
FINAL NOTICE

To: Falcon Securities (UK) Limited
Of: 154 Bishopsgate, London, EC2M 4LN
Date: 29 January 2010

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about issuing a public censure.

1. THE ACTION

- 1.1. The FSA gave Falcon Securities (UK) Limited ("Falcon") a Decision Notice on 29 January 2009 which notified Falcon that pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a public censure on Falcon in respect of breaches of the FSA Principles for Businesses ("the Principles") by Falcon's appointed representative, Montague Pitman Stockbrokers Limited ("MPS") which occurred between 17 September 2007 and 30 January 2009 ("the Relevant Period") in relation to advising on and arranging the sale of higher risk securities for MPS's retail clients

- 1.2. Falcon confirmed on 28 January 2010 that it will 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 public censure on Falcon. The FSA would have imposed a penalty of £240,000 on Falcon, were it not for the fact that it has undertaken to cease selling investments to clients and is in administration.

2. REASONS FOR THE ACTION

Introduction

- 2.1. An appointed representative is a firm that conducts regulated business on behalf of a directly authorised firm that acts as its principal. A written contract between the principal and the appointed representative specifies the type of business that the appointed representative is permitted to carry out on behalf of the principal. The principal takes regulatory responsibility for the appointed representative. It is ultimately accountable for the products its appointed representatives advise on, recommend and sell, including any liabilities that might arise for ensuring that the appointed representative complies with its regulatory responsibilities.
- 2.2. As a result, firms with appointed representatives need to have rigorous management information to allow robust supervision and monitoring of their appointed representatives, and to ensure that they are treating their customers fairly.
- 2.3. The breaches of the Principles outlined above relate to a number of serious failings arising from MPS's advice in relation to the sale of higher risk shares to its clients in the Relevant Period.
- 2.4. During the Relevant Period the conduct of Falcon, in relation to MPS, fell below the standards expected under the regulatory system for the following reasons:
 - (1) MPS failed to obtain sufficient information about its clients' personal and financial circumstances to assess whether its advice was suitable before recommending shares to clients and failed to take into account indications that

recommendations may not be suitable for its clients. Accordingly, Falcon failed to take reasonable care to ensure the suitability of its advice, in breach of Principle 9;

- (2) MPS failed to adequately disclose all commissions and charges, in particular inducements received by Falcon for selling the shares. MPS gave recommendations which did not fairly set out the risks of the shares recommended, including the liquidity of the shares. Its advisers also often undermined any risk warnings given and failed to deliver them in a clear manner, often speaking in a fast pace. Accordingly, MPS failed to pay due regard to the information needs of its clients, and failed to communicate with them in a way that was clear, fair and not misleading in breach of Principle 7;
- (3) MPS employed inappropriate sales practices which included pressurising clients to make a quick decision or inappropriately suggesting that if a client agreed to a purchase, it would be their last trade. Accordingly, Falcon failed to pay due regard to the interests of MPS's clients and treat them fairly in breach of Principle 6; and
- (4) Falcon failed to manage the risks to MPS's business and clients in relation to selling higher risk shares. MPS had a remuneration and rewards system which sought to incentivise MPS advisers to act compliantly. However it failed to ensure that this system operated effectively by enhancing these incentives when it became clear that non-compliant behaviour was still occurring and failed to adequately control the effect of this. Accordingly, Falcon failed to take reasonable care to organise and control the affairs of MPS responsibly and effectively in breach of Principle 3.

2.5. The FSA views Falcon's failings as particularly serious in view of the following considerations:

- (1) MPS's clients were entitled to rely on it to take reasonable steps to ensure the suitability of its advice, and to be treated fairly. Its clients should not have been subjected to inappropriate sales techniques or provided with information

that was inaccurate, incomplete or misleading. The use of such techniques presented a real and significant risk of clients being recommended shares which were unsuitable for them and not fully understanding the nature of the risks associated with the shares;

- (2) The breaches revealed weaknesses in the management systems and internal controls relating to the firm's business and presented a significant risk to the FSA's objectives of securing the appropriate degree of protection for consumers and maintaining confidence in the financial system; and
- (3) Falcon had been subject to a supervisory visit in September 2007 after which it was given extensive feedback about MPS's conduct. Falcon made some improvements but the conduct of MPS advisers failed to improve sufficiently such that by the time of a follow-up supervisory visit in May 2008, significant issues still remained.

2.6. In making the decision to impose a public censure on Falcon, the FSA has taken into account actions taken by the firm. It made improvements to its systems and controls in relation to its sales processes and compliance procedures during the Relevant Period. Falcon has also co-operated fully with the FSA investigation.

3. RELEVANT STATUTORY PROVISIONS

The FSA is authorised by the Act to exercise the following powers:

3.1. Section 205 of the Act provides:

“If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect.”

- (1) Falcon is an authorised person for the purposes of section 205 of the Act. A requirement imposed on a firm includes the FSA Principles and Rules made under section 138 of the Act.

- (2) The FSA Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the FSA's regulatory objectives.

3.2. Section 39(3) of the Act provides:

“The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility”.

3.3. Section 39(4) of the Act provides:

“In determining whether an authorised person has complied with a provision contained in or made under this Act...anything which a relevant person has done or omitted as respects for which the authorised person has accepted responsibility is treated as having been done or omitted by the authorised person.”

3.4. Section 39(5) of the Act provides:

““Relevant Person” means a person who at the material time was an appointed representative by virtue of being a party to a contract with the authorised person.”

3.5. MPS is an appointed representative of Falcon for the purposes of Sections 39(4) and 39(5) of the Act.

3.6. The FSA's Principles for Businesses are general statements 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.

3.7. Principle 3 states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

3.8. Principle 6 states that a firm must pay due regard to the interests of its customers and treat them fairly.

- 3.9. Principle 7 states 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.
- 3.10. Principle 9 states that a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
- 3.11. Relevant FSA Handbook Rules are set out in Annex 1 to this Notice.
- 3.12. The FSA's Principles and Rules constitute requirements imposed on authorised persons under the Act; breaching a Principle and/or a Rule makes a firm liable to disciplinary sanctions.

RELEVANT GUIDANCE

- 3.13. In deciding to take the action described above, the FSA has had regard to the guidance published in the FSA Handbook in the Decision Procedure and Penalties Manual ("DEPP"), which forms part of the FSA Handbook. In particular, the FSA has taken into account the general criteria for determining whether to take disciplinary action and the factors relevant to determining the imposition of a public censure set out in DEPP 6.2 and 6.4.

4. FACTS AND MATTERS RELIED ON

The firm

- 4.1. Falcon has been authorised by the FSA since 1 December 2001, having previously been regulated by the Securities and Futures Authority (from 29 April 1988). Falcon is authorised under the Act with permissions granted for the regulated activities of advising on investments, dealing in investments as principal and agent, arranging deals in investments, managing investments and making arrangements with a view to transactions.

- 4.2. On 1 February 2007 Falcon took on MPS as its appointed representative. As MPS's principal, Falcon was therefore responsible for MPS's compliance with the FSA's regulatory requirements.
- 4.3. MPS is majority-owned by Falcon's parent company and shares the same offices as Falcon. During the Relevant Period the key managers at MPS reported to the directors at Falcon.
- 4.4. MPS is a retail stock broking business primarily dealing with private individuals who are advised by MPS on stocks traded on AIM, the LSE Main Market and on contracts for difference. The FSA's findings relate to MPS's recommendations for smaller capitalised companies (commonly referred to as "small cap shares"). These recommendations were primarily made through telephone contact with clients. MPS then sent clients a contract note relating to the shares purchased, requesting payment.
- 4.5. Over the course of the Relevant Period, a team of 16 advisers was employed by MPS.
- 4.6. The FSA has reviewed a random sample of 38 recommendations in small cap shares made in the Relevant Period by MPS, covering 37 retail clients and 19 small cap companies.
- 4.7. In the period September 2007 to January 2009, MPS and Falcon completed 5,113 sales to approximately 947 clients.
- 4.8. During the Relevant Period, MPS and Falcon generated revenues from securities totalling approximately £2.4m.
- 4.9. The high risk nature of small cap shares is demonstrated in the sample of transactions reviewed, which covered 19 different small cap stocks. Analysis has shown that the value of these stocks has decreased significantly since the point of purchase to December 2009. Nine stocks lost 100% of their value, and seven stocks lost between 29% and 91% of their value. Only three stocks gained in value. The performance of small cap stocks as measured by the AIM index over the same period was a decrease of 41%.

Suitability of recommendations

- 4.10. When new clients were taken on by MPS, they were required to complete an application form following an account opening call with a MPS employee. This form included details of the client's financial circumstances and their investment objectives. It was then approved by MPS's compliance department, using a number of pre-set criteria. MPS advisers would then use this account opening information to make recommendations to the clients.
- 4.11. However, a review by the FSA of a sample of these forms suggests that these checks by the compliance department were not adequate. In 45% of cases, there was missing information on the KYC forms, but no recorded explanation of why it was appropriate to continue without the missing information.
- 4.12. Furthermore, during the Relevant Period, MPS's compliance monitoring procedures failed to adequately identify and resolve inappropriate practices in the provision of advice to clients which risked MPS making unsuitable sales.
- 4.13. The effect of this was demonstrated in the transactions reviewed by the FSA.
- 4.14. In 22 out of 38 transactions, the client expressed a clear reluctance or uncertainty about making a purchase. The client stated they were not in a position to invest due to a number of reasons, such as their financial circumstances or lack of interest in the market at the time, but the adviser continued with the recommendation. The adviser should have realised his recommendation may not be suitable for the client.
- 4.15. In 27 out of the 38 transactions, it was the practice for advisers to recommend the number of shares the client should buy. In nine of these cases, the client indicated that they did not want to buy the recommended amount, but the adviser ignored the client's preference and either asked the client to invest more or attempted to round up the amount suggested. These practices resulted in the risk that recommendations would be unsuitable for the client.

Disclosure of commissions and charges

- 4.16. During the Relevant Period, Falcon obtained inducements from third parties for the stocks sold by MPS to its clients. After following advice from its compliance consultants obtained during the Relevant Period, Falcon did not have a mechanism to notify clients of these inducements. However, in June 2008 MPS included a line on its contract note stating that *“Falcon may have received a commission from a third party in relation to this transaction”*. This was insufficient to inform clients of the extent of the inducements it received from selling stocks. There is a risk that this information may have affected how clients assessed MPS’s recommendations.

Providing recommendations paying due regard to risks

- 4.17. Falcon was required to take reasonable steps to ensure that MPS clients understood the shares being sold to them, including the nature of the associated risks.
- 4.18. MPS clients were provided with generic risk warnings about small cap shares as part of the client take-on process. MPS also provided its advisers with sales scripts for use when recommending stocks to clients. These contained a mandatory risk warning describing the general risks associated with small cap investments. The sales scripts also contained a list of risks which were specific to the stock being sold, including business, financial and political risks.
- 4.19. However, MPS did not ensure that its advisers communicated fairly those risks to its clients. In nine out of 38 recommendations, stock specific risks were not communicated at all, despite the benefits of the stock being emphasised. In 25 recommendations, the risks were undermined by the adviser seeking to caveat the risk. It was not until after the Relevant Period that the advisers were stopped from doing this. Consequently, many calls only contained information about the benefits of the shares, potentially providing a misleading impression of the risks of the securities.
- 4.20. Falcon’s failure to implement an effective control mechanism for ensuring that clients were provided with sufficient information about the investment being recommended

to them meant that there was a risk that clients were not made aware of the risks associated with the recommended investment.

Providing information about the liquidity of the stocks

- 4.21. The small cap shares sold by MPS generally had a low normal market size. This could mean that clients could experience difficulty in quickly selling their shares at the quoted price if they bought shares in excess of this size. Out of the 38 transactions reviewed by the FSA, 35 clients purchased more than the normal market size in a share, with ten instances noted where the clients purchased over ten times the normal market size. Following advice received by external compliance consultants, clients were not warned about this in their telephone calls. There was no process in the Relevant Period to warn clients that the recommended shares were in excess of the normal market size, and the potential implications of this.

Sales practices

- 4.22. MPS failed to have appropriate management and control systems, in particular adequate compliance monitoring processes, to prevent its advisers from using sales techniques that were unfair to its clients.
- 4.23. In 18 of the 38 transactions reviewed by the FSA, the adviser gave the client the impression that there was a need to move quickly to purchase shares, including suggesting that the firm had a limited allocation of shares which were already selling fast and could be sold out by the end of the day. Although it is possible that that they could have been sold out, analysis actually showed MPS continued to recommend the shares to other clients for several days after the recommendation.
- 4.24. Furthermore, in 12 out of 38 cases the adviser suggested to the client that the transaction in question would be their “last trade”. However, 11 of these clients were later sold further shares by MPS demonstrating that the advisers did not intend to keep to this statement. This inappropriate suggestion that a recommendation would be the last transaction for the client may have been stated to encourage the client to buy the stock.

Management and Controls

- 4.25. Senior management at Falcon recognised some of the risks involved in making telephone recommendations for high risk shares to retail clients.
- 4.26. However, as set out below, the Firm failed to take reasonable steps to establish and maintain an adequate risk management system to monitor and manage the risks of MPS.

Reward and remuneration systems

- 4.27. MPS failed to ensure that the reward and remuneration systems operated effectively and to act on indications of non-compliance on a timely basis.
- 4.28. MPS offered a basic salary plus commission. The basic salary ranged from £15,000 for trainee advisers to £27,000 for senior advisers. The commissions ranged from 3% to 5% of deal value, with the commissions being received by the advisers once they had achieved a certain level of sales. This reward for sales volume, if uncontrolled, risked advisers pursuing sales at the expense of client suitability. This was made worse by MPS offering commission for selling small cap stocks which was considerably higher than the advisers received for selling Main Market stocks. There was therefore a significant financial incentive for MPS advisers to sell small cap shares in favour of Main Market stocks. It was not until after the Relevant Period that the advisers received the same level of commission on all the stocks sold.
- 4.29. To mitigate the possible inappropriate incentives this may have caused, MPS introduced a fining policy in January 2008 as a form of sanction for advisers who did not follow procedure. This fining policy meant that advisers would lose commission for a number of compliance failures, which would be identified by MPS's compliance monitoring processes.
- 4.30. Senior managers at MPS were provided with the results of this compliance monitoring, including the number of calls reviewed, the advisers concerned and whether the advisers had been fined. This management information showed that there were a number of advisers, including the team leaders at MPS, who were being

repeatedly fined each month for the same breaches. Therefore it should have been apparent to MPS that its disciplinary procedures were not preventing misconduct.

5. ANALYSIS OF BREACHES

Principle 9

- 5.1. By reason of the facts and matters set out in paragraphs 5.2 to 5.3 below Falcon failed to take reasonable care to ensure the suitability of advice to those clients who were entitled to rely upon its judgment in breach of Principle 9.

Failure to obtain sufficient client information to assess suitability

- 5.2. In failing to obtain sufficient client information to assess suitability, there was a significant risk that clients were recommended shares that did not suit their financial circumstances and needs.

Failure to appropriately consider client information

- 5.3. By disregarding information from MPS clients that they could not afford to buy, or did not wish to buy, additional securities, Falcon failed to ensure that its recommendations were suitable for its clients, given their stated financial circumstances.

Principle 7

- 5.4. By reasons of the facts and matters set out in paragraphs 5.5 to 5.6 below, Falcon did not pay due regard to the information needs of MPS's clients, and did not communicate information to them in a way which is clear, fair and not misleading in breach of Principle 7.

Failure to adequately disclose all commissions and charges

- 5.5. By failing to disclose the nature or amount of any other income receivable and attributable to the shares sold to MPS clients, Falcon failed to pay due regard to the information needs of its clients.

Failure to provide a recommendation paying due regard to risks

- 5.6. By failing to mention the risks of particular stocks and by undermining or rushing the generic risk warnings that were given, MPS clients were provided with inadequate and unclear information which distorted the balance and content of the recommendation and risked misleading clients. MPS advisers also failed to provide adequate information about the liquidity of the shares they were recommending, particularly in instances where the client was being recommended share purchases significantly in excess of the normal market size for the stock, although the risk warnings which were given followed advice from external compliance consultants. Falcon therefore failed to take reasonable steps to ensure that MPS clients understood the nature of the risks inherent in its transactions.

Principle 6

- 5.7. By reasons of the facts and matters set out in paragraphs 5.8 to 5.9 below, MPS failed to pay due regard to its clients' interests, in breach of Principle 6:

Use of inappropriate sales practices

- 5.8. Falcon failed to supervise MPS sufficiently to ensure that MPS treated its clients fairly by:
- (1) suggesting to clients that they needed to make a quick decision in relation to a trade; and
 - (2) incorrectly suggesting to clients that if they agreed to a purchase it would be their last trade, potentially placing pressure on them to agree to the purchase.
- 5.9. Therefore clients were unfairly led or pressured into making investment decisions.

Principle 3

- 5.10. By reasons of the facts and matters set out in paragraphs 5.11 to 5.12 below, Falcon did not take reasonable care to organise and control the affairs of MPS responsibly and effectively, in breach of Principle 3.

Establishing a reward and remuneration system and sales driven environment that risked advisers putting the interests of MPS and Falcon ahead of the interests of clients

- 5.11. Falcon failed to implement strong countervailing controls, including disciplinary measures, to mitigate the risk that MPS's commission structure and pressurised environment could detrimentally effect how its clients were treated.
- 5.12. The FSA considers that, in addition to Falcon's breaches of the Principles, Falcon has also failed to comply with certain provisions of the Conduct of Business Rules ("COBS") as set out in Annex 1 to this Notice.

6. ANALYSIS OF SANCTION

- 6.1. The FSA's policy on the imposition of public censures is set out in Chapter 6 of DEPP, which forms part of the FSA Handbook and came into force on 28 August 2007. This manual sets out the factors that may be of relevance in determining whether it is appropriate to impose a public censure. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.
- 6.2. The FSA considers that the following factors are particularly relevant in this case.

The nature, seriousness and impact of the breach

- 6.3. In determining the appropriate sanction, the FSA has had regard to the seriousness of the contraventions, including the nature of the breaches, the number and duration of the breaches, and the number of clients who were exposed to risk of loss. For reasons set out at paragraph 2.4 above the FSA considers that the breaches identified in this case are of a serious nature.
- 6.4. It is noted that MPS and Falcon generated gross revenues of approximately £2.4m from the sale of retail securities in the Relevant Period.

The extent to which the breach was deliberate or reckless

The FSA has considered the extent to which Falcon's actions were reckless or deliberate. The FSA has determined that Falcon has not deliberately contravened regulatory requirements.

The size, financial resources and other circumstances of the firm

- 6.5. In determining the imposition of a public censure, the FSA has been mindful of the size and financial resources of the Firm. The Firm has undertaken to cease selling investments to clients and is in administration.

Conduct following the breach

- 6.6. After Falcon was informed by the FSA of its concerns it co-operated with the FSA. It has also agreed to write to all of its relevant current and former clients to inform them of the FSA's findings and the administration.

Disciplinary record and compliance history

- 6.7. Falcon has not previously been the subject of disciplinary action by the FSA.

Other action taken by the FSA

- 6.8. In determining whether to impose a public censure, the FSA has taken into account action taken by the FSA on other authorised persons for similar behaviour.

7. CONCLUSIONS

- 7.1. In light of the matters set out above, the FSA has concluded that Falcon breached the FSA's Rules and Principles for Business in relation to advising on and arranging the sale of higher risk securities to clients of MPS. The FSA therefore would have imposed a penalty of £240,000 on Falcon, were it not for the fact that the Firm has undertaken to cease selling investments to clients and is in administration.

8. DECISION MAKER

- 8.1. 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.

9. IMPORTANT

- 9.1. This Final Notice is given to you in accordance with section 390 of the Act.

Publicity

- 9.2. 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.

FSA contacts

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

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Georgina Philippou

for and on behalf of the FSA

Annex 1: Relevant FSA Rules

COBS 2.3.1R

A firm must not pay or accept any fee or commission, or provide or receive any non-monetary benefit, in relation to designated investment business or, in the case of its MiFID or equivalent third country business, another ancillary service, carried on for a client other than:

- (1) a fee, commission or non-monetary benefit paid or provided to or by the client or a person on behalf of the client; or
- (2) a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, if:
 - (a) the payment of the fee or commission, or the provision of the non-monetary benefit does not impair compliance with the firm's duty to act in the best interests of the client; and
 - (b) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, is clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, before the provision of the service;

COBS 4.5.2R

A firm must ensure that information:

- (1) includes the name of the firm;
- (2) is accurate and in particular does not emphasise any potential benefits of relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks;
- (3) is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received; and
- (4) does not disguise, diminish or obscure important items, statements or warnings.

COBS 9.2.1R:

- (1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.
- (2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:
 - (a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;
 - (b) financial situation; and
 - (c) investment objectives;

so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.

COBS 9.2.2R

- (1) A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:
 - (a) meets his investment objectives;
 - (b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and
 - (c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

(2) The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

(3) The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

COBS 9.2.6R

If a firm does not obtain the necessary information to assess suitability, it must not make a personal recommendation to the client or take a decision to trade for him.