSA with a calculation stating that, based on the remedial action taken, as described in paragraph 4.17 above, BIFS had a financial resources surplus as at 31 July 2007. BIFS subsequently provided the FSA with management accounts for the Firm as at 31 August 2007 which also showed a capital resources surplus.

5. ANALYSIS OF THE PROPOSED SANCTION

5.1 In deciding to take the action described above, the FSA has had regard to guidance published in the FSA Handbook. The relevant considerations in relation to the proposed action are set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP"). Although the references in this notice are to DEPP, the FSA has also had regard to the appropriate provisions of Chapter 13 of the FSA's Enforcement Manual ("ENF") which applied during the relevant period in which BIFS' misconduct occurred.

5.2 DEPP 6.1.2 states that the principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business. In determining whether a financial penalty is appropriate, and if so, its level, the FSA is required to consider all the relevant circumstances of a case. DEPP 6.5.2 sets out a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty.

5.3 The FSA considers that the following factors are particularly relevant in this case.

DEPP 6.5.2(1): Deterrence

- 5.4 A financial penalty will help to send a message to the industry that the manner in which a firm conducts its business and the way in which it interacts with the FSA are as important as ensuring that individual rules are not breached.

DEPP 6.5.2(2): The nature, seriousness and impact of the breach in question

- 5.5 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 failings in the firm's systems and controls and the number of customers who were affected and/or placed at risk of loss. For the reasons set out below the FSA considers that the breaches in this case are of a serious nature.

- 5.6 BIFS' failings are viewed as being serious because:

- (1) BIFS was in breach of its regulatory capital resources requirement for almost 4 years, from the date of authorisation, and was authorised on the basis of subordinated loans that did not exist;
- (2) when requested to provide copies of all subordinated loan agreements, BIFS provided the FSA with false agreements;
- (3) BIFS claims to have misunderstood the nature of a subordinated loan, yet evidence on file shows that the first subordinated loan agreement (for £10,000) was understood correctly at the time, and money was set aside although no loan was put in place; and
- (4) BIFS has demonstrated a serious lack of understanding of its regulatory capital resources requirement and the Retail Mediation Activities Return ("RMAR").

- 5.7 The FSA has taken into account the following steps taken by BIFS which have mitigated the seriousness of its failings:

- (1) the capital resources deficit which formed the initial basis for action was subsequently promptly rectified by BIFS, and the Firm now meets its regulatory capital resources requirement;
- (2) BIFS has employed the services of a compliance consultancy, Bankhall Investment Advisers Limited, and an accountancy firm, GBAC Accountancy, to oversee the completion of future RMARs;
- (3) BIFS has employed a new Head of Compliance, and
- (4) the accountancy firm which apparently advised BIFS in relation to the treatment of the subordinated loan agreements has been replaced.

DEPP 6.5.2(5): The size, financial resources and other circumstances of the firm

- 5.8 In determining the level of penalty, the FSA has been mindful of the need to ensure that the interests of customers are protected and has sought to ensure that the level of the financial penalty is not set at a level that would effectively cause BIFS to cease trading. Taking account of these factors, and having considered BIFS' latest financial information, the FSA considers that a penalty of £45,000 (subsequently discounted by 30% to £31,500 for early settlement) is appropriate.

DEPP 6.5.2(6): The amount of benefit gained or loss avoided

- 5.9 The FSA found no evidence that BIFS sought to profit or avoid loss as a result of the identified failings.

DEPP 6.5.2(8): Conduct following the breach

- 5.10 The FSA has taken into account BIFS' full co-operation with the FSA's inquiries and its stated commitment to ensuring in future that it will comply with the FSA's requirements on an ongoing basis, and that it never intended to mislead the FSA. BIFS has employed the services of a compliance consultant and an accountancy firm

to assist it in future RMAR submissions, and to ensure that it meets its capital resources requirement on an ongoing basis.

DEPP 6.5.2(9): Disciplinary record and compliance history

5.11 BIFS has not been the subject of previous disciplinary action by the FSA or any other regulator.

DEPP 6.5.2(10): Other action taken by the FSA

5.12 In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for broadly similar behaviour.

6. DECISION MAKERS

6.1 The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers on behalf of the FSA.

7. IMPORTANT

7.1 This Final Notice is given to BIFS in accordance with section 390 of the Act.

Manner of and time for Payment

7.2 The financial penalty must be paid in full by BIFS to the FSA in accordance with the schedule detailed in the Settlement Agreement between BIFS and the FSA.

If the financial penalty is not paid

7.3 If all or any of the financial penalty is outstanding on the date agreed by BIFS with the FSA, the FSA may recover the outstanding amount as a debt owed by BIFS and due to the FSA.

Publicity

- 7.4 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 BIFS or prejudicial to the interests of consumers.
- 7.5 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

- 7.6 For more information concerning this matter generally, you should contact John Kirby (Tel: 020 7066 1458) or Martin Badcock (Tel: 020 7066 1560) of the Enforcement Division of the FSA.

Jonathan Phelan
FSA Enforcement Division