
FINAL NOTICE

To: Mr Derrick Hales

Of 20 Keighley Road, Halifax, West Yorkshire HX2 8AL

Date: 9 October 2008

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you, Mr Derrick Hales ("Mr Hales") final notice about the decision to take the following action:

1. THE ACTION

- 1.1. The FSA gave you a Decision Notice dated 9 October 2008 the ("Decision Notice") which notified you that for the reasons listed below and pursuant to section 63 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to withdraw the approvals granted to you to perform the controlled functions of Compliance Oversight (CF10) and Money Laundering (CF11) in the terms set out below.
- 1.2. You confirmed on 2 September 2008 that you will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below and having agreed with you the facts and matters relied on, the FSA has withdrawn your approval to perform the controlled functions of Compliance Oversight (CF10) and Money Laundering (CF11).

2. REASONS FOR THE ACTION

- 2.1. The FSA has concluded that you are not a fit and proper person to perform the controlled functions of Compliance Oversight (CF10) and Money Laundering (CF11), and that those approvals should be withdrawn from you. The action by the FSA relates to your conduct between August 2004 and November 2005 (the "relevant period") whilst performing the controlled functions of Partner (CF4), Apportionment and Oversight (CF8), Compliance Oversight (CF10), CF11 (Money Laundering

Reporting), CF21 (Investment Adviser) and whilst responsible for insurance mediation on behalf of Derrick Hales Financial Planning ("DHFP"/ "the Firm").

2.2. In particular, you contravened the Statements of Principle and Code of Practice for Approved Persons ("APER") by virtue of:

- (1) your failure to exercise due skill, care and diligence in managing the business of DHFP, by inadequately monitoring staff to whom responsibility for compliance and administrative systems and controls had been delegated, in contravention of Statement of Principle 6; and
- (2) your failure to take reasonable steps to ensure that the business of DHFP complied with the relevant requirements and standards of the regulatory system through failing to implement and monitor systems and controls, in contravention of Statement of Principle 7.

2.3. The FSA has concluded by virtue of the matters referred to above that:

- (1) you are not a fit and proper person to perform the controlled functions of Compliance Oversight (CF10) and Money Laundering (CF11) as you lack the necessary competence and capability to carry out these controlled functions (FIT 2.2); and
- (2) having regard to its regulatory objectives, including the severity of the risk that you pose to consumers and to confidence in the market generally, it is necessary and desirable for the FSA to exercise its power to withdraw those approvals from you.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

3.1. The FSA's statutory objectives as set out in section 2(2) of the Act include the protection of consumers and market confidence.

3.2. The FSA has the power pursuant to section 63 of the Act to make an order withdrawing an approval given under section 59 of the Act, if it appears to the FSA that that individual is not a fit and proper person to perform the function to which the approval relates.

3.3. The FSA's policy in relation to withdrawals of approval is set out in Chapter 9 of the part of the FSA Handbook entitled the Enforcement Guide ("EG"). The relevant guidance in EG is set out at Annex A.

3.4. The FSA's guidance on the fitness and propriety of individuals is set out in the section of the FSA Handbook entitled the Fit and Proper Test for Approved Persons ("FIT"). The relevant sections of FIT are set out at Annex A.

3.5. Section 64 of the Act authorises the FSA to issue Statements of Principle with respect to the conduct expected of Approved Persons. These Statements of Principle are set out in APER and the relevant provisions are:

3.6 Statement of Principle 6

"An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function."

3.7 **Statement of Principle 7**

"An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system."

- 3.8 The FSA has issued a code of practice for the purpose of helping to determine whether or not a person's conduct complies with the Statements of Principle. This code of practice is set out at Annex A.

4. **FACTS AND MATTERS RELIED ON**

Background

- 4.1. You were a Partner of DHFP from the commencement of the Firm's trading in 1997. Following DHFP's authorisation by the FSA in December 2001 you became an approved person with responsibility for insurance mediation and were authorised to perform the following controlled functions including significant influence and customer functions with DHFP:
- (1) CF4 (Partner);
 - (2) CF8 (Apportionment and Oversight);
 - (3) CF10 (Compliance Oversight);
 - (4) CF11 (Money Laundering Reporting); and
 - (5) CF21 (Investment Adviser).
- 4.2. DHFP is a small family-run firm providing personal financial advice to the Halifax community. The Firm's customer base comprises of principally long-standing clients who are retired or approaching retirement. You are the sole financial adviser within the Firm.
- 4.3 During the relevant period, DHFP made 24 recommendations of GTEPs, of which only 9 proceeded to completion, earning DHFP commission in the region of £49,000 in addition to an ongoing trail commission.

GTEP Products

- 4.4 Traded endowment policies ("TEPs") are with-profits endowment policies (a long term, regular premium savings plan with a life policy attached, which may be associated with an interest-only mortgage) which are no longer required by their original holder and have been sold on the secondary market. The purchaser of such policies agrees to pay the remaining premiums on the policy and in return receives the

value of the policy at maturity or when the original owner dies, depending on which occurs first. This payout will include both bonuses declared at the time of the sale and subsequent bonuses, though such bonuses are not guaranteed.

- 4.5 Investment in GTEPs involves an added element of gearing, as part of a two stage investment process. At the first stage, a portfolio of TEPs is purchased using cash savings, funds raised through a mortgage on the investor's home or a charge on a bond already owned by the investor. At the second stage, the newly-acquired TEPs are then secured against a loan, which is used to invest in more TEPs. These varying levels of gearing are effectively using the strategy of borrowing to invest, which can be a high risk strategy. The product has to outperform the interest rate payable on the loan (and the mortgage, if applicable) in order for the investor to make a profit. In addition, gearing introduces an interest rate risk, increases exposure to the usual risks of the investment (such as fluctuations in performance and secondary market demand), and if the initial cash injection was raised through a mortgage, there is a risk that the investor could lose their home. There is no generic level of risk which a firm could apply to all clients of GTEPs as each portfolio of TEPs is constructed individually.
- 4.6 In respect of the GTEPs sold by DHFP, customers, on the basis of an illustration, are required to state whether they wish to proceed. A portfolio of TEPs is then constructed for them. The construction process is lengthy, taking up to 18 months, and there is no 'cooling off' period meaning that customers who decide not to proceed may incur a penalty fee.

DHFP's failings

- 4.7 As a result of the FSA investigation, the FSA has made the following findings:
- (1) DHFP failed to demonstrate that customers' attitude to risk was commensurate with the recommended product's risk profile, in breach of Principle 9 (Customers: relationships of trust);
 - (2) DHFP failed to gather or record adequate Know Your Customer ("KYC") information to support its assessment of suitability, or update that information, in breach of Principle 9 and COB 5.2.5R;
 - (3) DHFP failed to communicate: (i) why it had concluded that GTEPs were suitable or (ii) the characteristics of and risks associated with GTEPs to customers in a clear and fair way in breach of Principle 7 (Communications with clients) and COB 5.4.3 R;
 - (4) DHFP failed to undertake adequate or independent product research and as a consequence failed to ensure that its adviser fully understood GTEPs and their inherent risks prior to recommending them in breach of Principle 3 (Management and control);
 - (5) DHFP failed to take appropriate steps to monitor and review client files and the suitability of advice in breach of Principle 3; and

- (6) DHFP failed to organise and control its affairs responsibly and effectively and to allocate responsibility for compliance matters to a partner of the Firm, in breach of Principle 3.

4.8 The FSA's findings against DHFP are set out in more detail in the DHFP Warning Notice.

Your failings

Responsibilities of controlled functions

4.9 As Partner and sole adviser at DHFP, amongst other controlled functions, you were responsible for the day-to-day running of the business, including compliance matters and monitoring the administration of the business, and ensuring that DHFP complied with its regulatory requirements.

A number of general failings were identified in respect of the performance of your controlled functions:

- (1) You were unaware of which controlled functions you held and of each controlled function's corresponding obligations;
- (2) Despite holding the controlled function of CF10, you did not ensure that responsibility for compliance matters was allocated effectively. You did not involve yourself in day-to-day compliance issues or actively oversee compliance matters. You stated in interview that you '*don't get involved in the client files*' and had not done so since the 1970s. In response to issues raised by external compliance consultants, remedial action was delegated to an administrative assistant. As a result, there was no adequate oversight of compliance issues; and
- (3) You were unaware, when questioned at interview, that you were required to retain copies of key documents on file, such as the key facts information document

As a consequence of your lack of knowledge and understanding of your regulatory obligations, you failed to exercise due skill, care and diligence in respect of your management of DHFP's business, in breach of Statement of Principle 6.

Standard documentation

4.10 In addition, a number of failings were identified in respect of your standard documentation regarding the characteristics and inherent risks of GTEPs, as set out in more detail in the DHFP Warning Notice, including the following:

- (1) Marketing promotional material sent to clients were often long and complicated and lacked sufficiently clear information regarding GTEPs;
- (2) DHFP's standard suitability letter contained a generic explanation of GTEPs, their advantages and potential disadvantages, failing to explain in particular why DHFP had concluded that GTEPs were a suitable investment for the

particular client, on the basis of the personal and financial circumstances disclosed to it; and

- (3) The risk warnings in DHFP's standard suitability letter were inadequate. Again, they were generic rather than tailored to the clients' situation and placed at the end of the recommendation letter, which served to dilute their message.

4.11 By failing to use appropriate documentation that was tailored to the circumstances of the individual customer or ensure that the key features of GTEPs were clearly communicated, you failed to take reasonable steps to ensure that your business complied with regulatory requirements, in breach of Statement of Principle 7.

Advice and sales processes

4.12 Furthermore, a number of failings were identified in respect of the Firm's advice and sales processes regarding recommendations to invest in GTEPs, as set out in more detail in the DHFP Warning Notice, including the following:

- (1) You could not demonstrate that you had considered the needs and circumstances of each client prior to raising the possibility of an investment in GTEPs, instead suggesting such an investment to a large number of clients who approached the firm for financial advice during the relevant period. You explained in interview that this is because clients wanted the Firm to *'think outside the box and come up with innovative products, something a bit different, otherwise they'd go to another IFA and just do a pension or a bond and that would be it'*. You went on to explain that GTEPs were suitable for customers interested in generating income from equity in their homes or using an existing holding in bonds, even where they had no other assets to fund any shortfall. One result of this failure to consider suitability was that customers advised to apply for a loan to invest in GTEPs, were rejected by the lender on grounds such as age, health and low levels of income and assets;
- (2) Information recorded on files was incomplete, for example in some cases relevant sections of the fact find had not been filled in and/or a customer's attitude was not identified. Where a customer's attitude to risk was recorded, there was no explanation was provided as to how this matched the risk rating of the product, or when the two did not match. In your view, it was ultimately the product provider's responsibility to check suitability and match the GTEP portfolio to a customer's attitude to risk;
- (3) There is no evidence on the client files that alternatives to GTEPs were considered with the customer or researched. The 'alternative products considered' section of the suitability letter which purported to consider alternative products, adopted one of two pro-forma options which appear to be based on precedents supplied by the product provider, further suggesting that DHFP did not consider individual customers' needs and circumstances when recommending GTEPs ; and
- (4) You failed to apprise yourself of the lenders' criteria.

- 4.13 By failing to ensure that you followed an appropriate advice and sales process, where information to assess suitability was obtained and recorded, you failed to take reasonable steps to ensure that your business complied with regulatory requirements, in breach of Statement of Principle 7.

Systems and controls

- 4.14 A number of failings in relation to DHFP's systems and controls were identified, as set out in more detail in the DHFP Warning Notice including the following:
- (1) You failed to ensure that you fully understood the investment product prior to promoting it, or to apprise yourself of the lenders' criteria;
 - (2) Your oversight of compliance matters was inadequate, in that such matters were delegated to a junior member of staff without the implementation of formal procedures to supervise this work;
 - (3) Fact finds were not routinely completed or updated, with relevant sections left blank, including details of customers' income, expenditure, attitude to risk and investment objectives. At times, a client's attitude to risk was assessed after a meeting where an investment in GTEPs was considered, or not recorded at all. At interview, you were shown a copy of a completed fact find and asked various questions about the customer's situation. You admitted that the fact find did not always contain complete or sufficient information. In respect of the approach adopted to gathering client information you admitted that '*we didn't follow procedures*';
 - (4) You could not explain why certain documents were not contained within the files, and did not know at what point the Key Facts Information document ("the KFI") is sent out to customers. In fact, customers were sent the KFI two weeks after they had applied for the product; and
 - (5) Suitability letters were drafted by a junior member of staff, based on a template supplied by the product provider and were not tailored to each individual client's needs and circumstances.

- 4.15 By failing to take steps to implement adequate and appropriate systems and controls in respect of product research, oversight of compliance matters and sales and advice processes you failed to ensure that DHFP complied with the relevant regulatory standards, in breach of Statement of Principle 7. This was despite the fact that you held the controlled function of CF10 (Compliance Oversight) and that other than Mrs Hales, whose role was that of 'silent partner', you were the only person at DHFP who held any controlled functions.

Gravity of Misconduct

- 4.16. The misconduct summarised above is considered serious because your failure to act with due skill, care and diligence in respect of managing and monitoring the business of DHFP exposed clients to the risk of purchasing a product that was inappropriate for their needs and of suffering significant loss. As a qualified financial adviser with over 37 years in the industry, the FSA considers that you should have been aware that the

fundamental flaws in the sales, recommendation and monitoring processes described above would put your customers at risk.

5. RELEVANT GUIDANCE ON SANCTION

- 5.1. As outlined in paragraph 3.5 above, the FSA's policy in relation to withdrawals of approval as described in Chapter 9 of the Enforcement Guide is set out in more detail at Annex A.
- 5.2. Under APER 3.1.4, an approved person will only be in breach of a Statement of Principle if he or she is personally culpable, that is in a situation where his or her conduct was deliberate or where his or her standard of conduct was below that which would be reasonable in all the circumstances. While the FSA did not find that your conduct was deliberate, the FSA considers that the standard of your conduct was below that which is reasonable in all the circumstances.
- 5.3. Under APER 4.7.11, the FSA expects an approved person performing a significant influence function to take reasonable steps both to ensure his firm's compliance with the relevant requirements and standards of the regulatory system and to ensure that all staff are aware of the need for compliance.
- 5.4. The FSA considers that by virtue of the failings detailed at paragraphs 4.8 to 4.20 above you have breached Principles 6 and 7 of the Statements of Principle for Approved Persons. In this respect FSA considers that the misconduct identified shows that whilst carrying out your controlled functions at DHFP you failed to exercise due skill, care and diligence in respect of the management of DHFP's business and that you failed to take reasonable steps to ensure that the business of DHFP was conducted in a manner that complied with regulatory requirements and standards.
- 5.5. The FSA has considered whether you are a fit and proper person in accordance with the regulatory requirements of FIT and with regard to the relevant guidance. In this respect, the FSA considers that the misconduct identified shows that you have failed to demonstrate the competency and capability required to perform certain controlled functions, as outlined in this Warning Notice, in relation to regulated activities.
- 5.6. It is the FSA's view that the seriousness of your failings means you are unable to satisfy the FSA as to your ability to comply with regulatory requirements relating to controlled functions requiring a minimum level of technical competence; and that if you continued to perform these controlled functions in relation to regulated activities, you would pose a risk to consumers and market confidence.

6. CONCLUSION

- 6.1. In the light of the facts and matters described above, the FSA has concluded that you are not a fit and proper person to perform the controlled functions of Compliance Oversight (CF10) and Money Laundering (CF11).
- 6.2. Having regard to its regulatory objectives and the severity of risks posed to consumers, the FSA considers it necessary to withdrawal its approval in relation to those controlled functions from you.

7. DECISION MAKERS

- 7.1 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.

8. IMPORTANT

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

Publicity

- 8.2 Sections 391(4), 391(6) and 391(7) of the Act to 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. 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.

- 8.3 The FSA intends to publish such information about the matter to which this final notice relates as it considers appropriate.

FSA contacts

- 8.4 For more information concerning this matter generally, you should contact Andrea Bowe of the Enforcement Division of the FSA (direct line: 020 7066 5886 /fax: 020 7066 5887).

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Jonathan Phelan

**Head of Department
FSA Enforcement Division**

Annex A

Relevant Regulatory Rules and Guidance

1. The Enforcement Guide

- 1.1 EG 9.3 summarises the FSA's policy on withdrawing approvals.
- 1.2 EG 9.9 states that, when it decides whether to exercise its power to withdraw approval from an approved person, the FSA will consider a number of factors including the criteria for assessing the fitness and propriety of approved persons contained in the Fit and Proper test for Approved Persons, which includes the competence and capability of an approved person.
- 1.3 In accordance with EG 9.9 the FSA will also consider the relevant circumstances of the case, including whether and to what extent the approved person has:
 - (1) Failed to comply with the Statements of Principle for Approved Persons;
 - (2) Been knowingly concerned in a contravention by the relevant firm of a requirement imposed on the firm by or under the Act (including the principles and other rules);
 - (3) The relevance, materiality and length of time since the occurrence of any matters indicating unfitness;
 - (4) The particular controlled function the approved person is performing, the nature and activities of the firm concerned and the markets in which he operates;
 - (5) The severity of the risk which the individual poses to consumers and to confidence in the financial system; and
 - (6) The previous disciplinary record and general compliance history of the individual whether the FSA (or any previous regulator) has previously imposed a disciplinary sanction on the individual.
- 1.4 EG 9.10 states that the FSA may have regard to the cumulative effect of a number of factors which, when considered in isolation, may not be sufficient to show that the individual is fit and proper to continue to perform a controlled function. It may also take into account the particular controlled function held, the nature and activities of the firm and the markets within which it operates.
- 1.5 In summary, the relevant considerations are whether, in terms of competence and capability, the relevant individual is fit and proper to perform functions in relation to regulated activities and, if not, the severity of the risk posed by him. Having established these matters, it can be determined whether the withdrawal of approval will be necessary to achieve the FSA's regulatory objectives.

2. The Fit and Proper Test

- 2.1 The FSA has issued specific guidance on the fitness and propriety of individuals in the section of the FSA Handbook entitled the Fit and Proper Test for Approved Persons ("FIT"). The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function and FIT is also relevant in assessing the continuing fitness and propriety of an approved person.
- 2.2 As detailed above in accordance with EG 9.9 the criteria set out in FIT are relevant in considering whether the FSA may exercise its powers to make a prohibition order against an approved person.
- 2.3 **FIT 1.3** provides that the FSA will have regard to a number of factors when assessing the fitness and propriety of a person with the most important considerations being the person's honesty, integrity and reputation, competence and capability and financial soundness.
- 2.4 In determining a person's competence and capability **FIT 2.2.1G** provides that the FSA will have regard to matters including, but not limited to, whether the person satisfies the relevant training and competence requirements and whether the person has demonstrated by experience and training that the person is able, or will be able if approved, to perform the controlled function.

3. The Code of Practice for Approved Persons ("APER")

- 3.1 The guidance set out in **APER 3.1.3G** stipulates that when establishing compliance with, or a breach of, a Statement of Principle, will be assessed only after all the circumstances of a particular case have been considered. Account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour to be expected in that function.
- 3.2 **APER 3.1.4G** states that an approved person will only be in breach of a Statement of Principle if he or she is personally culpable, that is in a situation where his or her conduct was deliberate or where his or her standard of conduct was below that which would be reasonable in all the circumstances.
- 3.3 Conduct which does not comply with **Statement of Principle 6** includes an approved person failing to take reasonable steps to adequately inform himself about the affairs of the business for which he is responsible. **APER 4.6.4E** provides that failure could include:
 - (1) Permitting transactions without a sufficient understanding of the risks involved (**APER 4.6.4E(1)**); and
 - (2) Inadequately monitoring highly profitable transaction or business practices or unusual transactions or business practices (**APER 4.6.4E(3)**).
- 3.4 **APER 4.6.6E** and **4.6.7E** provide that it is a breach of Statement of Principle 6 if an approved person fails to maintain an appropriate level of understanding about an issue or a part of the business that he has delegated to an individual and that if an approved

person has delegated that issue or part of the business, he may not disregard it. **APER 4.6.8E** provides that failing to supervise and monitor adequately the individual to whom responsibility for dealing with an issue or part of the business has been delegated is in contravention of Statement of Principle 6.

- 3.5 **APER 4.6.14G** states that although an approved person may delegate authority for dealing with a part of the business, he cannot delegate responsibility for it.
- 3.6 Conduct which does not comply with **Statement of Principle 7** includes:
 - (1) Failure to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the regulatory system in respect of its regulated activities (**APER 4.7.3E**); and
 - (2) Failure to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulatory system in respect of its regulated activities (**APER 4.7.4E**).
- 3.7 The FSA expects an approved person performing a significant influence function to take reasonable steps both to ensure his firm's compliance with the relevant requirements and standards of the regulatory system and to ensure that all staff is aware of the need for compliance (**APER 4.7.11G**).