
FINAL NOTICE

To: **City Index Limited**
Of: **Moorgate Hall, 155 Moorgate**
London, EC2M 6XB
Date: **22 March 2005**

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. For the reasons listed below and pursuant to section 206 of the Financial Services and Markets Act 2000 (the "Act"), the FSA is imposing a financial penalty of £35,000 (the "Penalty") on City Index Limited ("City Index") in respect of breaches of rules 3.6.1R(1), 3.8.4R(1) and 3.8.8R(1)(a), (b) and (c) in the part of the FSA's Handbook entitled *Conduct of Business* ("COB"); rule 3.2.6R in the part of the FSA's Handbook entitled *Senior management arrangements, Systems and Controls* ("SYSC") and principles 3 and 7 of the FSA's Principles for Businesses (the "FSA's Principles").

2. REASONS FOR THE PENALTY

- 2.1. The FSA is imposing the Penalty on City Index in respect of breaches by City Index of the FSA's rules and principles referred to in paragraph 1.1. The breaches occurred in the period from 1 September 2003 to 30 November 2003 in relation to:
- (a) City Index's communication of a financial promotion which failed to include a fair description of the nature of an investment offered by City Index.
 - (b) City Index's communication of financial promotions which failed to include an adequate description of the commitment required and the risks involved with contracts for differences and spread betting.

- (c) City Index's failure to maintain effective systems and controls for ensuring compliance with the FSA's rules and principles relating to the communication of financial promotions including a financial promotion which could have created confusion in the market place between City Index and one of its competitors.

2.2. City Index's breaches are viewed by the FSA as being serious because of the following:

- (a) Of the 21 different financial promotions¹ that were communicated by City Index in a sample period from 1 September to 30 November 2003, the communication of 20 of those financial promotions involved a breach by City Index of at least one of the FSA's rules or principles referred to in paragraph 1.1. The majority of those financial promotions breached the FSA's rules because the nature or size of the risk warning notice in the financial promotion was inadequate for the purposes of COB 3.8.8R(1)(b) and (c). The risk warning notices in City Index's financial promotions contained statements which were consistent with those used by other participants in the contracts for differences and spread betting market. It is noted that City Index included additional risk warnings to prospective customers in their account opening documentation.
- (b) City Index's financial promotions promoted contracts for differences and spread bets. These are both high risk investment activities. A key risk is that if the customer loses the bet the customer can rapidly incur additional liabilities far in excess of the customer's initial stake. It is therefore important that financial promotions disclose that a customer's liability may exceed the customer's initial deposit (or margin) in a clear, simple and prominent manner so that potential customers fully understand the risk that they are taking on. In failing to do this, City Index communicated financial promotions which did not contain a fair description of the nature of an investment offered by City Index or an adequate description of the commitment required and the risks involved with contracts for differences and spread betting.
- (c) By communicating financial promotions to the general public through daily national newspapers, magazines and on bags used by sandwich shops City Index's promotional strategy had the potential of attracting customers to a high risk investment activity without adequately describing in those financial promotions the commitment required and the risks involved with contracts for differences and spread betting.
- (d) The FSA has previously highlighted, in a publication entitled "*The FSA's regulatory approach to financial promotions*" (published in April 2002), the need for all financial promotions to give a fair and balanced picture of the nature of the investment being promoted and the commitment and the risk involved.

¹ One of the financial promotions is attached for illustrative purposes (attachment "A").

- 2.3. The failings in this case merit the imposition of a financial penalty on City Index. In fixing the amount of such a penalty the FSA has recognised the actual and potential impact of these failings:
- (a) City Index estimate that 115 new customers signed up to City Index's services as a consequence of City Index's financial promotions in the period from 1 September to 30 November 2003. The decision of some, but not all, of these customers to sign up to City Index's service is directly attributable to specific publications in which City Index's financial promotions appeared.
 - (b) Neither the FSA nor City Index have received complaints from customers arising from the financial promotions that they communicated in the period from 1 September to 30 November 2003.
- 2.4. City Index has been open and co-operative with the FSA during its investigation. Were it not for the co-operation shown by City Index the Penalty would have been significantly higher. The FSA also understands that, following the commencement of the FSA's investigation, City Index has reviewed and amended its procedures for the communication of financial promotions.

3. RELEVANT STATUTORY PROVISIONS AND REGULATORY REQUIREMENTS

- 3.1. Section 206(1) 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 amount as it considers appropriate."

The COB rules

- 3.2. The FSA's rules which govern the communication and content of financial promotions are set out in Chapter 3 of the COB rules.

- 3.3. COB rule 3.6.1R(1) provides that:

"Before a firm communicates or approves a non-real time financial promotion, it must confirm that the financial promotion complies with the rules in this chapter."

- 3.4. COB rule 3.8.4R(1) provides that:

"A firm must be able to show that it has taken reasonable steps to ensure that a non-real time financial promotion is clear, fair and not misleading."

- 3.5. COB rule 3.8.4R(2) provides that:

"A non-real time financial promotion which includes a comparison or contrast must:

- (c) *not create confusion in the market place between the firm itself (or the person whose financial promotion it approves) and a competitor or between the firm's trademarks, trade names, other distinguishing marks, investments or*

services (or those of the person whose financial promotion it approves) and those of a competitor".

- 3.6. Evidential provision COB 3.8.5E provides further detail as to how firms can comply with COB 3.8.4R including that:

"A firm should take reasonable steps to ensure that, for a non-real time financial promotion:

- (f) the design, content or format does not disguise, obscure or diminish the significance of any statement, warning or other matter which the financial promotion is required by this chapter to contain;...*
- (h) it does not omit any matters the omission of which causes the financial promotion not to be clear, fair and not misleading;"*

- 3.7. COB rule 3.8.8R(1)(a) to (c) provides that:

"A specific non-real time financial promotion must include a fair and adequate description of:

- (a) the nature of the investment or service;*
- (b) the commitment required;*
- (c) the risks involved".*

- 3.8. Guidance provisions COB 3.8.9G(1) and (3)(a) state the following in respect of COB rule 3.8.8R:

"(1) A specific non-real time financial promotion should give a fair and balanced indication of the requirements in COB 3.8.8 R (1)(a) to (c), to meet COB 3.8.4 R (1)."

"(3) In giving a fair and adequate explanation of the investment or service being promoted firms should avoid:

- (a) accentuating the potential benefits of an investment without also giving a fair indication of the risks".*

The SYSC Rules

- 3.9. SYSC rule 3.2.6R provides that:

"A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system".

The FSA Principles

3.10. The FSA Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.

3.11. FSA principle 3 provides that:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

3.12. FSA principle 7 provides that:

"A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading."

The FSA's Regulatory Approach to Financial Promotions

3.13. In April 2002 the FSA issued a publication entitled "*The FSA's regulatory approach to financial promotions*", which explained the FSA's approach to all financial promotions after 1 December 2001. The publication highlighted:

- (a) the need for all financial promotions to give a fair and balanced picture of the nature of the investment being promoted and the commitment and risk involved, and the need to avoid unduly accentuating the benefits of an investment product without also giving a fair indication of the risk in order to ensure that the financial promotion is clear, fair and not misleading; and
- (b) the need to ensure that key information is presented in the main body of the promotion, rather than in the small print, and that negative features and risk warnings are not played down so much that they are effectively hidden in advertising material.

3.14. The publication warned that where serious or persistent rule breaches are found, firms may be subject to enforcement action under the FSA's disciplinary procedures.

4. FACTS AND MATTERS RELIED ON

City Index

4.1. City Index (part of the Intercapital Private Group) offers a service which allows its customers to purchase contracts for differences and spread betting products.

4.2. City Index became an authorised person on 1 December 2001 with permission granted by the FSA pursuant to the Act to conduct certain regulated activities including dealing as principal in spread bets and contractually based investments such as contracts for differences. It was previously authorised by the Securities and Futures Authority.

City Index's financial promotions

- 4.3. This notice relates to financial promotions communicated by City Index from 1 September to 30 November 2003.
- 4.4. The financial promotions which have been identified in this notice were published:
- (a) in the following United Kingdom newspapers and magazines: *Asian Voice*, *Bloomberg Money*, *The Business*, *The Daily Telegraph*, *The Financial Times*, *Growth Company Investor*, *Investors Chronicle*, *The Metro*, *Money Observer*, *Moneyweek*, *Shares Magazine*, *Traders Magazine* and *The Wharf*. These have a combined average readership of 1,940,000 per edition; and
 - (b) on bags used by certain selected sandwich shops in London.
- 4.5. The City Index advertisements which are detailed in this Final Notice are all "*specific non-real time financial promotions*" for the purposes of the COB Rules that have been breached by City Index as they identify and promote City Index's service and investments and "*induce*" the reader to enter into an agreement with City Index. The making of such an agreement involves buying or selling either a contract for differences or a contract whose purpose is to secure a profit or loss by reference to fluctuations in the value of property and/or indexes.

The "*free £25 bet*" financial promotion

- 4.6. In September and October 2003 City Index communicated a specific non-real time financial promotion on a sandwich paper bag.² Sandwiches purchased from certain selected sandwich shops in London were wrapped in this bag. On one side of the bag was the name "*City Index*" at the top, with the words "*free £25 bet*" underneath. The "*£25*" was much larger than the two words surrounding it. Beneath this was the sentence "*All you have to do is open a new Spread Betting account and place your first trade to claim your Free bet on Vodafone**" (the "*Caveat*"). The asterisk referred to a statement that terms and conditions applied, that the offer was valid until 1 December 2003 and that City Index could withdraw the promotion at any time. Below this statement was City's website address and a risk warning. Right at the bottom was a reference to industry awards which City Index had won. On the other side of the bag was the name "*City Index*". Beneath that was the word "*Mustard*" in large letters followed by a reference to the *Investors Chronicle* Investment Awards 2003. City Index's website address followed at the foot of the sandwich bag.
- 4.7. The use of the phrase "*free £25 bet*" implied that the £25 bet offered was free when in fact it was a requirement that a potential customer had first to place a trade through City Index, at a cost to the potential customer, in order to become entitled to the "*free*" bet. Although there was no minimum limit on the size of the initial spread bet that the customer had to place and a stop loss facility could be used on the initial spread bet, the £25 bet was not "*free*" because a customer would have to pay to place the initial spread bet with City Index in order to become entitled to the "*free*" bet. The customer could lose all, and potentially much more, of the customer's initial spread bet before

² Both sides of the "*free £25 bet*" sandwich bag financial promotion are attached for illustrative purposes (attachment "B").

becoming entitled to the "free" bet. Although the "free £25 bet" financial promotion did include the Caveat it was still misleading for the word "free" to have been used.

- 4.8. City Index breached COB 3.8.8R(1)(a) by using the word "free" in the financial promotion without including a fair description of the nature of the investment offered by City Index, namely that the conditions were incomplete as they did not make it clear that the "free" £25 bet could have resulted in investors being exposed to a high risk product and incurring significant losses.

Communicating financial promotions with inadequate risk warnings

Nature of risk warnings

- 4.9. From 1 September to 30 November 2003, City Index communicated 17 different specific non-real time financial promotions a total of 41 times in breach of COB 3.8.8R(1)(b) and (c) because their risk warnings did not contain an adequate description of the commitment required and the risks involved with contracts for differences and spread bets as the text of each risk warning was inadequately worded. These included the "free £25 bet" financial promotion and financial promotions issued during other advertising campaigns.
- 4.10. City Index used phrases in their risk warnings such as:
- (a) *"spread betting and CFDs carry a high level of risk to your capital";*
 - (b) *"only speculate with money that you can afford to lose";* and
 - (c) *"these products may not be suitable for all our customers; therefore ensure you fully understand the risks involved and seek advice if necessary".*
- 4.11. Although City Index's risk warnings were similar to statements used by their competitors, they are not adequate in their description of City Index's investments as they do not state that a customer's liability may exceed the customer's initial deposit or margin. Because they did not state this they did not adequately describe the commitment (namely the fact that a customer may be committed to place more money with City Index in order to meet the liability incurred through a spread bet) and the risks involved with spread betting and contracts for differences.

Size of risk warnings

- 4.12. In *"The FSA's regulatory approach to financial promotions"* April 2002 the FSA stated that *"Our research shows that small print is ineffective as a means of conveying key messages to consumers"* (para 1.14). In the same document, the FSA also stated that:

"Our consumer research, and that carried out for the Past Performance Task Force, showed that information contained in small print was widely felt to be overwhelming and unintelligible, and often went unread. Most respondents felt it impossible to interpret, calling into question its efficiency as an appropriate place for key information about risk or other important product features" (para 4.11).

- 4.13. From 1 September to 30 November 2003 City Index communicated 11 different specific non-real time financial promotions a total of 29 times in breach of COB 3.8.8R(1)(b) and (c) because the size of the risk warnings in the financial promotions was not prominent enough to constitute an adequate description of the commitment required and the risks involved in spread betting and contracts for differences.

City Index's failure to maintain effective systems and controls for ensuring compliance with the FSA's rules and principles relating to the communication of financial promotions

Failure to complete check lists

- 4.14. City Index's Compliance Manual (the "Compliance Manual") specified that it was the responsibility of individual staff to ensure that they were sufficiently trained. The Compliance Manual also specified that as a condition of employment staff agreed not to commit an act or omission which placed City Index in breach of any FSA rule.
- 4.15. The Compliance Manual included a check list which certain designated members of the Compliance Department completed and signed off in respect of each different financial promotion. The Compliance Manual included the statement (in bold text) that:

"Prior to issue, all financial promotions must be subject to a thorough compliance review, which, as a minimum, will be evidenced by completion of the Financial Promotion Check List".

- 4.16. Between 1 September and 30 November 2003 eight different financial promotions were communicated by City Index without either the respective check lists being completed or being signed off by a member of the Compliance Department prior to the publication of the promotion. This amounts to 38% of all financial promotions communicated during that period. City Index breached COB 3.6.1R as it failed to confirm that the financial promotions complied with Chapter 3 of the COB Rules prior to communication. City Index also breached SYSC 3.2.6R as it failed to maintain effective systems and controls for ensuring compliance with the COB Rules.

The "No Gimmicks" financial promotion

- 4.17. The Compliance Manual also provided that financial promotions must avoid industry comparisons, particularly with other spread betting competitors.
- 4.18. In September and October 2003 City Index communicated a financial promotion which used the phrase "No Gimmicks". The first version of the "No Gimmicks" financial promotion was published in the 26 September 2003 issue of *Investors Chronicle*.³ It featured a slogan "No gimmicks, just simply the best. But that's not the amazing part, we also won both awards last year." The "awards" mentioned were industry awards which City Index had won. It also contained a picture of a handheld computer which can also be used as a mobile phone, commonly known as an Xda. Underneath the Xda was the sentence "City Index...21st Century trading" followed by

³ The first version of the "No Gimmicks" financial promotion (which appeared over two pages) is attached for illustrative purposes (attachment "C").

a further slogan, City Index's website address and a risk warning. The second version of the "*No Gimmicks*" financial promotion contained similar text and images as the first but was laid out differently and was of a smaller size. This version was printed in the centre of the *Share Prices* page of *The Daily Telegraph* on 26 September and 6 October 2003.

- 4.19. Cantor Index Limited ("Cantor Index") is one of City Index's competitors. It provides spread betting services. The style of the "*No Gimmicks*" financial promotion is very similar to a financial promotion which had already been used by Cantor Index who, at the beginning of September 2003, had been promoting its spread betting service through financial promotions offering an Xda. City Index did not offer its service through an Xda. Cantor Index first communicated its financial promotion at least as early as 5 September 2003. City Index's "*No Gimmicks*" promotion was first communicated on 26 September 2003. City Index's Compliance Department was not aware, when approving the financial promotion, that it was similar to Cantor Index's financial promotion.
- 4.20. The style of the "*No Gimmicks*" financial promotion is similar to Cantor Index's financial promotion not only because it used the same image of an Xda, but also because it used the same phrase "*but that's not the amazing part*". As well as being published in the same period, on one occasion both financial promotions also appeared in the same publication on the same date (*Investors Chronicle*, 26 September 2003).
- 4.21. The "*No Gimmicks*" financial promotion risked breaching COB 3.8.4R(2)(c) as it could have created confusion in the market place between City Index and its competitor, Cantor Index. The risk of this potential confusion should have been recognised by City Index as the financial promotion copied elements of Cantor Index's financial promotion.
- 4.22. The fact that City Index communicated the "*No Gimmicks*" financial promotion indicates a breach of SYSC 3.2.6R as City Index did not take reasonable care to maintain effective systems and controls for ensuring compliance with COB 3.8.4R(2)(c).

Failure to take reasonable steps to ensure that financial promotions are clear, fair and not misleading

- 4.23. As detailed in paragraphs 4.6 to 4.13 above City Index breached COB 3.8.8R(1)(a), (b) and (c) because their financial promotions did not contain a fair description of the nature of an investment offered by City Index or an adequate description of the commitment required and the risks involved with contracts for differences and spread betting. Applying the guidance in COB 3.8.9G(1) City Index has, therefore, also breached COB 3.8.4R(1) as a consequence of the breach of COB 3.8.8R(1)(a), (b) and (c) as it has not taken reasonable steps to ensure that its financial promotions are clear, fair and not misleading.

Breaches of the FSA's Principles

- 4.24. City Index has breached principle 3 of the FSA's Principles as the breaches of COB 3.6.1R(1), COB 3.8.4R(1), COB 3.8.8R(1)(a), (b) and (c) and SYSC 3.2.6R detailed

in paragraphs 4.6 to 4.23 above indicate that City Index did not take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems with regard to compliance.

- 4.25. City Index has breached principle 7 of the FSA's Principles as the breaches of COB 3.6.1R(1), COB 3.8.4R(1), COB 3.8.8R(1)(a), (b) and (c) and SYSC 3.2.6R detailed in paragraphs 4.6 to 4.23 above indicate that City Index did not pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

5. RELEVANT GUIDANCE ON SANCTION

- 5.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the FSA's Enforcement Manual which forms part of the FSA Handbook. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.
- 5.2. It is stated at paragraph 13.3.4 of the FSA's Enforcement Manual that the criteria listed in the Enforcement Manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.
- 5.3. In determining whether a financial penalty is appropriate, and its level, the FSA considers all the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case.

The seriousness of the misconduct or contravention.

- 5.4. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. City Index's senior management arrangements, systems and controls relating to financial promotions were ineffective to ensure that it complied with Chapter 3 of the COB Rules.
- 5.5. The breaches identified in this case were serious due to the impact that they could potentially have had on customers. The financial promotions were widely circulated to members of the general public and were published in high circulation newspapers and magazines and on sandwich bags.

The extent to which the contravention is deliberate or misconduct was deliberate or reckless

- 5.6. There is no evidence that City Index deliberately or recklessly contravened the FSA's rules and principles.

The size, financial resources and other circumstances of the firm

- 5.7. There is no reason to believe that City Index will not be able to pay the financial penalty.

The amount of profit accrued or loss avoided

- 5.8. There is no evidence that City Index deliberately set out to accrue additional profits as a result of its failings.

Conduct following the contravention

- 5.9. Since the breaches were brought to its attention by the FSA City Index has sought to improve its procedures to ensure future compliance.

Disciplinary record and compliance history

- 5.10. City Index has not been subject to any previous enforcement action.

Previous action by the FSA and other regulatory authorities in relation to similar failings

- 5.11. The FSA has in the past taken action against firms for financial promotions failings. This action has included the imposition of financial penalties. The FSA has taken these penalties into account.

6. IMPORTANT NOTICES

- 6.1. This Final Notice is given to you in accordance with section 390 of the Act. The following statutory rights are important.

Manner of payment

- 6.2. The Penalty must be paid to the FSA in full.

Time for payment

- 6.3. The Penalty must be paid to the FSA no later than 8 April 2005, being not less than 14 days beginning with the date on which this Notice is given to City Index.

If the penalty is not paid

- 6.4. If all or any of the Penalty is outstanding on 8 April 2005, the FSA may recover the outstanding amount as a debt owed by City Index and due to the FSA.

Publicity

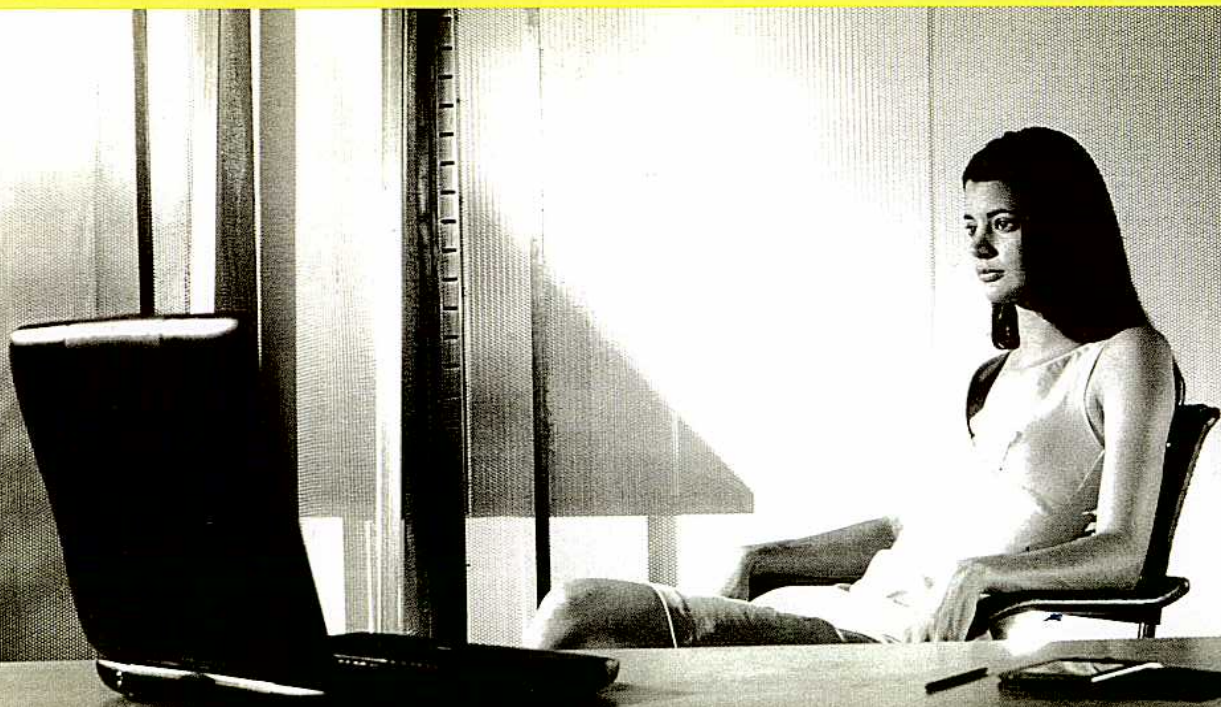
- 6.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may 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.
- 6.6. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

- 6.7. For more information concerning this matter generally, you should contact Stephen Robinson (direct line: 020 7066 1338/fax: 020 7066 1339) or Tim Dolan (direct line: 020 7066 5840/fax: 020 7066 5841) at the FSA.

Nicola Parish
FSA Enforcement Division

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* applies to Spread Betting only

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* Voted winner of Best Spread Betting firm 2002 by Investors Chronicle and Best Spread Betting Service 2002 by Shares Magazine

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All you have to do is open a new Spread Betting account and place your first trade to claim your Free bet on Vodafone*.

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