Financial Services Authority

FINAL NOTICE

To:	**Gracechurch Investments Limited (In Liquidation)**
Address:	**c/o The Official Receiver's Office** **2nd Floor** **4 Abbey Orchard Street** **London** **SW1P 2HT**
FSA Reference Number:	**474151**
Date:	**20 December 2012**

ACTION

1. The FSA gave Gracechurch Investments Limited (In Liquidation) ("**Gracechurch**" and the "**Firm**") a Decision Notice on 11 October 2012, which notified it that the FSA had decided to issue a public censure of Gracechurch pursuant to section 205 of the Financial Services and Markets Act 2000 (the "**Act**") in respect of Gracechurch's breaches of the FSA's:

   (1) Principles for Business ("**Principles**") 1, 3, 7 and 9;

   (2) Conduct of Business Sourcebook ("**COBS**"); and

   (3) Senior Management Arrangements, Systems and Controls sourcebook ("**SYSC**");

   between 1 April 2008 and 4 November 2009 (the "**Relevant Period**"). The public censure will be issued on 20 December 2012 and will take the form of this Final Notice, which will be published on the FSA's website.

2. The FSA has also decided (for the reasons set out below), to cancel the permission granted to Gracechurch pursuant to section 45 and Part IV of the Act ("**Gracechurch's Part IV permission**"), as notified in the same Decision Notice.

3. The Firm's liquidator has not referred either of these decisions to the Upper Tribunal (Tax and Chancery Chamber) within the time required.

4. Accordingly, for the reasons set out below, the FSA hereby:

   (1) issues this public censure of Gracechurch; and

   (2) cancels Gracechurch's Part IV permission.

5. The Official Receiver is acting as Gracechurch's liquidator. The FSA has been informed by the Official Receiver that the Firm is not only insolvent but has no assets whatsoever, such that any financial penalty imposed on the Firm would not be paid to any extent.

6. Were it not for Gracechurch's financial circumstances, the FSA would (for the reasons set out below) have imposed a financial penalty of £1.5 million on the Firm in respect of the breaches described below.

REASONS FOR THE ACTION

7. Gracechurch was a stockbroking firm, with its offices in the United Kingdom, directly authorised by the FSA from 1 April 2008, which advised individual clients as to their investments in the shares of small companies ("**small-cap stock**"), either unlisted or listed on the London Stock Exchange's Alternative Investment Market ("**AIM**") or the PLUS Stock Exchange. Gracechurch is now in liquidation, having ceased business on or about 2 February 2010.

8. Sam Thomas Kenny was a director and the chief executive of, as well as a broker at, the Firm. He was approved by the FSA in those roles, as well as its majority shareholder, during the entire Relevant Period. Carl Peter Davey was the Firm's compliance officer, approved by the FSA in that role, from 15 October 2008 and for the rest of the Relevant Period.

9. Gracechurch breached Principle 1 (a firm authorised by the FSA, should conduct its business with integrity) of the Principles during the Relevant Period by:

   (1) regular and organised pressure selling of small-cap stock, on an advised basis, as well as regular oral misrepresentations and knowingly misleading advice in relation to that stock, including by Mr Kenny personally, to its clients;

   (2) the deliberate withholding, by Mr Kenny and Mr Davey, of a recording of a particular call with a client. The recording of the call had been specifically requested by the FSA because it evidenced non-compliant advice being given to that client;

   (3) knowingly or recklessly failing adequately to disclose a conflict arising from the ownership of shares, by Mr Kenny and other persons employed by or connected with the Firm, in one of the companies whose small-cap stock the Firm, including Mr Kenny personally, advised clients to buy (and Mr Kenny's denial to the FSA that he gave such advice);

(4) knowingly or recklessly breaching its own procedures, regarding additional advised sales of that small-cap stock, at a higher price, without consideration by anyone at the Firm;

(5) the employment of an individual in a significant influence controlled function role at the Firm for approximately a year during the Relevant Period despite:

(a) withdrawing the Firm's application for FSA approval of that individual in that role, in the light of his connection with an FSA investigation into his previous employer; and

(b) knowing for much of that year that he was responsible for the unacceptable pressure sales culture at his previous employer and that he was actively maintaining the same culture at the Firm;

(6) the deliberate vetoing by Mr Kenny of a proposal by Mr Davey that the firm send out a questionnaire to clients aimed at establishing its compliance with the FSA's requirement that it treat its clients fairly; and

(7) the provision to the FSA of knowingly false dates of internal committee meetings at which the Firm had purportedly considered whether it was suitable to promote and advise clients to buy particular small-cap stock, minutes of which meetings Mr Kenny was prepared to forge if they were requested by the FSA.

10. Gracechurch breached Principle 3 (a firm authorised by the FSA, should take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems) of the Principles and SYSC during the Relevant Period by:

(1) failing to review any of the Firm's invitations or inducements to buy shares (termed "**financial promotions**" under the Act) and other written communications (also used as broker scripts) in relation to the small-cap stock it recommended, for compliance with relevant FSA requirements, during the period 1 April 2008 to 15 October 2008;

(2) failing to make clear within the Firm who was responsible for the review of the substance of such communications and promotions for such compliance during the period 15 October 2008 to 4 November 2009, with the result that there was no such review;

(3) failing to review recordings of initial suitability assessment calls with clients (for compliance) sufficiently or, during much of the Relevant Period, at all;

(4) failing to carry out organised or adequate broker advice call monitoring for compliance during the period 1 April 2008 to 15 October 2008;

(5) failing to recruit sufficiently qualified and experienced staff to carry out such monitoring or alternatively to train them sufficiently and give them adequate checklists to do so, with the result that it was ineffective;

(6) failing to take adequate account of the results of advice call monitoring through remedial action;

(7) failing to monitor, for most of the Relevant Period, whether the Firm's brokers' advice to clients to purchase small-cap stock was leading those clients to breach their risk capital limits, as agreed between clients and the Firm, therefore rendering such advice unsuitable; and

(8) remunerating brokers primarily on the basis of the volume of their sales, with little regard to the quality of their advice and their compliance with relevant requirements, thereby substantially increasing the risk that brokers would give unsuitable advice.

11. Gracechurch breached Principle 7 (a firm authorised by the FSA, should pay due regard to the information needs of its clients and communicate information to them in a way that is clear, fair and not misleading) of the Principles and COBS during the Relevant Period by:

(1) making regular serious misrepresentations in its communications and financial promotions to clients as to material features of the small-cap stock in question;

(2) failing, as a matter of course, to give generic risk warnings to clients in relation to the small-cap stock the Firm recommended until clients had agreed to buy it and then in any case undermining such warnings by the manner in which they were given; and

(3) its brokers generally failing to inform clients that they would exceed or had exceeded their risk capital limits, as agreed with the Firm, by buying small-cap stock on the basis of the Firm's advice.

12. Gracechurch breached Principle 9 (a firm authorised by the FSA, should take reasonable care to ensure the suitability of its advice) of the Principles and COBS during the Relevant Period by:

(1) significantly mis-describing the investment strategies and objectives it asked new clients to choose, with the result that they agreed to take on more risk than they intended;

(2) its brokers often advising clients to buy small-cap stock even where that would breach their risk capital limits, as described above; and

(3) assessing 20% of each client's net liquid assets as available to purchase high risk small-cap stocks, without any agreement with clients or any client-specific assessment (during the period 1 April 2008 to 15 October 2008).

13. As Gracechurch ceased business on or about 2 February 2010, the FSA considers that the Firm has failed to conduct any regulated activity to which its permission relates for a period of at least 12 months. As a result, and having regard to its regulatory objectives, the FSA decided to cancel Gracechurch's Part IV permission as set out in section 45 of the Act.

RELEVANT STATUTORY AND REGULATORY PROVISIONS

14. The relevant statutory provisions and regulatory requirements are set out in the Annex to this notice.

FACTS AND MATTERS RELIED ON

Broker and client numbers, client losses, transaction volumes, financials and reasons for insolvency

15. Gracechurch had a total of 35 individuals approved as brokers by the FSA during the Relevant Period. The Firm had an average of 15 to 20 individuals operating as brokers at any one time. Those brokers made advised telephone sales to customers, with one small-cap stock also being sold on an advised basis in face-to-face meetings.

16. During the Relevant Period, Gracechurch advised approximately 340 clients to buy about £4 million of small-cap stock. The Firm received the majority of its revenue in the form of corporate finance commissions from the companies whose shares it advised its clients to buy.

17. As to the top ten shares, by financial volume, that the Firm advised its clients to buy in the Relevant Period, no current price is available for two. As to the other eight, the Firm's clients would have lost 72% of the amount they invested (a loss of £1.901 million on £2.624 million invested) had they held those eight shares from the date they invested till 12 October 2011, the Firm's recommended holding period being generally two to five years.

18. Some clients sold a small proportion of those eight shares before the Firm ceased trading, but in such low volumes as not to undermine this 72% loss assessment. Given the significant financial volume of sales of these eight shares, as a proportion of the Firm's overall £4 million approximate sales total, the FSA considers that this 72% is representative of the losses applicable to all client investments through the Firm in the Relevant Period.

19. By comparison, between the beginning of the Relevant Period and close of markets on 11 October 2011:

    (1) the FTSE 100 Index fell by 7.8%;

    (2) the FTSE SmallCap Index fell by 9.3%;

    (3) the FTSE Fledgling Index rose by 16.6%; and

    (4) the FTSE AIM All-Share Index fell by 26.4%.

20. The Firm made an audited operating loss of £8,066 for the year to 31 January 2009 on turnover of £1.045 million, from which it paid wages and salaries of £426,388 and consultancy fees of £325,354, of which latter figure £169,435 went to a company controlled by Mr Kenny. The FSA believes that Mr Kenny was additionally paid at least £7,196 in other remuneration by the Firm during the same financial year.

21. The FSA does not have comparable figures for the rest of the Relevant Period but, according to Mr Kenny's report to the Official Receiver in relation to the Firm's liquidation, the Firm's income dropped by 90% after it started, in September 2009, using a compliance consultant to review its processes and procedures and all its ongoing advice.

22. Gracechurch appointed the compliance consultant in the light of the feedback the Firm received from the FSA in August 2009 after an FSA thematic visit in May 2009 that led to the FSA's current investigation and this notice. According to Mr Kenny's report to the Official Receiver, it was that 90% drop in income that led to the Firm's insolvency.

23. Having regard to the above, even allowing for recommendations by the Firm that may have led to losses without any breach of the FSA's requirements, the FSA considers that Gracechurch's misconduct during the Relevant Period caused at least £2 million in client losses.

Pressure sales

FSA sample review

24. The FSA has reviewed a sample of advice given by Gracechurch leading to client purchases of nine small-cap stocks, with sales chosen to cover as many of the Firm's brokers and as much of the Relevant Period, from July 2008 to September 2009, as possible and to focus on the largest transactions in each stock.

25. The sample covered ten purchases by eight clients ("**Sample Customers**"), advised by ten of the Firm's brokers. The review involved listening to recordings of relevant calls on which suitability information was gathered and advice was given, rather than face-to-face, and taking evidence from those clients who had relevant face-to-face meetings, or where call recordings were not available.

26. Deal calls reviewed by the FSA involving six of the eight Sample Customers evidence pressure selling techniques. Specifically, the review showed that Gracechurch's brokers:

    (1) persistently ignored refusals by several clients to buy stock – a technique used by Mr Kenny personally in relation to at least one client, which Mr Davey has acknowledged amounted to pressure-selling on Mr Kenny's part;

    (2) made calls day after day to clients in relation to particular small-cap stock until the clients were persuaded to purchase, which Mr Davey has again acknowledged amounted to pressure-selling;

(3) ignored clients' protests that they did not have any funds to invest;

(4) ignored or brushed off client requests for information in relation to the stocks in question or for time to conduct their own due diligence;

(5) pressured clients to buy more stocks than they had said they were willing to;

(6) lied to at least one client about the amount other clients were investing;

(7) told at least one other client that the Firm's recommendation was based on inside information; and

(8) sent at least two clients financial promotions and/or prospectuses in relation to stocks the clients had already refused to buy.

Compliance consultant's sample review

27. Gracechurch appointed a compliance consultant after the FSA thematic visit that led to the FSA's investigation into the Firm. The compliance consultant conducted its own review of recordings of 17 of the Firm's advised sale calls occurring in the three months immediately after the FSA's thematic visit.

28. The compliance consultant identified further pressure sales, even after that visit, in relation to two additional clients of the Firm in the Relevant Period, describing:

(1) one as "*extremely pressured*"; and

(2) another as involving a broker "*hell bent on making a sale*" to a client who had, after an operation, just come out of hospital that day, stated he was "*broke*", refused to buy but was eventually persuaded to change his mind.

Mr Kenny's wider role

29. Mr Kenny, in addition to his personal engagement with clients, also, as the Firm's chief executive:

(1) trained the Firm's other brokers how to overcome client objections to buying stock;

(2) told at least one of the Firm's brokers that, if a client said that they had no money to buy stock, the broker should suggest that they sell other stock and reinvest the proceeds in the stock the Firm was then promoting; and

(3) on at least one occasion, informed all Firm staff by email that only brokers who had "*dealt that morning*" could attend a particular Firm lunch, despite the fact that the Firm was giving advice to clients and its responsibilities to ensure the suitability of that advice.

Misrepresentations and misleading advice to clients

30. The FSA reviewed the Firm's promotional documents for each of the small-cap stocks included in the sample review referred to above, checking whether those documents accurately relayed the financial position of the small-cap stock, and identified call recordings where information from those promotional documents was provided to customers.

31. The promotional documents for four of the nine small-cap stocks contained material misrepresentations of the financial position of the stock.

32. In addition, in recorded calls the brokers made statements which misrepresented material financial features of and comparators with the small-cap stock they were advising clients to buy. Specifically:

    (1) one broker misleadingly cited performance announcements by FTSE 100 listed companies as reasons to buy small-cap stock;

    (2) the same broker misleadingly cited the share price performance of a listed company as a reason to buy shares in an unlisted private company;

    (3) one broker simply misrepresented the recent price performance of a specific small-cap stock;

    (4) Mr Kenny told two clients that unlisted companies whose stock the Firm was promoting would list when that was by no means certain; and

    (5) Mr Kenny also told one of those clients that Gracechurch would in future almost certainly buy back, at a profit to the client, the small-cap stock Mr Kenny was advising him to buy. However, there was no obligation on the Firm to do so.

33. Further:

    (1) the FSA's review revealed one broker advising at least one client to cash in a unit trust investment to buy small-cap stock; and

    (2) Gracechurch identified, through the inadequate call recording monitoring that it carried out in the Relevant Period, that its brokers were often misleading clients in the way they advised them to buy small-cap stock, but the practice continued.

Withholding of call recording

34. The FSA requested from the Firm on 6 May 2009 copies of broker call recordings relating to a specific sale of a small-cap stock in a particular company to a specific client, Mr S.

35. One recording was on the Firm's system at the time. It evidenced an employee of the Firm who was not approved by the FSA inappropriately recommending that small-cap stock to Mr S.

36. That recording was never supplied to the FSA. Mr Davey repeatedly asserted to the FSA in writing that it could not be found or that it had never been made. As Mr Davey and Mr Kenny have since admitted, they, in fact, deliberately decided to withhold this call recording from the FSA.

Conflicted advice

37. In or about March 2009, at least two clients were supplied by the Firm with an information memorandum ("**IM**"), produced by and in relation to shares in a particular small-cap company being recommended by the Firm at 1p per share.

38. That IM disclosed that several persons, including Mr Kenny, were shareholders in the small-cap company in question and how many shares they held. The IM did not, however, identify those persons' links to the Firm.

39. Further, Mr Kenny, who had been allotted his shares in the small-cap company at only 0.001p per share, attended meetings with clients at which the Firm, and Mr Kenny, recommended the stock and provided clients with copies of the IM.

40. Mr Kenny recognised his personal conflict by recusing himself from voting at the meeting of the Firm's relevant committee at which it was decided that the stock was suitable to be promoted to clients on an advised basis at 1p per share.

41. The FSA considers that Mr Kenny knew or should have known that the IM should have but failed to fully disclose the positions at Gracechurch that he and other shareholders in this company held.

42. Mr Kenny then assured the FSA in writing in August 2009 that "*no conflicted persons were involved in the advisory process*" in relation to this stock. This was untrue and Mr Kenny must have known this was untrue.

43. After the FSA's thematic visit and after the resulting initial FSA feedback, the Firm amended its conflicts policy from 1 June 2009, so as to require that at least two persons with no relevant conflict should attend any such committee meeting and no conflicted person could vote at such a meeting.

44. Despite this amendment to its conflicts policy in light of the FSA's initial feedback, Gracechurch, in August and September 2009, promoted the same stock in a second round of advised sales, this time at 3p per share, three times the previous price, but had no relevant committee meeting, in breach of its own procedures.

45. Mr Kenny has been unable to explain how the decision to undertake the second round of advised sales was made by the Firm. He has conceded that whoever decided that the Firm should promote and advise clients to buy the stock at 3p per share was conflicted, in further breach of the Firm's own procedures, and that that breach was his responsibility.

46. Further to the FSA's final feedback after the thematic visit, Gracechurch cancelled all such 3p sales. It refunded £13,350 in cash to some of the clients

who had paid for such stock at 3p. It advised other such clients to reinvest further such refunds in other small-cap stock rather than take them in cash.

Questionnaire veto

47. Mr Davey suggested to Mr Kenny, when the former first joined Gracechurch that the Firm should, in accordance with relevant specific FSA guidance published in June 2008, send out a questionnaire to clients intended to identify whether it was treating them fairly. Mr Kenny vetoed this proposal.

48. The FSA considers that Mr Kenny vetoed the questionnaire to prevent clients being prompted to complain about the way they had been treated by the Firm.

Employment of unapproved SIF holder

49. Gracechurch applied in September 2008 for FSA approval of an individual at the Firm as a senior manager with significant responsibility for its business. Such a role is categorised by the FSA as a significant influence function ("**SIF**"). Persons approved in SIF roles have extra obligations (beyond those of persons approved in other functions) under the FSA's Handbook.

50. By December 2008, if not earlier, the Firm, including Mr Davey and Mr Kenny, had become aware that that individual was linked to an ongoing investigation by the FSA into his previous employer. The Firm therefore withdrew the application in December 2008, by notice to the FSA.

51. That notice, signed by Mr Davey and of which the FSA believes Mr Kenny was aware, expressly referred to that investigation and was sent to the FSA on the basis that the Firm would reapply once "*events have unfolded fully and been brought to a satisfactory close*".

52. The investigation in question concluded after the Relevant Period and the Firm never reapplied for that approval in relation to that individual but nevertheless continued to employ him for at least eight months as primarily responsible for broker recruitment and responsible alongside Mr Kenny for broker training.

53. Further, while at the Firm, the individual in question, by email copied to Mr Kenny, on at least one occasion, threatened all brokers with disciplinary action if they failed to reach monthly advised sales volume targets.

54. Mr Davey has conceded that, given the withdrawal, the individual "*had too much of a role in running the floor*" and has also stated that he raised concerns with Mr Kenny at the possibility that the individual was transplanting the pressure sales culture of his previous employer to Gracechurch.

55. The FSA considers that that individual was performing the SIF role in respect of which the Firm had applied to the FSA for approval, until approximately September 2009, if not later. This was a breach by the Firm of section 59(1) of the Act.

56. Further (and quite apart from Mr Davey's warnings), the Firm employed that individual despite Mr Kenny at least knowing, by December 2008 that the FSA's concerns were well-founded and that that individual had in fact been responsible for creating the pressure sales culture at his previous employer. Mr Kenny has admitted to the FSA that the decision to recruit the individual was "*a bad one*".

False committee meetings

57. The FSA asked Gracechurch, on 8 September 2009, to provide the dates, since the FSA's thematic visit of 19 May 2009 referred to above, on which the committee of the Firm, which was, as described above, responsible for considering whether to promote and advise clients to buy particular small-cap stock, had met.

58. By letter dated 11 September 2009, lawyers for the Firm informed the FSA that such meetings had occurred on 4 and 8 June, 1, 17 and 27 July and 10 August 2009 but the FSA has been unable to identify, in the large number of the Firm's electronic and other documents it subsequently obtained, any evidence that such meetings took place other than on 4 June and 1 July 2009.

59. However, a recording of a call between Mr Kenny and a third party on 11 September 2009 indicates clearly that Mr Kenny knew that there was no such meeting on 8 June, 17 or 27 July or 10 August 2009. Nonetheless, Gracechurch through its lawyers, represented to the FSA otherwise and the FSA considers that the Firm's lawyers did so on Mr Kenny's instructions. Indeed the recording also shows that Mr Kenny and the third party:

    (1) deliberately picked those false dates so as to be able to say that the committee met to discuss specific stocks; and

    (2) were prepared, if the FSA requested copies of relevant minutes, to forge those minutes.

Communications and financial promotions

60. Before October 2008, no-one at Gracechurch reviewed its written communications or financial promotions in relation to the small-cap stock it recommended to ensure compliance with the FSA's relevant requirements, under both Principle 7 and COBS.

61. Thereafter, while the risk warnings and disclosures in those communications and financial promotions were reviewed for such compliance, their substance was not. Mr Kenny claims to have believed that Mr Davey was responsible for review of that substance and vice versa.

62. Whether as a result or otherwise, those communications and financial promotions, which were prepared by an external consultant and sent out to clients and/or used as the basis of scripts for broker calls to clients, regularly contained significant material inaccuracies and omissions in relation to the small-cap stocks they covered. Mr Davey has admitted that the Firm's clients were, as a result, systematically misled.

63. On the basis of an FSA sample review, the FSA considers the following to be indicative of Gracechurch's general practice during the Relevant Period:

(1) One of the Firm's communications/financial promotions in relation to a particular company failed to disclose, as had been publicly reported in the press the day before the communication/promotion was dated, that one of the company's significant newly-acquired businesses, referred to by name in the communication/promotion, had ceased to trade.

(2) The Firm's separate script for broker calls to clients in relation to that company failed to note that its most recent unaudited accounts, then nine months old, showed that the company had made a six-month loss of £258,000, while a communication/promotion produced by the Firm a month later, to be sent to clients in relation to the same company, revealed that fact.

(3) One of the Firm's communications/promotions, sent to clients, revealed that another company's last public audited accounts showed creditors and corporation tax payable, treated as liabilities in those accounts, of £163,000, while a broker call script, produced at the same time about the same company, failed to reveal as much.

(4) Communications/promotions produced by the Firm in relation to a third company asserted that it was also debt-free, when in fact that was not the case, and failed to reveal that the company had just made aggregate losses, in just over a year, of almost £1.6 million, both of which facts the Firm knew from documentation supplied to it by the company. Mr Kenny has accepted that clients could have been confused.

(5) In respect of a fourth company:

(a) A broker call script, produced by the Firm in April 2009, stated that the company had "*been consistently profitable and [had] a debt-free balance sheet*".

(b) A contemporaneous communication/promotion sent to clients by the Firm in respect of the same company admitted that, because the company had produced no interim balance sheet for the six months to July 2008, and no financial results since, it was "*difficult ... to gauge the strength of [the company's] balance sheet*".

(c) The latter document failed to add that the company's last public audited accounts, to January 2008, showed current creditors of £147,414.

(d) That communication/promotion also stated that the company's unaudited interim profit for the six months to July 2008 was £2,898, without disclosing public audited pre-tax losses for the year to January 2008 of £190,945.

Stock advice risk warnings

64. From a review of the sample calls referred to above in which clients not only received advice from the Firm's brokers but also agreed to buy small-cap stock, six out of seven calls, involving sales to four clients, contained no generic risk warnings until after the client had agreed to buy. The seventh involved no such risk warning at all.

65. Mr Davey has admitted that it was the Firm's standard practice to give generic risk warnings at the end of sales advice calls. Further, the FSA's sample review indicates that when given, such risk warnings were often further undermined by broker references to them being "*quick*" or "*standard*" and by being rushed.

Risk capital limits

66. When taking on each new client, at least from about October 2008, the Firm agreed with them their risk capital limits, set by reference to the risk categories of the investments they held and the value of investments in each risk category they held as a proportion of their overall net liquid assets. Those limits changed when clients submitted new figures in respect of those assets and/or the Firm reviewed initial suitability data with clients.

67. The Firm did not, however, then prevent brokers recommending small-cap stocks to clients where their purchase would breach such clients' risk capital limits. Nor did the Firm require brokers to warn clients that they would exceed their risk capital limits by buying particular stocks.

68. Only from July 2009, 15 months after the Firm became directly authorised by the FSA, were transactions retrospectively checked to monitor risk capital limits and clients then contacted to be told that they had exceeded their limits and could cancel relevant transactions or increase their limits.

69. Before that date there was no real monitoring of client risk capital limits, in breach of the Firm's own procedures, with the result that at least some clients were advised by the Firm to buy (and did buy) small-cap stock despite those transactions taking them over their risk capital limits.

70. Further, before October 2008, the Firm appears merely to have decided that 20% of each client's net liquid assets could be used to buy high risk small-cap stocks, with no agreement with the client in this regard nor any differentiation by reference to each client's specific circumstances, objectives and risk tolerances.

Client-specific suitability assessments

71. Gracechurch misdescribed the investment strategies and objectives it asked new clients to choose from/between. Specifically, from October 2008, after Mr Davey these criteria:

    (1) they specified that a client choosing a conservative growth investment strategy had:

(a) the objective of "*significantly*" increasing the capital value of his or her portfolio; and

(b) a willingness to take "*high*" overall risk such that "*capital returns may be negative over short to medium time horizons*"; and

(2) the Firm classified three out of four of the clients, whose files the FSA reviewed as part of the sampling exercise referred to above and who had stated that their investment objectives were such that they were willing to accept a "*balanced level of risk*", as willing to accept the high level of "*overall risk*" just described.

72. Mr Kenny approved the updated criteria. Subsequently, Gracechurch's compliance consultant advised the Firm that these criteria were confusing and inconsistent but only at the end of the Relevant Period did the Firm recognise as much and attempt to resolve the issue.

Call recording monitoring

73. Gracechurch failed to carry out either advice or initial suitability assessment call recording monitoring in an organised or adequate manner before October 2008 and the FSA has not found nor been presented with any records of such monitoring.

74. Thereafter the Firm failed to monitor more than a very small proportion of initial suitability assessment call recordings and none from January 2009, despite its procedures previously stating that it aimed to monitor 20% of them.

75. Further, the Firm's procedures did not require any remedial action, for example that clients be contacted, if call recording monitoring identified that these initial suitability assessment calls were inadequate, nor did such inadequate initial suitability assessment calls impact broker remuneration.

76. As to the monitoring of recordings of calls in which brokers gave clients advice, this was carried out largely by staff who were unqualified, untrained and/or insufficiently experienced to do so and who were given, as Mr Davey has conceded, inadequate checklists to use to carry out their task, with the result that:

(1) at least on some occasions that the FSA has identified, these staff passed calls which clearly failed the Firm's own criteria and Mr Davey has recognised that that was inappropriate;

(2) the criteria used in the checklist were not weighted, until after the FSA's feedback following the thematic visit referred to above, so significant failings did not count as more problematic than more minor issues;

(3) although advice call monitoring did lead to transactions being failed, the Firm neglected to take sufficient corresponding remedial action to correct the failings with clients until prompted by FSA feedback at or after the thematic visit; and

(4) the Firm's compliance consultant assessed all of the call monitoring staff employed by the Firm in 2009, other than Mr Davey himself, as incompetent in that monitoring role.

Broker remuneration

77. The Firm's brokers were paid a base salary of only £15,000 plus commission on the gross value of sales made, with the result that their remuneration was heavily commission-based. That commission was calculated almost exclusively by reference to the financial volume of sales made, despite almost all those sales being advised.

78. The Firm's broker remuneration structure, which was partly designed by Mr Kenny, with Mr Davey's input, only took some account of the results of advice call monitoring and was insufficient in that:

    (1) it was not retroactive, rather applying to future commission;

    (2) the scoring of calls was flawed in that it did not sufficiently reflect their quality - for example, a small number of calls assessed as significant failures balanced against a large majority of calls would lead to no adverse impact on remuneration;

    (3) no account was taken of the relative financial volume of sales resulting from failed calls; and

    (4) no account was taken of call monitoring scores when the Firm considered broker promotion, which promotion gave brokers access to better quality leads and more lucrative existing clients.

Ceased business

79. As Gracechurch ceased business on or about 2 February 2010, the FSA considers that the Firm has failed to conduct any regulated activity to which its permission relates for a period of at least 12 months.

No representations

80. By its Warning Notice dated 04 May 2012 (the "**Warning Notice**"), the FSA gave notice that it proposed to take the action described above and Gracechurch was given the opportunity to make representations to the FSA about the proposed action.

81. No representations having been received by the FSA from Gracechurch within the time allowed by the Warning Notice, the default procedures in DEPP 2.3.2G of the FSA's Decision Procedure and Penalties Manual ("**DEPP**") permit the facts and matters described in the Warning Notice, and repeated in this Final Notice, to be regarded as undisputed.

82. The FSA has therefore decided (for the reasons described herein) to take the action to:

    i. issue a public censure of Gracechurch; and

    ii. cancel Gracechurch's Part IV permission.

FAILINGS

Breach of Principle 1

83. The FSA considers that the results of its and Gracechurch's compliance consultant's sample reviews demonstrate that the pressure sale methods, misrepresentations and misleading advice described above were routinely and deliberately used, made and given by most of the Firm's brokers, including Mr Kenny himself, during the Relevant Period. The FSA considers such conduct to amount to a serious lack of integrity at the heart of the Firm's regulated business.

84. In relation to the Firm's breach of Principle 1, the FSA notes that:

    (1) Mr Kenny's personal leadership role in inappropriately training and influencing other brokers at the Firm; and

    (2) the fact that the Firm identified misrepresentations and misleading advice as a compliance issue during the Relevant Period but such misrepresentations and misleading advice continued to be made and given.

85. Further, each of the following also amounted to a significant breach of Principle 1 by the Firm, involving, as each did, the Firm's senior management:

    (1) the decision by Mr Kenny and Mr Davey to withhold the recording of the Firm's advice to Mr S, specifically requested by the FSA;

    (2) the deliberate falsification by Mr Kenny of relevant committee meeting dates, also requested by the FSA, and his plan to forge minutes of those meetings, if they were requested by the FSA;

    (3) the employment of the non-approved individual described above in a SIF role, in deliberate breach of section 59(1) of the Act (see the Annex), knowing that:

        (a) he was linked to an FSA investigation;

        (b) he had introduced the pressure sales culture at his previous employer; and

        (c) he was maintaining the same sales culture at the Firm;

    (4) the knowingly or recklessly conflicted advice to clients in respect of at least one stock, accompanied by the false denial by Mr Kenny described above;

(5) Mr Kenny's questionnaire veto; and

(6) the subsequent flagrant breach of the Firm's own conflict procedures in advising clients to buy the same stock at three times the original price, which Mr Kenny has accepted was his responsibility;

Breach of Principles 3, 7 and 9, COBS and SYSC

86. The Firm's failures in respect of review of its financial promotions and communications provided to its clients, risk capital limit monitoring, call recording monitoring and remuneration of brokers (the latter, in particular, being at odds with relevant July 2007 FSA guidance in its document entitled "*Treating customers fairly – culture*") amounted to breaches by the Firm of specific requirements of SYSC, in addition to Principle 3. In particular, (the Firm having been a "*common platform firm*", as that term is used in the FSA Handbook, during the Relevant Period) they amounted to serious breaches of SYSC 6.1.1R to 6.1.4R, as SYSC was worded during the Relevant Period, in that they were comprehensive failures to:

(1) establish and/or implement adequate policies and procedures sufficient to ensure compliance by the Firm with its obligations under Principles 7 and 9 and COBS 4 and 9 and/or designed to detect and/or minimise the risk of such non-compliance;

(2) maintain an effective compliance function responsible for monitoring and assessing the adequacy and effectiveness of such policies and procedures and the actions taken to address any deficiencies in the Firm's compliance with those obligations; and

(3) ensure that the compliance function had the necessary resources, expertise and access to all relevant information to discharge its responsibilities properly and independently.

87. In addition to Principle 7, the FSA considers that, on the basis of the facts and matters described herein, specifically the material inaccuracies and omissions in Gracechurch's written communications, the way in which it provided generic risk warnings and its failures to inform clients of potential or actual risk capital limit breaches:

(1) the Firm breached, as a matter of course, the requirements of COBS 4.2.1R(1), 4.5.2R(2) and (4), and 4.6.2R(2); and

(2) the Firm did so in that its financial promotions and communications in relation to its designated investment business:

(a) were routinely:

(i) unfair, unclear and misleading; and

(ii) inaccurate and failed to balance emphases on the attractive features of small-cap stock with fair and prominent indications of relevant risks;

(b) often disguised, diminished or obscured important items, statements or warnings; and

(c) generally failed to include appropriate performance information.

88. Further, in addition to Principle 9, the FSA considers that, on the basis of the facts and matters described above, the Firm also repeatedly breached the more specific requirements of COBS 9.2.1R, 9.2.2R and 9.2.6R in that:

(1) its client-specific suitability assessment was so flawed; and

(2) it paid so little regard to its clients' risk capital aims and limits during most of the Relevant Period;

89. Much of the advice Gracechurch gave clients that they buy the small-cap stock in question during most of the Relevant Period should not have been given because the Firm cannot and/or should not have genuinely considered it suitable.

Client detriment

90. As to all the failings described above, the FSA specifically notes:

(1) Mr Kenny's report to the Official Receiver in the context of the Firm's liquidation – that the introduction of the compliance consultant described above, as reviewer of all the Firm's transactions from September 2009, led to the Firm's income dropping by 90%; and

(2) the serious losses that would have been made by the Firm's clients had they kept the most significant of the small-cap stock the Firm advised them to buy to October 2011, which losses far exceed any losses they would have incurred since the Relevant Period began had they invested in even small-cap listed UK equity indices.

91. The FSA's conclusion is that:

(1) the great majority of the Firm's business was not carried out in a compliant manner, during that part of the Relevant Period before the Firm's compliance consultant started reviewing it thoroughly (from September 2009);

(2) many of the Firm's clients were mis-sold, often deliberately, the small-cap stock they bought on the basis of the Firm's advice during the Relevant Period; and

(3) the Firm's misconduct caused at least £2 million in client losses.

SANCTION

92. Having regard to the terms of the relevant guidance set out in DEPP, specifically DEPP 6.2.1G, 6.2.14G, 6.4.1G and 6.4.2G, as the latter was worded during the Relevant Period, the FSA has decided to publish a public censure against the Firm rather than impose a penalty.

93. The reason for this is that, as already noted above, the FSA has been informed by Gracechurch's liquidator that the Firm is not only insolvent but has no assets whatsoever, such that any financial penalty imposed on the Firm would not be paid to any extent.

94. But for that fact the FSA would, having regard to the guidance in DEPP 6.5.1G and 6.5.2G, as they were worded during the Relevant Period, have imposed a financial penalty of £1.5 million on the Firm for the failings described herein.

95. The FSA has reached this £1.5 million figure, having regard to the:

    (1) seriousness and number of the breaches described above and their comprehensive nature by reference to the Firm's regulated activities;

    (2) number and seriousness in particular of the breaches of Principle 1, the fact that almost all of those breaches were deliberate rather than merely reckless and the direct relevant involvement of senior managers of the Firm;

    (3) fact that more than one of those breaches of Principle 1 involved deliberate withholding or falsification of information requested by the FSA;

    (4) length of time during which the breaches took place;

    (5) fact that Mr Kenny and Mr Davey knew that the Firm's sales methods were unacceptable;

    (6) fact that the FSA published Final Notices in relation to very similar failings at Square Mile Securities Limited in January 2008, before the Relevant Period, and Pacific Continental Securities (UK) Limited in January 2009, during the Relevant Period;

    (7) fact that the principal purpose for which the FSA imposes penalties is to promote high standards of regulatory conduct by deterrence;

    (8) comprehensive failures of the Firm's compliance systems and controls during much of the Relevant Period and the results arising, quite apart from the Firm's breaches of Principle 1;

    (9) extent to which the Firm ignored specific prior FSA guidance, as described above;

    (10) amount of small-cap stock which the Firm advised its clients to buy during the Relevant Period and the losses the FSA believes were thereby caused;

(11) amounts paid in wages, salaries and consultancy fees by the Firm during the financial year to 31 January 2009;

(12) fact that it was the FSA that identified the issues through its thematic visit, referred to above;

(13) penalties imposed by the FSA in similar cases, taking into account material factual differences; and

(14) following mitigating factors:

(a) the Firm appointed a compliance consultant to conduct a review of its business;

(b) the Firm's senior management have, at least since the FSA's investigation commenced, co-operated fully and admitted several of its failings, albeit when faced with clear evidence of wrongdoing; and

(c) Gracechurch refunded some clients at least £13,350 as described above.

96. As Gracechurch ceased business on or about 2 February 2010, the FSA considers that the Firm has failed to conduct any regulated activity to which its permission relates for a period of at least 12 months. As a result, and having regard to its regulatory objectives, the FSA has decided to cancel Gracechurch's Part IV permission as set out in section 45 of the Act.

PROCEDURAL MATTERS

Decision makers and statutory basis

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

98. This Final Notice is given under, and in accordance with, section 390 of the Act.

Publicity

99. Section 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 such information if such publication would, in the opinion of the FSA, be unfair to the Firm or prejudicial to the interests of consumers.

100. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA Contact

101. For more information concerning this matter generally, contact Kate Tuckley (direct line: 020 7066 7086/fax: 020 7066 7087) of the Enforcement and Financial Crime Division of the FSA.

Bill Sillett
FSA Enforcement and Financial Crime Division

ANNEX

THE ACT

Section 45

The FSA is authorised by section 45(1)(b) of the Act to cancel an authorised person's permission where it appears to the FSA that such person has failed, during a period of at least 12 months, to conduct any regulated activity for which he has Part IV permission.

Section 59

"*(1) An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.*

...

(10) "Arrangement":

(a) means any kind of arrangement for the performance of a function of A which is entered into by A ... with another person; and

(b) includes, in particular, that other person's ... employment (whether under a contract of service or otherwise)."

Section 205

"*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.*"

THE FSA'S HANDBOOK

Definitions

"*advising on investments*" means:

"*(1) advice given to a person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and*

(2) advice on the merits of his ... (whether as principal or agent) ... buying ... a particular investment which is a security or a relevant investment; …"

"*ancillary services*" includes:

" *... financial analysis or other forms of general recommendation relating to transactions in [shares]*"

"*client*" means:

"*a person to whom a firm provides, intends to provide or has provided:*

(1) a service in the course of carrying on a regulated activity; or

(2) in the case of MiFID ... business, an ancillary service; "

including: "*a potential client*";

and, in relation to any of the rules in COBS 4 that impose requirements in relation to financial promotions (but only to the extent they do), including:

"*a person to whom a financial promotion is or is likely to be communicated"*

"common platform organisation requirements" mean: SYSC 4 to SYSC 9

"*designated investments*" include: shares

"*designated investment business*" includes:

"*advising on investments but only in relation to designated investments*"

"eligible counterparty" means

an entity or undertaking fulfilling one of several sets of alternative criteria but not an individual

"*excluded communication*" includes:

"*a financial promotion that would benefit from an exemption in the [FPO] if it were communicated by an unauthorised person*"

"*investment services and activities*" include:

the making of personal recommendations (as defined above)

"*MiFID business*" includes:

"*the making of a personal recommendation*" (see definition below); and

"*ancillary services*" (see definition above)

"a non-retail communication" means:

a financial promotion that is made only to a recipients whom the firm in question reasonably believes to be professional clients or eligible counterparties or may reasonably be regarded as directed at recipients who are professional clients or eligible counterparties

"*a personal recommendation*" means:

> "*a recommendation that is advice on investments … and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person.*"

"*a professional client*" means:

> an entity or undertaking fulfilling one of several sets of alternative criteria or an individual who has asked in writing to be treated as a professional client, having been given appropriate written warnings

"*regulatory system*" means:

> "*the arrangements for regulating a firm … in or under the Act, including … the Principles and other rules [made by the FSA under the Act]*" and therefore including COBS

"*relevant business*" includes: advice on shares

"*relevant investments*" include: shares

"*relevant persons*" includes:

> directors of firms as well as their employees involved in the provision of regulated activities, and therefore including advice on shares

"*a retail client*" means: "*a client who is not a professional client or an eligible counterparty*"

The Conduct of Business Sourcebook ("COBS")

COBS 1 – Application

COBS 1.1.1R

> "*[COBS] applies to a firm with respect to the following activities carried on from an establishment maintained by it … in the United Kingdom:*
>
> *(1) …*
>
> *(2) designated investment business;*
>
> *… .*"

COBS 4 – Communicating with Clients

COBS 4.1.1R

> "*[COBS 4] applies to a firm:*

(1) communicating with a client in relation to its designated investment business; [or]

(2) communicating … a financial promotion."

COBS 4.2.1R

"*(1) A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.*

(2) This rule applies in relation to:

(a) a communication by the firm to a client in relation to designated investment business … ;

(b) a financial promotion communicated by the firm that is not:

(i) an excluded communication; [or]

(ii) a non-retail communication; … ."

COBS 4.2.2G(2)

"*COBS 4.2.1R(2)(b) does not limit the application of the fair, clear and not misleading rule under COBS 4.2.1R(2)(a). So, for example, a communication in relation to designated investment business that is both a communication to a professional client and a financial promotion will still be subject to the fair, clear and not misleading rule.*"

COBS 4.5.1R

(as worded between 1 November 2007 and 5 August 2010)

"*(1) Subject to (2) and (3), [COBS 4.5] applies to a firm in relation to:*

(a) the provision of information in relation to its designated investment business; and

(b) the communication … of a financial promotion;

where such information or financial promotion is addressed to, or disseminated in such a way that it is likely to be received by, a retail client.

(2) …

(3) [COBS 4.5] does not apply in relation to a communication that is not made by a firm in relation to its MiFID … business: … to the extent that it is an excluded communication."

COBS 4.5.2R

"*A firm must ensure that information:*

(1) ...

(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) ...; and

(4) does not disguise, diminish or obscure important items, statements or warnings."

COBS 4.5.4G

"*In deciding whether, and how, to communicate information to a particular target audience, a firm should take into account the nature of the product or business, the risks involved, the client's commitment, the likely information needs of the average recipient, and the role of the information in the sales process.*"

COBS 4.5.5G

"*When communicating information, a firm should consider whether omission of any relevant fact will result in information being insufficient, unclear, unfair or misleading.*"

COBS 4.6.1R(1)

(as worded between 6 February 2008 and 5 August 2010)

"*(1) Subject to (2) and (3) [COBS 4.6] applies to a firm in relation to:*

(a) the provision of information in relation to its MiFID ... business;

(b) the communication ... of a financial promotion;

where such information or financial promotion is addressed to, or disseminated in such a way that it is likely to be received by, a retail client.

(2) ...

(3) [COBS 4.6] does not apply in relation to a communication by a firm other than in relation to its MiFID ... business ... to the extent it is an excluded communication."

COBS 4.6.2R

"*A firm must ensure that information that contains an indication of past performance of relevant business, a relevant investment or a financial index, satisfies the following conditions:*

(1) ...

(2) the information includes appropriate performance information which covers at least the immediately preceding five years, or the whole period for which the investment has been offered, the financial index has been established, or the service has been provided if less than five years, or such longer period as the firm may decide, and in every case that performance information must be based on and show complete 12-month periods;

... ."

COBS 9 – Suitability

COBS 9.1.1R

"*[COBS 9] applies to a firm which makes a personal recommendation in relation to a designated investment.*"

COBS 9.1.4R

"*In respect of the business of a firm which is not MiFID ... business, [COBS 9] applies only if ... the client is a retail client*."

COBS 9.2.1R

"*(1) A firm must take reasonable steps to ensure that a personal recommendation ... is suitable for its client.*

(2) When making the personal recommendation ..., 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 ...;

(b) financial situation; and

(c) investment objectives;

so as to enable the firm to make the recommendation ... 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, …:

(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 … .

(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."

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 ... .*"

The Senior Management Arrangements, Systems and Controls Sourcebook ("SYSC")

SYSC 1.2.1G

(as worded between 1 January 2007 and 31 March 2009)

"*The purposes of SYSC are:*

(1) to encourage firm's directors and senior managers to take appropriate practical responsibility for their firm's arrangements on matters likely to be of interest to the FSA because they impinge on the FSA's functions under the Act;

(2) to increase certainty by amplifying Principle 3, under which a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;

(3) to encourage firms to vest responsibility for effective and responsible organisation in specific directors and senior managers;[and]

(4) to create a common platform of organisational and systems and controls requirements for firms subject to … MiFID."

(and then as amended from 1 April 2009)

"*(4) to create a common platform of organisational and systems and controls requirements for all firms*."

SYSC 1.3.2R

(as worded between 1 November 2007 and 31 March 2009)

> "*The common platform organisational requirements apply with respect to the carrying on of the following (unless provided otherwise within a specific rule):*
>
> *(1) regulated activities;*
>
> *(2) …;*
>
> *(3) ancillary activities ; and*
>
> *(4) in relation to MiFID business, ancillary services*."

SYSC 1.3.6R

(as worded between 1 January 2007 and 31 March 2009)

> "*The common platform organisational requirements … also apply with respect to the communication and approval of financial promotions which:*
>
> *(1) if communicated by an unauthorised person without approval would contravene section 21(1) of the Act … ; and*
>
> *(2) may be communicated by a firm without contravening section 238(1) of the Act … ."*

SYSC 6.1.1R

(as worded between 1 November 2007 and 31 March 2009)

> "*A common platform firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers [and] employees … with its obligations under the regulatory system …* ."

(as amended from 1 April 2009)

> "*A firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers [and] employees … with its obligations under the regulatory system …* ."

SYSC 6.1.2R

(as worded between 1 January 2007 and 30 June 2011)

> "*A common platform firm must, taking into account the nature, scale and complexity of its business, and the nature and range of investment services and activities undertaken in the course of that business, establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under the regulatory system … and put in place adequate measures and procedures designed to minimise such risks …* ."

SYSC 6.1.3R

(as worded between 1 January 2007 and 30 June 2011)

> "*A common platform firm must maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:*
>
> *(1) to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with SYSC 6.1.2R, and the actions taken to address any deficiencies in the firm's compliance with its obligations; and*
>
> *… .*"

SYSC 6.1.4R

(as worded between 1 January 2007 and 30 June 2011)

> "*In order to enable the compliance function to discharge its responsibilities properly and independently, a common platform firm must ensure that the following conditions are satisfied:*
>
> *(1) the compliance function must have the necessary authority, resources, expertise and access to all relevant information;*
>
> *… .*"

The Decision Procedure and Penalties Manual ("DEPP")

DEPP 1.1.1G

(as worded between 28 August 2007 and 5 August 2010)

> "*DEPP is relevant to firms … . it sets out:*
>
> *(1) …*
>
> *(2) the FSA's policy with respect to the imposition and amount of penalties under the Act (see DEPP 6);*
>
> *… .*"

DEPP 6.2.1G

> "*The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty or public censure. Set out below is a list of factors that may be relevant for this purpose. The list is not*

exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

(1) The nature, seriousness and impact of the suspected breach, including:

(a) whether the breach was deliberate or reckless;

(b) the duration and frequency of the breach;

(c) the amount of any benefit gained or loss avoided as a result of the breach;

(d) whether the breach reveals serious or systemic weaknesses of the management systems or internal controls relating to all or part of a person's business;

(e) ...

(f) the loss or risk of loss caused to consumers or other market users;

...

(2) The conduct of the person after the breach, including the following:

(a) how quickly, effectively and completely the person brought the breach to the attention of the FSA or another relevant regulatory authority;

(b) the degree of co-operation the person showed during the investigation of the breach;

(c) any remedial steps the person has taken in respect of the breach;

(d) the likelihood that the same type of breach (whether on the part of the person under investigation or others) will recur if no action is taken;

(e) ... ; and

(f) the nature and extent of any false or inaccurate information given by the person and whether the information appears to have been given in an attempt to knowingly mislead the FSA.

(3) The previous disciplinary record and compliance history of the person including ...

(4) ...

(5) Action taken by the FSA in previous similar cases. ... "

DEPP 6.2.14G

"*The Principles are ... a general statement of the fundamental obligations of firms under the regulatory system. The Principles derive their authority from the FSA's rule-making powers set out in section 138 (General rule-making power) of the Act. A breach of a Principle will make a firm liable to disciplinary action. Where the FSA considers this is appropriate, it will discipline a firm on the basis of the Principles alone.*"

DEPP 6.4.1G

"*The FSA will consider all the relevant circumstances of the case when deciding whether to impose a penalty or issue a public censure. As such, the factors set out in DEPP 6.4.2G are not exhaustive. Not all the factors may be relevant in a particular case and there may be other factors, not listed, that are relevant.*"

DEPP 6.4.2G

(as worded between 28 August 2007 and 5 March 2010)

"*The criteria for determining whether it is appropriate to issue a public censure rather than impose a financial penalty are similar to those for determining the amount of penalty set out in DEPP 6.5. Some particular considerations that may be relevant when the FSA determines whether to issue a public censure rather than impose a financial penalty are:*

(1) whether or not deterrence may be effectively achieved by issuing a public censure;

(2) if the person has made a profit or avoided a loss as a result of the breach, this may be a factor in favour of a financial penalty, on the basis that a person should not be permitted to benefit from its breach;

(3) if the breach is more serious in nature or degree, this may be a factor in favour of a financial penalty, on the basis that the sanction should reflect the seriousness of the breach; other things being equal, the more serious the breach, the more likely the FSA is to impose a financial penalty;

(4) if the person has brought the breach to the attention of the FSA, this may be a factor in favour of a public censure, depending upon the nature and seriousness of the breach;

(5) if the person has admitted the breach and provides full and immediate co-operation to the FSA, and takes steps to ensure that those who have suffered loss due to the breach are fully compensated for those losses, this may be a factor in favour of a public censure, rather than a financial penalty, depending upon the nature and seriousness of the breach;

(6) ...

(7) the FSA's approach in similar previous cases: the FSA will seek to achieve a consistent approach to its decisions on whether to impose a financial penalty or issue a public censure; and

(8) the impact on the person concerned. In exceptional circumstances, if the person has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it would only be in an exceptional case that the FSA would be prepared to agree to issue a public censure rather than impose a financial penalty if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include where there is:

(a) verifiable evidence that a person would suffer serious financial hardship if the FSA imposed a financial penalty; ... ."

DEPP 6.5.1G

(as worded between 28 August 2007 and 5 March 2010)

"*(1) The FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned. The list of factors in DEPP 6.5.2 G is not exhaustive: not all of these factors may be relevant in a particular case, and there may be other factors, not included below, that are relevant.*

(2) The FSA does not apply a tariff of penalties for different kinds of breach. This is because there will be very few cases in which all the circumstances of the case are essentially the same and because of the wide range of different breaches in respect of which the FSA may take action. The FSA considers that, in general, the use of a tariff for particular kinds of breach would inhibit the flexible and proportionate policy which it adopts in this area."

DEPP 6.5.2G

(as worded between 28 August 2007 and 5 March 2010)

"*The following factors may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act:*

(1) Deterrence

When determining the appropriate level of penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

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

The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached. The following considerations are among those that may be relevant:

(a) the duration and frequency of the breach;

(b) whether the breach revealed serious or systemic weaknesses in the person's procedures or of the management systems or internal controls relating to all or part of a person's business;

(c) …

(d) the loss or risk of loss caused to consumers, investors or other market users; …

(3) The extent to which the breach was deliberate or reckless

The FSA will regard as more serious a breach which is deliberately or recklessly committed. The matters to which the FSA may have regard in determining whether a breach was deliberate or reckless include, but are not limited to, the following:

(a) whether the breach was intentional, in that the person intended or foresaw the potential or actual consequences of its actions;

(b) where the person has not followed a firm's internal procedures and/or FSA guidance, the reasons for not doing so;

(c) …

(d) whether the person has given no apparent consideration to the consequences of the behaviour that constitutes the breach; …

If the FSA decides that the breach was deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case.

(4) *...*

(5) *The size, financial resources and other circumstances of the person on whom the penalty is to be imposed*

(a) *...*

(b) *...*

(c) *The degree of seriousness of a breach may be linked to the size of the firm. For example, a systemic failure in a large firm could damage or threaten to damage a much larger number of consumers or investors than would be the case with a small firm: breaches in firms with a high volume of business over a protracted period may be more serious than breaches over similar periods in firms with a smaller volume of business.*

(d) *The size and resources of a person may also be relevant in relation to mitigation, in particular what steps the person took after the breach had been identified; the FSA will take into account what it is reasonable to expect from a person in relation to its size and resources, and factors such as what proportion of a person's resources were used to resolve a problem.*

(e) *The FSA may decide to impose a financial penalty on a mutual (such as a building society), even though this may have a direct impact on that mutual's customers. This reflects the fact that a significant proportion of a mutual's customers are shareholder-members; to that extent, their position involves an assumption of risk that is not assumed by customers of a firm that is not a mutual. Whether a firm is a mutual will not, by itself, increase or decrease the level of a financial penalty.*

(6) *The amount of benefit gained or loss avoided*

The FSA may have regard to the amount of benefit gained or loss avoided as a result of the breach, for example:

(a) *the FSA will propose a penalty which is consistent with the principle that a person should not benefit from the breach; and*

(b) the penalty should also act as an incentive to the person (and others) to comply with regulatory standards and required standards of market conduct.

(7) Difficulty of detecting the breach

A person's incentive to commit a breach may be greater where the breach is, by its nature, harder to detect. The FSA may, therefore, impose a higher penalty where it considers that a person committed a breach in such a way as to avoid or reduce the risk that the breach would be discovered, or that the difficulty of detection (whether actual or perceived) may have affected the behaviour in question.

(8) Conduct following the breach

The FSA may take the following factors into account:

(a) the conduct of the person in bringing (or failing to bring) quickly, effectively and completely the breach to the FSA's attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of co-operation the person showed during the investigation of the breach by the FSA, ... Where a person has fully co-operated with the FSA's investigation, this will be a factor tending to reduce the level of financial penalty;

(c) any remedial steps taken since the breach was identified, including whether these were taken on the person's own initiative or that of the FSA or another regulatory authority; for example, identifying whether consumers or investors or other market users suffered loss and compensating them where they have; correcting any misleading statement or impression; taking disciplinary action against staff involved (if appropriate); and taking steps to ensure that similar problems cannot arise in the future; and

(d) ...

(9) ...

(10) Other action taken by the FSA (or a previous regulator)

Action that the FSA (or a previous regulator) has taken in relation to similar breaches by other persons may be taken into account. This includes previous actions in which the FSA (whether acting by the RDC or the settlement decision makers) and a person on whom a penalty is to be imposed have reached agreement as to the amount of

the penalty. As stated at DEPP 6.5.1 G (2), the FSA does not operate a tariff system. However, the FSA will seek to apply a consistent approach to determining the appropriate level of penalty.

(11) ...

(12) FSA guidance and other published materials

(a) A person does not commit a breach by not following FSA guidance or other published examples of compliant behaviour. However, where a breach has otherwise been established, the fact that guidance or other published materials had raised relevant concerns may inform the seriousness with which the breach is to be regarded by the FSA when determining the level of penalty.

(b) The FSA will consider the nature and accessibility of the guidance or other published materials when deciding whether they are relevant to the level of penalty and, if they are, what weight to give them in relation to other relevant factors. ... ."

Cancellation of Part IV permission

The FSA's policy on exercising its power to cancel a Part IV permission is set out in the Enforcement Guide ("EG"), the relevant provision of which is summarised below.

EG 8.13(2) states that the FSA will consider cancelling a Part IV permission using its own-initiative power contained in section 45 of the Act where a firm's regulated activities have come to an end and it has not applied to cancel its permission.