FINAL NOTICE

To: **Hemscott Investment Analysis Ltd**

Of: **2nd Floor**
Finsbury Tower
103 – 105 Bunhill Row
London EC1Y 8TY

Date: **13 January 2005**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives Hemscott Investment Analysis Ltd ("the Firm") final notice about a requirement to pay a financial penalty.

THE PENALTY

The FSA gave the Firm a Decision Notice dated 10 January 2005 which notified the Firm that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA has decided to impose a financial penalty on the Firm in the amount of £50,000 in respect of breaches of FSA Rules COB 3.6.1, COB 3.7.1, COB 3.7.4, COB 3.8.4, COB 3.8.8, COB 3.8.11, COB 3.8.15, COB 3.9.15, COB 3.9.24, T&C 2.6.1, SYSC 3.1.1, SYSC 3.2.6, SYSC 3.2.20 and Principles 3, 7 and 8 of the FSA Principles for Business ("the FSA Principles").

The Firm has confirmed that it does not intend referring the matter to the Financial Services and Markets Tribunal.

Accordingly, for the reasons listed below and having agreed with the Firm the facts and the matters relied upon, the FSA imposes a financial penalty of £50,000 on the Firm ("the Penalty").

1. REASONS FOR ACTION

1.1. The FSA imposes a financial penalty on the Firm in respect of breaches of the FSA Rules and Principles in relation to the Firm's:

(1) Failure to put in place in place appropriate systems and controls for:

(a) confirming compliance of financial promotions;

(b) managing conflicts of interests; and

(c) ensuring that staff who have been assessed as competent to engage in or oversee an activity maintain their competence.

(2) Issuing the "We even make a Bear Market all Soft & Cuddly" promotion ("the Bear Market Promotion")[1] published in June 2003[2] without confirmation of compliance; and

(3) Issuing further financial promotions which failed to be fair and balanced or contain a clear and adequate disclosure of the risks involved although the FSA had drawn the Firm's attention to the failings in the Bear Market Promotion.

1.2. The Firm's breaches are viewed by the FSA as serious in view of the following particular factors:

- The Firm failed to have in place appropriate systems and controls to ensure that its financial promotions were "clear, fair and not misleading" and that the risks associated with the investments referred to in its financial promotions were included and/or made explicit, even after the FSA had drawn the Firm's attention to its failings in the Bear Market Promotion. There was no formal process for compliance approval of financial promotions and the Bear Market Promotion was issued without any reference to the Firm's Compliance Department or any approved person.

- The Firm's systems and controls in respect of conflicts of interest failed to operate adequately on two occasions. As a result, on two occasions, staff of the Firm (who were approved persons) made share recommendations without disclosing to the Firm and/or to the public their transactions in shares or in contracts for differences ("CFDs") with reference to shares or their intentions concerning such transactions. This was a breach of the Firm's Compliance Code which was not detected by the Firm until brought to its attention by the FSA.

- As a result of the Firm's deficient systems and controls its financial promotions were not balanced. They accentuated the benefits of the service for example, in the Bear Market Promotion, by presenting only the best performing

[1] A "bear market" is a common description for a market trend where prices of equities (or other investments) have persistently declined over an extended period of time.
[2] The "Bear Market Promotion" is attached for the purpose of illustration.

recommendations rather than a cross section of all recommendations.

- The Bear Market Promotion and another promotion (Promotion B see paragragh 4.16.) did not draw attention to the fact that the past performance of the virtual Hemscott Analyst portfolio (see paragraph 3.5.) referred to in each promotion would not necessarily be repeated. The statement as to past performance contained in another promotion (Promotion B, paragraph 4.16) was not sufficiently prominent.

- The Bear Market Promotion and another promotion (see paragraph. 4.19) were published in financial periodicals with circulations of approximately 54,000 and 42,000 respectively. Further Direct Offer Promotions were directly emailed to 198,000 subscribers to the Hemscott plc web site.

The FSA's General Approach to Financial Promotions

1.3. Financial promotions are defined in detail in the Act, the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 No. 1335 ("The Financial Promotion Order"), and in the FSA's Handbook. In essence, a financial promotion is any communication made in the course of business which invites or induces a person to engage in investment activity. A share tipping service provides investment advice, which constitutes an investment activity, and is therefore subject to the FSA's regulation as set out in its handbook, and in particular in its sourcebooks Senior Management Arrangements, Systems and Controls ("SYSC"); Conduct of Business ("COB"); Training and Competence ("T&C"); and Principles for Businesses. The documents issued by the Firm induced people to become subscribers to its service or to act on recommendations made and therefore constituted financial promotions. These are subject in particular to Chapter 3 of COB.

1.4. The FSA made it clear that it regarded financial promotion as a priority issue in both the 2002/3 and the 2003/4 FSA Plans and Budgets. In the Plan and Budget 2002/3, one of the FSA’s key priorities for the year was to be the pursuit *“of fair treatment of consumers by enhancing the minimum standards for information given by firms to customers.”* In the Plan and Budget 2003/4, the reduction of unclear and misleading financial promotions was identified as a major workstream.

1.5. In the Plan and Budget 2004/5, the FSA again stated its focus on financial promotions. This has lead to the creation of a new department within the FSA, with greater resources and an ability to look at a wide range of issues.

***The FSA's Regulatory Approach to Financial Promotions* ("the FSA's April 2002 Publication").**

1.6. In April 2002, the FSA issued the above publication. The FSA's April 2002 publication made it clear that one of its key regulatory priorities was the enhancement of the minimum standards for information given by firms to customers. The publication stated that vigorous enforcement action would be taken in relation to serious breaches and specifically warned against the following deficiencies:

(a) A lack of balance, with headline benefits emphasised without clear and fair mention of material risks or drawbacks;

(b) Misleading claims, and the creation of unrealistic expectations; and

(c) Key information hidden in small print.

1.7. While the FSA's April 2002 Publication does not constitute and is not treated by the FSA as having the effect of formal guidance, it does contain detailed statements regarding the FSA's expectations. This publication stressed the importance of promoting a balanced picture.

1.8. The publication stated that a key aim is to help consumers get a fair deal, with a view to ensuring that consumers' expectations are met. It highlighted the need to avoid misleading claims, buried risk warnings and unrealistic past performance or headline rates.

1.9. The Firm was aware of this publication. Its Compliance Department and Analytical Team confirmed to the FSA that they had previously seen the publication. Nevertheless, the promotions issued by the firm failed to satisfy the FSA's stated expectations, in particular with regard to promoting a balanced picture by mentioning material risks and drawbacks, avoiding the creation of unrealistic expectations and misleading claims, and ensuring that key information was not omitted or hidden in small print.

1.10. The defects in all of the promotions in question were identified not by the Firm but by the FSA's Financial Promotion Monitoring Team ("FPMT") and/or by the FSA's investigators during its investigation.

1.11. Following the identification of the failings by the FSA, the Firm changed its procedures for approving its financial promotions to ensure that the content of the promotions are clear, fair and not misleading. In particular:

- The Firm ensured the appropriate prominence of risk warnings in its financial promotions.

- The Firm improved sign-off procedures and provided formal training on financial promotions for its staff.

1.12. The FSA has taken into consideration, that:

- The Firm has been open and co-operative with the FSA during the investigation;
- It has been informed that limited resources are available to the Firm;
- The Firm did not profit from the conduct which is subject of this notice; and
- The Firm quickly agreed the facts and actively sought to agree a basis on which enforcement action could be concluded.

2. RELEVANT STATUTORY PROVISIONS AND REGULATORY REQUIREMENTS

2.1. Section 206 of the Act provides:

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

Systems and Controls Rules - General Application

2.2. FSA Rule SYSC 3.1.1 requires that:

"*A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business*."

2.3. FSA Rule SYSC 3.2.6 states that:

"*A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime*."

2.4. FSA Rule SYSC 3.2.20 (1) provides that:

"A firm must take reasonable care to make and retain adequate records of matters and dealings (including accounting records) which are the subject of requirements and standards under the regulatory system."

Financial Promotion

2.5. The glossary of definitions of the FSA's handbook defines a financial promotion as

" (in accordance with section 21(1) of the Act (Restrictions on financial promotion)) an invitation or inducement to engage in investment activity".

2.6. Section 21 (8) of the Act defines:

" '*Engaging in investment activity' means:*

(a) entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity; or

(b) exercising any rights conferred by a controlled investment to acquire, dispose of, underwrite or convert a controlled investment."

2.7. Section 21 (9) of the Act defines:

"*An activity is a controlled activity if –*

(a) it is an activity of a specified kind or one which falls within a specified class of activity; and

(b) it relates to an investment of a specified kind, or to one which falls within a specified class of investment."

2.8. Section 21 (10) of the Act defines:

"*An investment is a controlled investment if it is an investment of a specified kind or one which falls within a specified class of investment*."

2.9. Article 4 of The Financial Promotion Order defines:

"*(1) For the purpose of section 21 (9) of the Act, a controlled activity is an activity which falls within any of paragraphs 1 to 11 of Schedule 1.*

(2) For the purpose of section 21 (10) of the Act, a controlled investment is an investment which falls within any of paragraphs 12 to 27 of Schedule 1."

2.10. Paragraph 7 of Part 1 "Controlled Activities" of Schedule 1 of The Financial Promotion Order defines:

"Advising a person is a controlled activity if the advice is

(a) given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and

(b) advice on the merits of his doing any of the following (whether as principal or agent) –

> *(i) buying, selling, subscribing for or underwriting a particular investment which is a security or a contractually based investment; or*
>
> *(ii) exercising any right conferred by such an investment to buy, sell, subscribe for or underwrite such an investment."*

2.11. Paragraph 14 (1) (a) of Part 2 "Controlled Investments" of Schedule 1 of The Financial Promotion Order lists:

"*Shares or stock in the share capital of*

(a) any body corporate (wherever incorporated);"

Application of Chapter 3 - Financial Promotion - of the FSA's Conduct of Business Rules

2.12. FSA Rule COB 3.1.1 provides that:

"This chapter [Chapter 3] applies to every firm (other than ICVC) which communicates or approves a financial promotion."

Definition of a "non- real time" financial promotion

2.13. FSA Rule 3.5.5 (1) and (2) define:

"(1) A "real time financial promotion" is a financial promotion which is communicated in the course of a personal visit, telephone conversation or other interactive dialogue.

(2) A "non-real time financial promotion" is a financial promotion that is not a real time financial promotion. It includes a financial promotion made by letter, e-mail or contained in a newspaper, journal, magazine , other periodical publication, website, television or radio programme, or teletext service."

Clear, fair and not misleading - General Application

2.14. FSA Rule COB 3.8.4 (1) provides that*:*

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

Fair Comparison - General Application

2.15. FSA Rule COB 3.8.4(2) provides that:

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

(b) objectively compare one or more material, relevant, verifiable and representative features of those investments or services, which may include prices;"

Evidential Provisions

2.16. The relevant parts of COB 3.8.5 (1) contain the evidential provisions applicable to this rule and provide:

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

(b) any statement of fact, promise or prediction is clear, fair and not misleading and discloses any relevant assumptions;

(d) the facts on which any comparison or contrast is made are verified, or, alternatively, that relevant assumptions are disclosed and that the comparison or contrast is presented in a fair and balanced way, which is not misleading and

includes all factors which are relevant to the comparison or contrast;

(f) the design, content or format does not disguise, obscure or diminish the significance of any statement, warning or other matter which the financial promotion is required by this chapter to contain;

(h) it does not omit any matters the omission of which causes the financial promotion not to be clear, fair and not misleading; and

(i) the accuracy of all material statements of fact in it can be substantiated."

2.17. FSA COB 3.8.5 (2) provides that:

"(a) Compliance with COB 3.8.5 E (1) may be relied on as tending to show compliance with COB 3.8.4 R (1).

(b) Contravention of COB 3.8.5 E (1) may be relied on as tending to show contravention of COB 3.8.4 R (1)."

General Requirements – General Application

2.18. FSA Rule COB 3.8.8(1) provides that:

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

(c) the risks involved."

Past Performance – General Application

2.19. FSA Rule COB 3.8.11 provides as follows:

"A specific non-real time financial promotion which gives information about the past performance of specified investments or of a firm must include:

(1) suitable text:

(a) that is specifically designed as suitable for the type of financial promotion being promoted and its target audience; and

(b) which draws attention to the fact that past performance will not necessarily be repeated; and

(2) information relating to a relevant and sufficient period of past performance to provide a fair and balanced indication of the performance."

2.20. FSA Rule COB 3.8.15 provides that:

"Information about past performance in a specific non-real time financial promotion must not be presented in such a manner as to suggest that it constitutes a projection illustrating the possible future value of an investment contract or fund."

Rules which only apply to the Direct Offer Promotions

2.21. FSA Rules COB 3.9.15 and COB 3.9.24 apply only to the Direct Offer Promotions referred to in paragraph 4.15. below.

2.22. A direct offer promotion is defined in the FSA's glossary of definitions as:

"*A financial promotion which*

(a) contains:

(i) an offer by the firm or another person to enter into a controlled agreement with anyone who responds to the financial promotion; or

(ii) an invitation to anyone who responds to the financial promotion to make an offer to the firm or another person to enter into a controlled agreement;

(b) specifies the manner of response or includes a form in which any response is to be made (for example by providing a tear-off slip); and

(c) is not a real time financial promotion."

2.23. FSA Rule COB 3.9.15 provides that:

"(1) A direct offer financial promotion relating to an investment which can fluctuate in value, or which offers income distributions which can fluctuate, must make clear in terms which are likely to be understood by the kind of recipient to whom the financial promotion is communicated.

(2) The explanation given in conformity with (1) must be set out with due prominence and in a print size no smaller than that used in the main text of the financial promotion."

2.24. FSA Rule COB 3.9.24 requires that:

"*If an indication of the price of a particular penny share is included in a direct offer financial promotion, the bid-offer spread must also be included (based on the best price available in the relevant market at the time for transactions of the largest bid or offer price of that share).*"

Rules about Procedures for Confirmation of Compliance and Record Keeping

2.25. FSA Rule COB 3.6.1 requires that:

"(1) Before a firm communicates or approves a non-real time financial promotion, it must confirm that the promotion complies with the rules in this chapter [Chapter 3 of COB].

(2) A firm must arrange for this confirmation exercise in (1) to be carried out by an individual or individuals with appropriate expertise."

2.26. FSA Rule COB 3.7.1 (1) requires that:

"A firm must make an adequate record of each non-real time financial promotion which it has confirmed as complying with the rules in this chapter [Chapter 3 of COB]. "

2.27. FSA Rule COB 3.7.4 states that:

"A record in COB 3.7.1 R may be in any form, provided that it is readily accessible for inspection by the FSA."

Training and Competence – General Application

2.28. FSA Rule T&C 2.6.1 requires

"A firm must have appropriate arrangements in place to ensure that an employee who has been assessed as competent to engage in or oversee an activity maintains competence."

FSA Principles - General Application

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

2.30. FSA Principle 7 states that a firm must communicate with its clients in a way that is clear, fair and not misleading.

2.31. FSA Principle 8 states that a firm is required to manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

3. BACKGROUND

Hemscott Investment Analysis Ltd

3.1. The Firm is a UK incorporated company. Its principal activity is to advise its customers to buy, sell or hold certain shares ("share tipping"). It also provides commentary and technical analysis through a variety of subscription only e-mail newsletters and its websites.

3.2. The Firm is wholly owned by Hemscott Plc ("Hemscott"), a company that is listed on the Alternative Investment Market of the London Stock Exchange. Hemscott provides financial information mainly about companies listed in the UK through its website and a variety of subscription only newsletters.

3.3. The Firm was previously regulated by the Personal Investment Authority from 9 October 1998. It has been authorised by the FSA since 1 December 2001 and holds the following permissions under Part IV of the Act to undertake the following regulated activities:

- Advising on investments (except on Pension Transfers and Pension Opt Outs);
- Agreeing to carry on a regulated activity;
- Arranging (bringing about) deals in investments; and

- Making arrangements with a view to transactions in investments.

The Firm's Service

3.4. The Firm provides a share tipping newsletter called "Hemscott Analyst" which is circulated to subscribers up to three times a week via email. Subscribers pay £12.50 per month for the service. During the period May 2002 to December 2003, there were an average 2,452 subscribers to the service. The terms of subscription to this service include the right to cancel the subscription at any time within the first two weeks without being charged for the service provided. Hemscott Analyst was regularly promoted in emails to users of a free website operated by the Firm's parent company containing data about UK-listed companies. This website had up to 300,000 subscribers, of whom 198,000 were sent promotional emails by the Firm as they had previously agreed to receive them.

3.5. As part of the Hemscott Analyst service, the Firm maintained the Hemscott Analyst Portfolio. This was a virtual portfolio which had no actual holdings of shares but which mirrored the performance of shares previously recommended in Hemscott Analyst's share tips. The number of shares in the portfolio depended upon the recommendations made. The performance of this virtual portfolio was measured by Hemscott's internal software on the assumption that all of the Hemscott Analyst share recommendations were followed. Based on a mathematical calculation the software considered the performances of each individual share weighed against the value of previous share tips, and produced one figure to form an index, which purported to represent the increase or decrease of the value of the portfolio. The value of this index could then be compared with the performance of the FTSE 100 index. A description of the underlying mathematical calculation was set out on one of the Firm's websites, which was only accessible to subscribers of Hemscott Analyst.

3.6. Prior to September 2003, the Firm's Analytical Team conducted research, provided analytical content for the Firm's websites and drafted the share recommendations for Hemscott Analyst. The Analytical Team was also responsible for drafting, editing and approving financial promotions for the Firm. After FPMT contacted the Firm on 19 June 2003, it changed its internal procedures in that all financial promotions were thereafter formally approved by the Firm's Compliance Department.

4. CONTRAVENTION OF RELEVANT STATUTORY PROVISIONS AND REGULATORY REQUIREMENTS

4.1. The financial penalty is to be imposed pursuant to section 206 of the Act in respect of breaches of FSA Rules and Principles. Details of the breaches are set out below.

Systems and Controls

4.2. By virtue of FSA Rules SYSC 3.1.1, SYSC 3.2.6 and COB 3.6.1 the Firm was required to take reasonable care to establish appropriate systems and controls to comply with regulatory requirements and:

(1) To ensure before approving a financial promotion, that financial promotions

issued by the Firm comply with the FSA's rules relating to financial promotions;

(2) To ensure that conflicts of interests are identified and managed appropriately;

(3) To ensure that the Firm have in place appropriate arrangements to assess that staff involved in drafting financial promotions are sufficiently trained; and

(4) To ensure that adequate records confirming compliance of each financial promotion with Chapter 3 of COBS are retained in a form that is readily accessible for inspection by the FSA.

4.3. On two occasions the Firm's systems failed to identify that its employees involved in drafting share tips held interests in shares which were subject of the share tips. The Firm's compliance procedures were insufficient to ensure that such conflicts of interest were properly identified by its staff and its Compliance Department.

4.4. The Firm did not establish and maintain effective systems and controls to ensure compliance with the FSA Rules. These deficiencies are evidenced by the failure of the Firm to ensure that its staff complied with its Compliance Code and that conflicts of interests were identified and managed appropriately by the Firm as evidenced in paragraphs 4.6. to 4.9. below and by the fact that the Firm failed to identify that the promotions it published were not in compliance with the FSA Rules.

4.5. Specific deficiencies and weaknesses in the Firm’s procedures that contributed to the issue of the non-compliant promotions include the following:

- The Firm did not have a formal approval process in place, which could have detected breaches of FSA financial promotion rules as evidenced in paragraphs 4.10. to 4.18. below.

- Prior to July 2003 the Firm failed to provide any formal training to its staff involved in the drafting of financial promotions as evidenced in paragraphs 4.32. to 4.34. below.

- Prior to July 2003 the Firm’s procedures did not require the Compliance Department to be adequately involved in the approval of financial promotions as set out in paragraphs 4.28. to 4.31. below. This resulted in over reliance on the Analytical Team to be aware of the relevant compliance issues involved. The Compliance Department did not see any of the financial promotions prior to their publication.

- Although the Compliance Department operated a formal approval procedure after the issues with the Bear Market Promotion were brought to its attention, it continued to breach FSA rules when publishing the SmallCaps Promotion, the promotions D and E, and promotions published on its website and contained in its information pack as referred to in paragraphs 4.17., 4.20. to 4.25., and 4.27.

The Firm's Procedures for Managing Conflicts of Interest

4.6. The Firm's Compliance Code ("the Compliance Code") included written instructions and guidance on its personal share dealing policy. These instructions were issued to the Firm's staff who were directly involved in the writing or editing of the Firm's share tips or newsletters. The purpose of the Compliance Code was to ensure that the Firm's staff did not act in a way that might expose them or the Firm to a conflict of interest with the Firm's clients.

4.7. This Compliance Code stated that the Firm's staff should not undertake any transactions either in shares, CFDs with reference to shares, or option transactions in shares if "they know they are or they believe they are likely to recommend purchase of the shares or securities, until the second day after publication". The Firm's staff were not allowed to buy shares, or undertake CFDs if "they have recently published negative comments about the share or securities" and if they could be reasonably seen as profiting from their published comments. The Firm's staff were also not allowed to sell shares, or sell CFDs with reference to shares which they had recently written positively about unless "material publicly reported events negate the original recommendation".

4.8. Members of the Hemscott Analytical Team who held approved person status undertook the following share transactions in shares which they had recommended in their share tips:

(1) In July 2002, a share tip was published recommending the sale of a share listed in the FTSE 100 index. On the same day as the publication, a CFD with reference to 50,000 of those shares was sold by a member of the Analytical Team.

(2) In December 2003, a share tip was published recommending the acquisition of a share listed in the FTSE SmallCap index was published. On the same day as the publication, a purchase order for 7,000 of those shares was made by a member of the Analytical Team.

4.9. The Firm acted in breach of Principles 3 and 8 in that it failed to enforce the Firm's Compliance Code, which required the approved persons who were members of the Hemscott Analytical Team to pay due regard to the interest of subscribers when it published the two share tips referred to in the paragraph above. The Firm failed to have in place sufficient systems and controls to ensure conflicts of interest were identified and avoided as required by its Compliance Code. Subsequently the Firm failed to manage conflicts of interest by failing either to disclose on publication transactions by the Firm's staff in the recommended shares or in CFDs with reference to those shares or to ensure that no such trading took place. This led to the risk that tips made could be influenced by personal benefits to the staff member making the tip.

The Firms' Financial Promotions

<u>The Bear Market Promotion</u>

4.10. The Firm issued the Bear Market Promotion in the June 2003 edition of "Money", a separately chargeable monthly magazine under the Financial Mail on Sunday brand with a circulation of 54,000.

4.11. FPMT wrote to the Firm on 19 June 2003 highlighting a number of concerns with the Bear Market Promotion. The Firm acknowledged deficiencies in the Bear Market Promotion.

4.12. By virtue of FSA Rule COB 3.8.4(1), the Firm was required to take reasonable steps to ensure that the Bear Market Promotion was clear, fair and not misleading. It failed to do so. The promotion did not present a balanced picture of the nature of products the Firm was advising on and, in particular, did not give due emphasis to the risks involved with the Firm's share recommendations. Deficiencies include -

(a) The promotion accentuated the benefits of the service without giving any indication of the risks involved in equity investment, in particular, that investors could lose their capital. There is no capital risk warning in the promotion as required by COB 3.8.4 and COB 3.8.8(1)(c).

(b) In breach of FSA Rule COB 3.8.11, the Firm failed to include suitable text in the Bear Market Promotion to draw attention to the fact that the past performance of previous share tips will not necessarily be repeated. The promotion states "since 2000, our portfolio has grown by 14%, yet the market is down 39%"; but it fails to include any warning stating that any previous periods of favourable performance will not necessarily be repeated in the future.

(c) Under "Recent Hemscott Analyst Recommendations" the promotion lists price data for six previous share recommendations made from 10 September 2002 to 9 December 2002. Each of these has a positive outcome such that the investor would have made a significant profit, or avoided a loss, had they followed the recommendations. The word "recent" in this context is misleading as the samples have not been chosen, as implied, because they were up-to-date, but because of their positive results. These data, furthermore, failed to give a clear and balanced view because only the best performing share recommendations are included. As a result, an overly optimistic impression is given about the success of the Firm's share tips.

(d) The promotion states, "Since 2000, our portfolio has grown by 14%, yet the market is down by 39%" and "You could be ahead of the market by 50%". The promotion omits to mention that the Firm's portfolio is actually a virtual portfolio; and that the Firm is not in fact acquiring the stocks itself. The promotion does not mention what the portfolio actually comprises of or how it is constructed. The promotion does not explain the assumption underlying the forecast of the claimed advantage of "50%".

4.13. The Firm breached FSA Rule COB 3.8.15 when it presented information about past performance in such a manner that it constituted a projection illustrating the possible future value of a fund of shares the investor would hold if he followed all of the Hemscott Analyst share tips. The Bear Market Promotion claimed "You could be ahead of the market by 50%". Together with the statement referred to in paragraph 4.12(b), this text creates the overall impression that past performance and future prospects are linked.

Emails promoting Hemscott Analyst

4.14. To promote Hemscott Analyst the Firm sent promotions via email to subscribers to Hemscott's free corporate information website.

4.15. All of the emails constitute direct offer financial promotions because they were non-real time financial promotions inviting anyone who responded to these promotions to make an offer to the firm to enter into a contractual agreement allowing access to Hemscott Analyst. The emails specified the manner of response as they featured highlighted hyperlinks that provided access to a webpage containing the Hemscott Analyst registration form for its subscription. The responding addressee activated the link with a mouse-click and was guided via another webpage promoting Hemscott Analyst to the Hemscott Analyst registration form.

4.16. The promotions featured the following statements within the bold printed text:

Promotion	**Statements**
A[3]	"Since November 2000 when we started our regular emails to subscribers our tips have risen by an average of 19% while the market has fallen 38%."
B[4]	"Since November 2000 when we started our regular emails to subscribers a portfolio of our tips has risen by an average of 28% while the market has *fallen* by 38%."
C[5], D[6]	"As you can see from the graph, our portfolio has convincingly beaten the market – a 48% gain versus the Footsie's 36% loss."
E[7]	"As you can see from the graph, our portfolio has convincingly beaten the market – a 67% gain versus the Footsie's 36% loss."

Throughout this Notice the promotions are identified by reference to the letters above.

4.17. As explained in paragraph 4.27. below the Firm has been unable to verify the percentage figures used in promotions C and E. The Firm informed the FSA that the percentages had been calculated by the Firm's portfolio software described in paragraph 3.5**.** The figures in each statement were calculated by the system on the day each promotion was edited. The Firm did not retain any hardcopies of these calculations. Following the FSA's request to provide records for figures used in promotions C and E the Firm was unable to replicate the historical calculations and to confirm the figures used in either promotion.

4.18. In contravention of FSA Rule COB 3.8.4(1), the Firm failed to ensure that the email promotions were clear, fair and not misleading. The direct offer promotions did not present a fair, clear and balanced picture of the products the Firm was promoting. Deficiencies include:

[3] "Hemscott Analyst on a winning roll – don't miss out, profit from your free trial today" issued in May 2003.
[4] "Hemscott Analyst – we tell what to buy and (what really matters) when to sell it again" issued in May 2003.
[5] "Hemscott Analyst: hitting new heights" issued in July 2003.
[6] "Hemscott Analyst – Making Significant Gains" issued in July 2003.
[7] "Hemscott Analyst: leaving the market behind", which was issued in September 2003.

(1) In contravention of FSA Rule COB 3.8.8 (1)(c) promotion B, which was issued after the Bear Market promotion but prior to receipt of FPMT's letter dated 19 June 2003, did not contain any fair and adequate description of the risks of the Firm's share tipping service.

(2) In contravention of FSA Rule COB 3.8.11, the Firm failed to include suitable text in promotion B, which draws attention to the fact that the past performance of previous share tips referred to in the promotion will not necessarily be repeated. In addition, while suitable text is included in promotion A, this text appears on page 11 of the 12-page long email and is not presented in the main text of the financial promotion.

(3) In contravention of FSA Rule COB 3.9.15 the Firm failed to state in clear terms and with due prominence that the investments referred to in its promotions can fluctuate in value in such a way that it was likely to be understood by the relevant recipients. The direct offer promotions A and B include lists of previously tipped shares, which are investments that fluctuate in value. Such statements have to be set out with due prominence pursuant to FSA Rule COB 3.9.15 (2). Promotion B did not contain any such reference at all in breach of COB 3.9.15 (1). The text at the end of promotion A is not set out with due prominence in breach of COB 3.9.15(2).

(4) In contravention of FSA Rule COB 3.9.24 the Firm failed to include details of the bid-offer spread on a penny share which was included in the direct offer promotions A and B. Both promotions contained a list of shares previously recommended by the Hemscott Analyst service, which included one "penny share" and its mid price as of the date of the buy recommendation and subsequent sell recommendation.

The SmallCaps Promotion

4.19. The Firm published a financial promotion entitled "SmallCaps Storm Back" in the Investors Chronicle on 25 July 2003 promoting the Hemscott Analyst service ("the SmallCaps Promotion"). The magazine had a circulation of 43,000 copies at that time. The promotion was published after FPMT had contacted the Firm on 19 June 2003 informing it about potential breaches of the FSA's Conduct of Business rules arising from communication of the Bear Market promotion and after the Firm had responded acknowledging the deficiencies.

4.20. The Firm acted in breach of FSA Rule COB 3.8.4(1) and failed to ensure that the SmallCaps Promotion was clear, fair and not misleading. The promotion did not present a fair, clear and balanced picture of the products the Firm was promoting and, in particular, failed to disclose relevant assumptions. The SmallCaps Promotion:

(1) features the phrase "Over the last two and a half years, a portfolio of Hemscott recommendations has risen by 45% while the market as a whole has fallen by 36%". The 36% fall is a reference to the FTSE 100. This is a misleading comparison given that the Firm's recommendations are (as referred to elsewhere in the financial promotion) mainly SmallCap shares. The promotion itself

indicates that the performance of SmallCap shares does not mirror that of the FTSE 100 highlighting a 10% differential over an undefined period. While the promotion indicates that the Firm recommends SmallCap shares, the phrases are ambiguous in the context of the term "the market as a whole" or the "portfolio of Hemscott recommendations."

(2) the promotion features a table of shares headlined as "Top performing Hemscott Analyst share recommendations as at July 15th 2003." The table claims gains of 57% to 102%, which would have been made if the recommendations had been followed. The selected "top performing" share tips which show substantial gains are then compared with performance of the FTSE 100 index and consequently the firm did not present the comparison in a fair and balanced way as set out in COB E 3.8.5 (1)(d).

4.21. As described in paragraph 5.27 below the Firm was unable to verify the percentage figures referred to in paragraph 5.20.(1).

Promotions on the Firm's Website

4.22. FPMT reviewed financial promotions contained on the Hemscott website home page as at 31 July 2003 and identified several issues that were similar to those found in the Bear Market Promotion.

4.23. The Firm acted in breach of FSA Rule COB 3.8.4(1) by failing to ensure that the promotion published on Hemscott's website prior to 31 July 2003 was clear, fair and not misleading.

4.24. The Firm breached FSA Rule COB 3.8.8(1)(c) by failing to include a fair and adequate description of the risk involved in the promoted service and the investments related to such service.

The Firm's Information Pack

4.25. The Firm promoted Hemscott Analyst and its other services in a hardcopy of a screen print taken from one of the Firm's websites. The print-out was created on 14 November 2002 as part of an information pack which was handed out to potential customers at conferences and exhibitions. The promotion invited addressees to sign up to a two-week free trial of the Firm's share tipping service but did not contain any sufficient risk warning in breach of FSA Rule COB 3.8.8.

Contents of Records

4.26. Prior to and at the time of the publication of the Bear Market promotion the Firm did not retain adequate records of the approval of financial promotions, as required by FSA Rules COB 3.7.1 and SYSC 3.2.20(1). The Firm did not retain any of the following documentation:

(1) the name of the individual or individuals who confirmed that the financial promotion complied with the rules in Chapter 3 of the FSA's "Conduct of Business" Handbook ;

(2) the date of confirmation and (where appropriate) approval; and

(3) details of the medium for which the financial promotion was authorised.

4.27. The Firm also failed to comply with FSA Rules COB 3.7.1 and COB 3.7.4 because it failed to retain the evidence supporting material factual statements made in its Bear Market Promotion, the SmallCaps Promotion, and promotions C and E. The Firm did not retain copies of those records in a form which is readily accessible for inspection by the FSA. The deficiencies are:

(1) In its Bear Market Promotion the firm referred to the growth figure of "14%" of its virtual portfolio as set out in paragraph 4.12.(b). During the course of the FSA's investigation, attempts by the Firm to verify the 14% figure produced a lower figure of 11.3%. The Firm stated that the figures for the underlying calculations had been copied from the screen of Hemscott's portfolio software at that time, however, no screen print or copies of the calculations were retained.

(2) When the Firm was asked to provide verification of the figures used in promotions C and E as referred to in paragraph 4.16. and in paragraph 4.20.(1) in the SmallCaps Promotion the Firm was unable to verify the figures. The figures in each statement were calculated by the system on the day each promotion was edited, however, the Firm did not retain any hardcopies of these calculations. Following the FSA's request to provide records for figures used in these promotions the Firm was unable to replicate the historical calculations and to confirm the figures used.

The Firm's Procedures for Approving Financial Promotions

4.28. Prior to 19 June 2003, the Firm did not provide any written instructions or guidance on financial promotions and marketing to its staff, although it did provide oral guidance on the requirements. The Firm explained that the procedure for approving financial promotions had not been written down in a compliance manual or elsewhere because the creation of promotions involved only a small team of five people within the Firm. Prior to August 2002 promotional advertisements were drafted by the Analytical Team and then informally discussed with the Compliance Department.

4.29. After August 2002, the Analytical Team drafted and approved financial promotions although this procedure was not documented. The Compliance Department did not approve any of the promotions. Hard copies of drafts of financial promotions documenting the approval process were not retained.

4.30. The Bear Market Promotion was drafted and issued by members of the Firm's Marketing Department. Although the Analytical Team provided some of the underlying financial data for the promotion, it was not shown the final version of this promotion for approval. The Compliance Department was not contacted before the promotion was published. The Firm did not have any formal procedure to approve or check financial promotions where relevant members of the Analytical Team or of the Compliance Department were absent.

4.31. Following correspondence with FPMT after the publication of the Bear Market Promotion, the Firm introduced a formalised approval process which involved the Compliance Department approving all financial promotions and retaining a hard copy of each approved promotion.

The Firm's Training and Competence Procedures

4.32. Prior to July 2003, the Firm did not have training programmes in place for any member of staff involved in the preparation of financial promotions. The Hemscott Analytical Team received what was described as "on the job" training. Neither the Hemscott Analytical Team nor members of the Marketing Department, who edited and published the Bear Market Promotion, had received any formal training.

4.33. Consequently, by virtue of FSA Rule T&C 2.6.1, the Firm failed to have appropriate arrangements in place to ensure that an employee who had been assessed as competent to engage in or oversee an activity maintained competence. The FSA regards "on the job training" that members of the Analytical Team claimed to have received prior to August 2002 as insufficient, as it did not ensure that staff were sufficiently updated about regulatory developments.

4.34. Following the correspondence with FPMT in June 2003, the Firm's Compliance Department in July 2003, circulated copies of Chapter 4 of the FSA's April 2002 publication and provided further documentation and training on the FSA's financial promotion rules to the Firm's staff and its Marketing Department.

Breach of FSA Principles

4.35. By virtue of FSA Principles 3, 7 and 8 the Firm was required to conduct its business with due care, skill and diligence, take reasonable care to organise and control its affairs responsibly, manage conflicts of interest fairly and communicate with its clients in a way that was clear, fair and not misleading:

(1) The Firm failed to have in place systems and controls to manage conflicts of interest fairly in breach of Principle 3 and Principle 8.

(2) The Firm failed to pay due regard to the information needs of its clients in that it published financial promotions, which were not clear, fair and not misleading. Consequently, the Firm acted in breach of Principle 7.

(3) The Firm has failed to exercise due skill, care and diligence; and to organise and control its internal affairs in a responsible manner. It failed to ensure that arrangements were in place to ensure that there were appropriate review and approval procedures to ensure that misleading and unfair advertisements were not issued. The existing compliance systems and the internal Compliance Code were not effective nor were they put into practice. Consequently, the Firm acted in breach of Principle 3.

5. REGULATORY HISTORY

Previous interaction between the Firm and its Regulators

5.1. The Firm has not previously been subject to disciplinary action by the FSA or its previous regulator. The Firm agreed with a number of the criticisms raised by FPMT in June 2003 in particular concerning the Bear Market Promotion. Despite this, other deficiencies continued to appear in other financial promotions published after June 2003.

6. RELEVANT GUIDANCE ON SANCTION

6.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement Manual ("ENF"), which forms part of the FSA Handbook. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.

6.2. It must be made clear to regulated firms that failure to issue financial promotions that are clear, fair and not misleading represents misconduct which may lead to disciplinary measures being taken. This should act as a deterrent to other firms and help to ensure that regulatory standards are upheld. Financial promotions are, as set out above, an area which the FSA has, since April 2002, repeatedly said is a priority. It is critical that firms, in all sectors of the market, understand the importance the FSA places on such communications to potential consumers.

6.3. It is stated at ENF 13.3.4 that the criteria listed in the manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.

6.4. In determining whether a financial penalty is appropriate, and its level, the FSA considered all the relevant circumstances of the case. The FSA considered the following factors to be particularly relevant in this case.

The Seriousness of the Misconduct or Contravention.

6.5. The level of financial penalty must be proportionate to the nature and seriousness of the contravention.

6.6. The Firm did not operate sufficient systems and controls and compliance procedures to identify or prevent the rule breaches. The Firm did not identify that the financial promotions referred to in paragraph 4 were misleading and featured numerous material breaches of FSA Rules relating to financial promotions. The FSA's April 2002 Publication had provided examples of claims that could mislead, including claims about past performance which could have a misleading impact when the required "health warnings" are buried in small print or crouched in vague or ambiguous language.

6.7. Despite being notified by the FSA of the deficiencies in the Bear Market Promotion, the Firm continued to issue non-compliant promotions. These promotions were issued despite the considerable material issued by the FSA highlighting the importance of financial promotions and setting out the regulatory approach to this area. The FSA had previously emphasised balance was an important part of ensuring that the overall effect of a financial promotion was not misleading.

<u>The amount of profit accrued or loss avoided</u>

6.8. There is no evidence that the Firm or the individuals breaching the Compliance Code accrued additional profits as a result of their failings.

<u>Conduct following the contravention</u>

6.9. The Firm did not itself identify the breaches. However, once the breaches were brought to its attention, it actively sought to respond to concerns raised by the FSA and improve its procedures to ensure future compliance. The firm amended its promotions to include suitable text highlighting the potential risks involved and implemented a formal review procedure to ensure regulatory compliance.

Disciplinary Record and Compliance History

6.10. The Firm has not been subject to any previous enforcement action.

<u>Impact of the Financial Promotions</u>

6.11. The Firm's records indicate that subscriptions to its share tipping service did not increase substantially during the period when the financial promotions were issued.

6.12. The FSA has also noted that the promotions were issued only in subscription periodicals or to Hemscott's subscribers and not in mass media.

<u>Previous action by the FSA in relation to similar failings. Action taken by other regulatory authorities in relation to similar findings</u>

6.13. The FSA has in the past, taken action against firms for advertising/financial promotions failings. The FSA has not previously taken action in respect of a financial promotion for a service of the nature offered by the Firm. The FSA has taken into account the nature of the business provided by the Firm and the potential risk to consumers' interests when it decided the level of the financial penalty in this matter.

7. IMPORTANT NOTICES

7.1. This Final Notice is given to the Firm in accordance with Section 390 of the Act.

Manner of Payment

7.2. The Penalty must be paid to the FSA in full.

Time for payment

7.3. The Penalty must be paid to the FSA no later than 27 January 2005, being not less than 14 days beginning with the date on which the Notice is given to the Firm.

If the Penalty is not paid

7.4. If all or any of the Penalty is outstanding on 28 January 2005, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

Publicity

7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under these 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 a manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to the Firm or prejudicial to the interests of consumers.

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

FSA contacts

7.7. For more information concerning this matter generally, you should contact Paul Smith (direct line: 020 7066 4686 fax: 020 7066 4687) or Alex Splittgerber (direct line: 020 7066 3064 fax: 020 7066 3065) at the FSA.

Tracey McDermott

Head of Perimeter, Stockbroking and Asset Management
FSA Enforcement Division