
FINAL NOTICE

To: The London Adventist Credit Union Limited

**Of: c/o The John Loughborough School
Holcombe Road
London
N17 9AD**

Date: 3 May 2006

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you notice about publishing a statement, in the following terms, censuring the London Adventist Credit Union ("LACU") for contravening regulatory requirements under the FSMA.

ACTION

1. The FSA gave you a Decision Notice on 27 October 2004 which notified you that pursuant to section 205 of the Financial Services and Markets Act 2000 ("FSMA"), the FSA had decided to publish a statement in the following terms, censuring the LACU for contravening regulatory requirements under the FSMA.
2. The FSA postponed issuing this notice until after an associated decision was reached by the Financial Services and Markets Tribunal ("The Tribunal") on the FSA's case against the LACU's former Chairman, Dr Albert Alphonso Caryle Waite ("Dr Waite"). The Tribunal upheld the FSA's decision. A subsequent application by Dr Waite to the Court of Appeal for leave to appeal against the decision of the Tribunal was also declined.

Terms of the Statement

3. In March 2001 the LACU invested £100,000 in a property in East London ("the Property"). On 14 July 2002 a letter was received by the LACU Board ("the Board") from the developer offering to repay LACU £120,000 on the condition that LACU's Chairman, Dr Waite, relinquish his interest in the freehold of the property. Owing to a personal financial interest in the property Dr Waite refused to transfer the freehold to the developer. Consequently the LACU did not receive, and has still not received, repayment of its original investment. Despite having been made aware of its Chairman's conflict of

interest the LACU Board left monitoring and management of the investment solely to Dr Waite. The LACU Board also failed to take adequate or appropriate steps to recover the investment or protect its position. In particular it failed to take timely and independent legal advice.

4. The fact that the investment was not repaid resulted in the LACU breaching the capital requirement under the Credit Union Sourcebook ("CRED") R 8.3.1, which imposes on a credit union a requirement that it must, at all times, maintain a positive amount of capital. Further, owing to the residential nature of the property, the investment is not authorised under CRED. In response to concerns about the conduct of the Board and its Chairman a Special General Meeting was called on 11 July 2004, at which members of the LACU elected a new Board. This censure relates to the FSA's concerns about the activities of the previous Board and does not relate to the new Board.

REASONS FOR THE ACTION

5. The FSA has concluded on the basis of the facts and matters described below that the LACU has contravened requirements imposed on it under the FSMA.

Summary of Relevant Conduct

6. The FSA took over regulation of credit unions on 2 July 2002 ("Credit Union Day"). In reaching a conclusion about the behaviour of the LACU by reference to the Principles for Businesses and CRED, only behaviour after this date has been taken into account. Facts referred to before this date are relied on as background only. Breaching a Principle and other FSA Rules makes a credit union liable to the FSA's disciplinary sanctions.

Factual Background Prior to Credit Union Day

7. In March 2001 the LACU Board voted unanimously to invest £100,000, which equated to approximately a quarter of the credit union funds, in the development of a residential property in East London. This was completely outside the terms of reference of the credit union. The investment was facilitated by the Board's Chairman, Dr Waite. The Board did not make independent inquiries into the nature of the investment and in doing so it failed in its professional responsibility to ensure that credit union funds were used in an appropriate and authorised manner. The investment was in breach of sections 12(1) and 13(1) of the Credit Unions Act 1979, in that the property was a residential development and therefore not an investment authorised by an order made by the chief Registrar of the Registry of Friendly Societies ("the RFS"). The credit union invested in an unsecured way and without taking professional advice. The Board did not obtain any enforceable security over the investment, as such the £100,000 was invested on an unsecured basis and in doing so the Board failed in its professional duty to protect members' funds.

Failures of LACU occurring after 2 July 2002

8. In the period post 2 July 2002 the LACU failed to protect adequately the £100,000 investment. In particular the LACU Board:

- (1) left monitoring and management of the investment entirely to Dr Waite, despite being made aware of a conflict of interest between Dr Waite's role as the Chairman of LACU and his personal financial interest in the property;
 - (2) failed to take adequate or appropriate steps to recover the investment and protect the position of LACU. In particular the LACU Board failed to take independent and timely legal advice;
 - (3) failed to ensure that LACU met its capital requirement as prescribed by the Credit Unions Source Book ("CRED") resulting in the LACU voluntarily varying its own permission in November 2003 in order to preserve its financial position; and
 - (4) failed to ensure that the investment was one authorised by CRED 7.
9. In the light of the above the FSA considers it necessary to publish a statement censuring LACU in the terms proposed in order to achieve its regulatory objectives.¹ Those objectives include maintaining market confidence in the financial system and consumer protection.

RELEVANT STATUTORY AND REGULATORY PROVISIONS

The FSA's power to issue a public censure

10. The FSA is empowered by Part XIV of the FSMA to take action against a firm if it has contravened a requirement imposed on it by or under the FSMA.
11. Section 205 states that:
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 Credit Unions Source Book

12. CRED sets out the types of investment which a credit union may make² and the restricted circumstances in which a credit union may hold land and buildings.³ CRED 7.2.8 provides that:
A credit union may only hold land (and buildings) for the purpose of conducting its business on that land, and where it needs to do so as security for loans to members (section 12 of the Credit Unions Act 1979). This means that a credit union must not acquire as an investment land (and buildings) greatly in excess of its operating requirements, with the real purpose of letting out the excess.
13. CRED R 8.3.1 imposes on a credit union a requirement that it must at all times maintain a positive amount of capital.

¹ Set out in FSMA section 2 (2)

² CRED R 7.2.1

³ CRED R 7.2.8

The Principles for Business

14. The Principles for Business ("PRIN") are a general statement of the fundamental obligations of firms under the regulatory system. Breaching a Principle makes a firm liable to disciplinary sanctions.

Relevant Guidance

15. In deciding on the action proposed, the FSA has had regard to the guidance published in the FSA Handbook and in particular Chapters 12, "Public Censures and Public Statements" and Chapter 13 "Financial Penalties" of the Enforcement manual ("ENF"). In respect of public censures:

- (1) ENF 12.1.1(1) provides that:

The FSA may issue a public censure on a firm under section 205 of the Act (Public censure) where it considers that the firm has contravened a requirement imposed on it by or under the Act.

- (2) ENF 12.2.2 states:

The FSA regards the decision to issue a public censure or public statement as a serious sanction. The FSA is aware of the effect such a statement may have on the reputation or business of a firm or approved person. However, where it is not appropriate to impose a financial penalty, the FSA considers that a public censure or public statement may have particular value in enabling the FSA to pursue its regulatory objectives by highlighting the requirements and standards of conduct expected of firms and approved persons, and demonstrating that those standards are being effectively enforced, so helping to maintain confidence in the financial system. In addition, public censures and public statements promote public awareness of the standards of behaviour expected of firms and approved persons. Increased public awareness also contributes towards greater consumer protection.

- (3) ENF 12.3.3 states:

The criteria for determining whether it is appropriate to issue a public censure or public statement rather than impose a financial penalty are similar to those for determining the level of financial penalty listed in ENF 13. The starting point is that the FSA will consider all the relevant circumstances of the case.

There follows a list, which is expressly described as "not exhaustive" of factors which may be relevant in a particular case, including:

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

(6) If the firm or approved person has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach or misconduct would otherwise attract, this

may be a factor in favour of a lower level of penalty or public statement rather. However, it would only be in an exceptional case that the FSA would be prepared to agree to impose a public statement rather than a financial penalty, if a financial penalty would otherwise be the appropriate sanction.

16. In respect of financial penalties, the FSA had regard to the following:

(1) ENF 13.1.1 (1) provides that:

the FSA may impose a financial penalty on a firm where the FSA considers that the firm has contravened a requirement imposed on it by or under section 206 of the Act.

(2) In deciding whether to impose a financial penalty the FSA had regard to:

(a) ENF 13.3.3(3):

Whether the person on whom the penalty is to be imposed is an individual, and the size, financial resources and other circumstances of the firm or individual.

(b) ENF 13.6.2:

In considering whether to impose a financial penalty on a mutual (such as a building society), the FSA will take into account the impact that a penalty may have on a firm's customers, as the FSA would with any firm. However, the FSA may decided to impose a financial penalty on a mutual, taking into account all the circumstances of the case (including the factors listed in ENF 13.3.3.G), 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 incorporated as a company...

FACTS AND MATTERS RELIED ON

LACU

17. LACU is an FSA regulated credit union. Throughout the period March 2001, when the investment in the property was made, until 11 July 2004, its Chairman was Dr Waite.
18. On 22 August 2003 the FSA commenced its investigation into the conduct of Dr Waite and the LACU Board in respect of the investment in the property.
19. On 24 November 2003 the FSA varied LACU's permission on its own application because LACU no longer met the capital requirement of the Credit Unions Sourcebook.⁴ As a result of the voluntary variation of permission ("VVOP") LACU may not without the written consent of the FSA:

⁴ CRED R 8.3.1

- (1) carry on the regulated activity in its permission, of accepting deposits;
- (2) in any way dispose of, deal with or diminish the value of any of its assets;
- (3) borrow money;
- (4) accept a payment representing the whole or any part of an amount due by way of subscription for a share in the credit union other than a payment which fell due before the effective date of the variation;
- (5) lend money; or
- (6) repay share capital.

Pre Credit Union Day Background

20. At an Extraordinary Board Meeting held on 25 March 2001 the LACU Board decided unanimously to invest £100,000 of credit union funds in the development of a residential property in East London. The investment was solicited from LACU by its Chairman, Dr Waite. In reaching its decision to invest, the Board relied entirely on information supplied by Dr Waite. The Board did not carry out its own enquiries or due diligence.
21. The investment was made on an unsecured basis and was used to purchase the property in the names of Dr Waite and the developer, and to secure finance from a finance company. The investment was not a deposit or a part payment on an actual flat, nor did it secure a specified purchase price. The investment purported to secure for LACU an option to purchase a flat and, in the event that LACU did not purchase a flat, the repayment of its investment and an additional £20,000.
22. To make the investment on 29 March 2001 the Board transferred £100,000 to the personal bank account of Dr Waite.
23. After the LACU Board voted to invest the £100,000 Dr Waite signed an agreement with the developer whereby he would facilitate the investment from LACU and personally receive £55,000 from the proceeds of the development. The terms of the finalised agreement between Dr Waite and the developer were set out in an agreement ("the Investment Agreement") dated 11 April 2001. The terms of the Investment Agreement were not disclosed by Dr Waite to the LACU Board.
24. On 12 April 2001 a separate letter ("the option letter") was sent by the developer to the LACU Board. The option letter acknowledged receipt of the £100,000 and an option for LACU to purchase a ground floor flat. The option letter also provided for the £20,000 return to be paid by 20 September 2001 to LACU in the event that LACU did not purchase the flat. The letter did not refer to Dr Waite's personal financial interest in the investment.

Failure to monitor the investment adequately

25. The LACU Board left the monitoring of the investment entirely to Dr Waite, even after the Board had been made aware of the full terms of the Investment Agreement

by a letter dated 14 July 2002 from the developer to LACU care of one of the Board members.

26. The letter of 14 July 2002 repeated a previous offer made in a letter to Dr Waite dated 1 July 2002 in which the developer sought to:

- (1) pay LACU the £120,000 plus interest specified in the Investment Agreement;
- (2) pay Dr Waite the £55,000 specified in the Investment Agreement; and
- (3) end Dr Waite's interest in the property by obtaining a transfer of his interest in the freehold of the property.

27. Dr Waite refused to transfer the freehold interest without first personally obtaining a greater share in the profits than the £55,000 specified in the Investment Agreement. As a result LACU did not receive repayment of its investment.

28. Following receipt of the developer's letter the LACU Board convened an Extraordinary Board meeting on 21 July 2002. Dr Waite was not present at this meeting. An email records the conclusions of the discussions. These included:

- (1) the investment was made on a sound basis (no reasons were provided);
- (2) it was "not applicable" to have given the Chairman guidelines;
- (3) the Board members would need to see the Investment Agreement;
- (4) the £100,000 was recoverable (no basis was provided);
- (5) the investment was lawful under the FSA rules (no basis was provided).

The email records a request for a written report of the transaction from the Chairman to be provided to the Board. This report was never provided.

29. The email was sent to Dr Waite on 20 August 2002. The email was subsequently brought before a LACU Board meeting where, at the prompting of Dr Waite, a manuscript conclusion was added confirming confidence in Dr Waite, and his actions to date, and that Dr Waite should continue to deal with matters relating to the investment.

30. The continued failure by the Board to take appropriate steps to monitor the Investment even after having been made aware of the full terms of the Investment Agreement, and in particular the conflict of interest between Dr Waite's personal financial interest in the investment and his position as Chairman, breached the following Principles for Business:

- (1) *Principle 2 – Skill, care and diligence. A firm must conduct its business with due skill, care and diligence.*
- (2) *Principle 3 – Management and control. A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.*

- (3) *Principle 8 – Conflicts of interest. A firm must manage conflicts of interest fairly both between itself and its customers and between a customer and another client.*
- (4) *Principle 10 – Clients' assets. A firm must arrange adequate protection for clients' assets when it is responsible for them.*

Failure to take adequate or appropriate steps to recover the investment and protect the position of LACU

31. Despite having been made aware of the Investment Agreement, and Dr Waite's personal financial interest in the investment, the LACU Board failed to take adequate or appropriate steps to recover the investment and protect LACU's position. In particular:
- (1) monitoring and negotiations regarding repayment of the investment continued to be carried out exclusively by Dr Waite notwithstanding the Board's knowledge that a conflict existed between Dr Waite's personal interest in the investment and his position as Chairman of LACU and despite knowing that Dr Waite had prevented repayment of the investment to LACU because of his personal dispute with the developer;
 - (2) the Board failed to take timely and independent legal advice regarding its position or means by which it could secure repayment of the investment; and
 - (3) settlement discussions took place between Dr Waite, the developer and the finance company between September 2002 and April 2003. LACU was not a party to these discussions and was not separately represented from Dr Waite. The settlement discussions were ultimately unsuccessful.

Failure to ensure LACU met capital requirements

32. LACU's audited year end accounts for 2002 reported uncertainty as to whether the £100,000 deposit was an asset or whether a loss of £100,000 would be incurred by LACU. The accounts were qualified in this respect.
33. LACU's 2003 accounts were corrected to show the £100,000 investment as a loss to LACU. As a result LACU failed to meet the capital requirement under CRED R 8.3.1 which imposes on a credit union a requirement that it must at all times maintain a positive amount of capital.
34. LACU also breached Principle 4 of the Principles for Business, Financial Prudence, which provides that "*a firm must maintain adequate financial resources.*"

Failure to ensure that the investment was authorised under CRED

35. The Board was required both by the provisions in CRED, and the LACU rules to ensure that LACU's surplus funds were invested in an authorised manner. Owing to the residential nature of the property the investment breached the provisions of CRED 7.2.8 (set out above).

Conclusions

36. Public censure is an alternative disciplinary option to imposing a financial penalty and the FSA considers that in this case a public censure is more appropriate because of the detrimental effect that a financial penalty would have upon the credit union. It would be to the ultimate disadvantage of members and the failure to recover the £100,000 investment has left the LACU with inadequate means to meet a financial penalty.
37. The FSA considers that the LACU Board has breached requirements imposed on it by the FSMA.
38. The FSA considers these breaches to be such that it is necessary to issue a public censure in the terms proposed.

IMPORTANT

This Final Notice is given to LACU in accordance with section 390 of the Act.

Publicity

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

For more information concerning this matter generally, you should contact Francesca Harte at the FSA (direct line 020 7066 1482 / fax: 020 7066 1483)

Jonathan Phelan
Head of Division
FSA Enforcement Division