FINAL NOTICE

To: **Mansion House Securities Limited**

Of: **8-10 Mansion House Place**
London
EC4N 8LB

Date: **31 March 2008**

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

1. THE PENALTY

1.1. The FSA gave Mansion House Securities Limited ("MHS/the Firm") a Decision Notice on 27 March 2008 which notified MHS that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("FSMA"), the FSA had decided to impose a penalty of £122,500 on MHS for breaches of the FSA Principles for Businesses ("FSA Principles") and Conduct of Business Rules ("COB") by MHS that occurred between 3 May 2006 and 18 January 2007 ("the Relevant Period") in relation to its advising and arranging the sale of higher risk shares to private customers. In particular, MHS failed to:

(1) pay due regard to the interests of its customers and treat them fairly in breach of Principle 6;

(2) pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading in breach of Principle 7;

(3) take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely on its judgement in breach of Principle 9; and

(4) take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in breach of Principle 3.

1.2. In addition to the Principle breaches, MHS also breached the following rules: COB 5.2.5 R (know your customer), COB 5.3.5(1)R (suitability), COB 5.4.3R (requirement for risk warnings), and COB 5.7.3(1)R (disclosure of charges, remuneration and commissions).

1.3. MHS confirmed on 13 March 2008 that it will not be referring the matter to the Financial Services and Markets Tribunal.

1.4. Accordingly, for the reasons set out below and having agreed with MHS the facts and matters relied on, the FSA imposes a financial penalty on MHS in the amount of £122,500.

1.5. MHS agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (Stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount the FSA would have imposed a financial penalty of £175,000 on MHS. MHS will also obtain an independent review of its current compliance with regulatory standards and also of its past business during the Relevant Period, and will remediate customers where appropriate.

2. REASONS FOR THE ACTION

2.1. The breaches of the FSA Principles and Rules relate to a number of serious failings arising from MHS's advice in relation to, and sale of, shares to private customers in

respect of higher risk shares in five small capitalised companies over the Relevant Period.

2.2. In summary, MHS fell below the standard to be expected under the regulatory system for the following reasons:

(1) MHS made inaccurate statements about its expertise, the services that the Firm could offer and the extent of the Firm's research into the shares it recommended. It failed to give a balanced description of the shares and did not give its customers clear and accurate information about the higher risk and potential lack of liquidity of the shares it sold. It also failed adequately to disclose all the commission and charges it was earning on its transactions. Accordingly, MHS failed to pay due regard to the information needs of its customers, and failed to communicate information to them in a way that is clear, fair and not misleading in breach of Principle 7 (Communications with clients) of the FSA Principles;

(2) MHS failed to obtain sufficient information about its customers' personal and financial circumstances to assess whether its advice was suitable before recommending shares to customers and ignored concerns about suitability from the limited information it did obtain. Accordingly, MHS failed to take reasonable steps to ensure the suitability of its advice, in breach of Principle 9 (Customers: relationships of trust) of the FSA Principles;

(3) MHS employed inappropriate sales practices that included continuing to recommend shares to customers who had told MHS that they were not interested in purchasing the shares offered, and placing pressure on customers by often inaccurately suggesting that the opportunity to purchase would be lost if not swiftly taken up as the available shares were running out, although. each issue of the shares was limited, and there was sometimes a risk that the opportunity to purchase may be lost. It failed to mitigate the risks arising from its reliance on due diligence undertaken by parties with significant interests in the shares it recommended. It also failed to disclose the income received by the Firm from the companies whose shares it promoted. Accordingly, MHS

failed to pay due regard to its customers and treat them fairly in breach of Principle 6 (Customers' interests) of the FSA Principles;

(4) MHS failed to identify, assess and manage the risks to its business and its customers in selling higher risk shares. It failed to establish adequate and robust training programmes and implement compliance procedures to adequately monitor sales and to identify and remedy failures or weaknesses in the sales process. Accordingly, MHS failed to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems in breach of Principle 3 (Management and control) of the FSA Principles; and

(5) In addition to the breaches of FSA Principles, MHS also breached the following Rules, which were then in force and were set out in the part of the FSA Handbook entitled Conduct of Business: COB 5.2.5R (know your customer), COB 5.3.5(1)R (suitability), COB 5.4.3R (requirement for risk warnings), and COB 5.7.3(1)R (disclosure of charges, remuneration and commissions).

2.3. MHS's failings are considered to be serious because of the following matters:

(1) MHS's customers were entitled to rely on the Firm to take reasonable steps to ensure the suitability of its advice, and to be treated fairly. Its customers should not have been subjected to inappropriate sales practices which actively encouraged and pressured them to make immediate investment decisions about higher risk shares based on information that was inaccurate, incomplete and misleading. The use of such practices presented a real and significant risk of customers being recommended shares by MHS such investments being unsuitable for them and without fully understanding the nature of the risks associated with the shares;

(2) MHS's customers were exposed to the risk of loss as they relied on the brokers' skills, knowledge and expertise as MHS failed to assess adequately the competence of its advisers, or provide appropriate training for them, knowing that customers would rely on their skills, knowledge and expertise; and

(3) The breaches revealed serious weaknesses in the sales process, management systems and internal controls relating to the Firm's business and presented a significant risk to the FSA's objectives of securing the appropriate degree of protection for customers and maintaining confidence in the financial system.

2.4. In making the decision to impose a financial penalty on MHS, the FSA has taken into account actions taken by the Firm on learning of the FSA's concerns. In particular, MHS's failings are mitigated by the fact that the Firm engaged an independent compliance consultant and has reviewed and where necessary re-written its operating documents and procedures. It has made improvements to its systems and controls in relation to its sales processes and compliance procedures. The Firm has also been open and co-operative with the FSA and has agreed the facts quickly ensuring efficient resolution of the matter.

3. RELEVANT STATUTORY PROVISIONS AND GUIDANCE

Provisions of the Act

3.1. 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 an amount as it considers appropriate."*

(1) MHS is an authorised person for the purposes of section 206 of the Act. A requirement imposed on a firm includes the FSA Principles and Rules made under section 138 of the Act.

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

3.2. By virtue of COB 5.2.5R, before a firm gives a personal recommendation concerning a designated investment to a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that customer relevant to the services that the firm has agreed to provide.

3.3. By virtue of COB 5.3.5R, a firm must take reasonable steps to ensure that, if in the course of designated investment business, it makes any personal recommendation to a

private customer to sell, buy, subscribe for or underwrite a designated investment (or to exercise any right conferred by such an investment to do so), the advice on investments or transaction is suitable for the client.

3.4. By virtue of COB 5.4.3R, a firm must not make a personal recommendation of a transaction to a private customer unless it has taken reasonable steps to ensure that the private customer understands the nature of the risks involved.

3.5. By virtue of COB 5.7.3R, before a firm conducts designated investment business with or for a private customer, the firm must disclose in writing to that private customer the basis or amount of its charges for conducting that business and the nature or amount of any other income receivable by it or, to its knowledge, by its associate and attributable to that business.

3.6. The above Rules were the rules in force during the Relevant Period.

3.7. The FSA's Principles and Rules constitute requirements imposed on authorised persons under the Act; breaching a Principle and/or a Rule makes a firm liable to disciplinary sanctions.

3.8. The procedures to be followed in relation to the imposition of a financial penalty are set out in section 207 and 208 of FSMA.

Relevant guidance

3.9. In deciding to take the action proposed, the FSA has had regard to the guidance published in the FSA Handbook in the Decision Procedure and Penalties Manual ("DEPP"), which forms part of the FSA Handbook. In particular, the FSA has taken into account the general criteria for determining whether to take disciplinary action and the factors relevant to determining the appropriate level of financial penalty set out in DEPP 6.2 and 6.5.

3.10. The FSA has also had regard to the guidance published in the Enforcement Manual (ENF), and in particular Chapters 11 and 13 which set out the relevant guidance in force when the breaches were committed. In this case, there are no material differences between the guidance and factors to be taken into account when determining whether to take disciplinary action and the factors relevant to determining

the appropriate level of financial penalty that were in force during the Relevant Period and those presently in force.

4. BACKGROUND

The Firm

4.1. MHS is a limited company that was incorporated in the United Kingdom on 28 September 2005. It is a small retail stockbroking firm that has undertaken transactions with customers from its offices located in London since 3 May 2006. By the end of the Relevant Period it had been undertaking transactions with customers for approximately 8 months.

4.2. MHS became authorised by the FSA on 17 February 2006. It has permissions granted for the regulated activities of advising, dealing in investments both as principal and agent, arranging deals in investments, making arrangements with a view to transactions in investments and arranging, safeguarding and administration of assets.

4.3. MHS deals almost exclusively with UK private clients, providing an advisory service primarily in relation to higher risk shares issued by smaller capitalised companies. The Firm makes its recommendations principally by telephone contact with its customers. It then sent its customers documentation relating to the shares sold and payment details. The shares recommended by MHS during the Relevant Period were mainly "private equity" shares in companies that had not been admitted to trading on any market. The Firm also provides an execution-only service.

4.4. In 2006, MHS completed 1,451 sales to approximately 750 customers. The value of these transactions was £6,781,024.

The Investigation

4.5. The investigation by the FSA involved a review of the Firm's systems and controls and a random sample of 30 recommendations to 30 private customers of higher risk shares issued by smaller companies. Customers orally agreed to purchase shares, although, for the private equity trades, this agreement ("the oral agreement") was not binding until the application had been accepted by the Registrar; customers may not have understood this and may have believed they were committed to the purchase.

Customers orally agreed to purchase shares in the 30 recommendations; in 22 of the recommendations customers then paid for the shares after receiving documentation relating to the shares and after recommendations eight customers did not complete their transactions.

4.6. The transactions reviewed by the FSA involved 15 different brokers. These transactions related to shares issued by five companies. Four of those shares were "private equity" shares which were not admitted to trading on any market. One share was trading on AIM at the time of its recommendation by MHS brokers.

5. BREACHES OF REGULATORY REQUIREMENTS

Misleading information regarding the services offered and expertise of the Firm

5.1. MHS generally contacted potential customers for the first time with a mailshot offering them a complementary corporate profile in relation to a company in which the customer was already a shareholder.

5.2. The mailshots described the services offered by MHS as including "advising on and dealing in securities listed on the London Stock Exchange, the Alternative Investment Market (AIM), OFEX (now PLUS) and securities in companies that are awaiting a listing or have not yet applied for one" including Initial Public Offerings (IPOs).

5.3. These representations were misleading. MHS did not have the expertise in-house to advise on shares other than those which they sold, which were (except for one AIM-listed company) all companies whose shares were not trading on any market. Nor did it deal or arrange for the sale of securities listed on the London Stock Exchange on an advised basis; any such transactions were on an execution-only basis.

5.4. As a result a customer may well have believed that MHS had a greater expertise and a wider range of services than it could in fact provide. There was a significant risk that customers were reassured by this impression of expertise and services and purchased shares in reliance on those representations. Accordingly, customers were given a false impression of the services offered by MHS and of its expertise and were given information that was false and misleading by the Firm in breach of Principle 7.

Failure to pay due regard to customers' interests arising from the sourcing of shares and commission paid to MHS

5.5. As background to MHS's failure to pay due regard to customers' interests, it was noted that a corporate advisory firm connected to MHS packaged shares for sale by MHS, supplying an offer document in which the price of the shares was already determined. MHS did not pay the corporate advisory firm for this work.

5.6. MHS did not have a selection process in place nor did it undertake any formal review of the proposed issue of shares. The corporate advisory firm undertook a degree of due diligence on the proposed issue of shares it packaged for MHS to sell. MHS were not obliged to undertake their own due diligence and relied on this other firm's due diligence. The extent of this due diligence was not known to MHS. MHS did not receive or review any due diligence report nor did it undertake any due diligence of its own. MHS checked over the documentation supplied and would only make minor alterations. It would make no independent assessment of the individual companies.

5.7. MHS failed to pay due regard to customers' interests because the individual at the corporate advisory firm who carried out the due diligence was also at that time a director of two of the companies that the corporate advisory firm packaged for MHS and which MHS subsequently sold. MHS was aware of this.

5.8. This issue was not discussed at MHS board level nor was it disclosed to customers. It was not mitigated in any other manner such as, for example, by MHS undertaking its own due diligence on the companies it promoted.

5.9. Consequently there was a potential conflict in having the person doing the due diligence on the security also having an interest in that company as a director and accordingly having a degree of self-interest in the successful sale of the company's shares by MHS. MHS had no way of assessing if the due diligence was unduly biased towards the positive factors in favour of the investment.

5.10. This was compounded by MHS brokers often referring to "our analysts" in their discussions with customers. MHS did not employ any analysts nor did it purchase any third party analysis or assessment of the companies whose shares it sold. In eight out of the 30 MHS recommendations reviewed as part of the investigation, brokers

made reference to "our analysts" and stated that the analysts had given the shares a strong buy recommendation.

5.11. Furthermore, MHS was required to comply with the requirements of COB 5.7.3R in relation to the disclosure of charges. This requires that before a firm conducts designated investment business with a private customer, the firm must disclose in writing the basis or amount of its charges for conducting that business and the nature or amount of any other income receivable by it and attributable to that business. COB 5.7.2G emphasises that the purpose of the disclosure requirement is to ensure that private customers are made aware of the costs to them, directly or indirectly, of financial services, so that they are better able to make informed choices.

5.12. During the Relevant Period MHS derived most of its income from the commission paid to it by the companies whose shares it promoted. Of the five share offerings forming part of the FSA sample the gross commission for three of those shares was 30% and for one it was 40%. In relation to the remaining AIM shareholding, which MHS bought and sold primarily as principal, the gross income earned was the difference between the purchase and sale price.

5.13. The commissions outlined above were not disclosed by MHS staff over the telephone to their customers. In fact in 17 out of the 30 recommendations reviewed by the FSA, customers were told that their transaction would be commission-free. While MHS did not charge any commission directly to customers on these transactions, the commission levels paid by the companies whose shares were being sold were not adequately disclosed to customers.

5.14. With respect to the four companies represented in the FSA's sample whose shares were offered for sale by an offer for subscription document, two of the four offer for subscription documents only described the amount of the commission paid to MHS by those companies as 'offer costs' in a breakdown of how the offer proceeds were to be employed. There was no indication that this amount was payable to MHS. The offer documents relating to the other two other unlisted companies did not even directly disclose the offer costs, stating only the gross proceeds and net proceeds of the offer. The final company in the FSA sample was the AIM shareholding and the gross

income earned (the difference between the purchase price and sale price) was not disclosed to customers being sold these shares.

5.15. MHS knew that the person carrying out due diligence was a director and shareholder of two of the companies whose shares MHS promoted. MHS promoted shares as being chosen by MHS after the Firm had analysed and assessed the proposed investment. MHS did not disclose the source of the due diligence. This led to a real risk that the interests of others were put ahead of the interests of MHS's customers. As a result, MHS failed to pay due regard to the interests of its customers and failed to treat them fairly in breach of Principle 6.

5.16. In failing to disclose the amount of its charges and the nature or amount of any other income receivable and attributable to the shares it sold to its customers in writing, MHS was in breach of COB 5.7.3 R and failed to pay due regard to the information needs of its customers and communicate information to them in a way which is clear, fair and not misleading, in breach of Principle 7.

Failure to assess the suitability of advice before, or in the course of, recommending shares to customers

General assessment of suitability

5.17. In assessing whether it was suitable to advise a customer to invest in the higher risk shares the Firm recommended, MHS relied on a review of suitability by the Firm's compliance department which occurred when a new account was to be opened. This review in turn relied upon each customer completing a Client Information Form ("CIF"). This was supposed to set out the customer's personal and financial circumstances and so enable an assessment of suitability to be made. However, this compliance review occurred only after the customer had received a personal recommendation from MHS and had sent in a cheque.

5.18. In the 18 recommendations reviewed by the FSA relating to new customers, little or no information was obtained from the customer in order to assess suitability prior to the recommendation. For six of the seven customers where the brokers did seek some suitability information prior to the recommendation, what little information was obtained was limited to confirmation that the prospective customer had assets worth at least £50,000. No information was obtained from the other 11 new customers.

5.19. For the 12 recommendations reviewed relating to existing customers, there was no evidence that suitability was reconfirmed before the senior broker made the recommendation despite the fact that MHS's procedures handbook stated *"It is the responsibility of the Account Executive advising clients to ensure that each individual transaction is suitable for each individual client prior to the client being provided with any information about the investment"*.

5.20. There were also deficiencies in the operation of the suitability assessment used by MHS. For example, the CIF used by MHS recorded the percentage of the customer's portfolio that they were prepared to invest in higher risk investments.

5.21. MHS interpreted the customer's answer to this enquiry to mean the maximum amount of the customer's portfolio that the customer would invest with MHS. This was then used to set a trading limit above which MHS would not recommend the purchase of higher risk shares by the customer. There was nothing to indicate to the customer or to MHS that the percentage should exclude higher risk investments already held in the customer's portfolio. MHS took no steps to obtain from customers the current spread of risk across the customer's existing portfolio.

5.22. Furthermore, there were no clear and consistent guidelines as to what level of previous investment experience would be sufficient to classify a customer as suitable for investing in higher risk shares. MHS's failure to provide adequate suitability guidelines for its staff posed the real and significant risk that customers were sold shares by MHS without MHS taking reasonable steps to ensure that the advice was suitable for the Firm's customers in light of the customer's attitude to risk and investment experience.

5.23. Furthermore, Compliance's review was inadequate in ensuring that MHS's own suitability criteria were met. Analysis of the CIFs relating to the sample of 30 recommendations reviewed by the FSA identified deficiencies in the customer information used by MHS to assess suitability. A CIF was available in relation to only the 22 transactions which completed. Of these 22, 13 CIFs failed to demonstrate that MHS's suitability requirements in relation to income had been met, with nine of these failing to record any income at all (although some of those customers had disclosed substantial savings and investments).

5.24. For all of the customers where the CIF did not meet MHS's own minimum criteria for income, risk appetite or investment portfolio, the associated notes on MHS's internal customer database did not indicate any restrictions imposed on the customer's trading pattern with MHS or any additional sign-offs given by the compliance department or MHS's senior management. Consequently MHS's own procedures were not being followed for the recommendations and the review by the compliance department was ineffective and/or undocumented.

5.25. Consequently, the Firm did not have sufficient up-to-date information about customers' personal and financial circumstances before giving advice and could not therefore properly assess the suitability of its advice before making a recommendation to invest. It then failed adequately to check the suitability of this advice after the recommendation had been made. Therefore the Firm breached COB 5.2.5R, COB 5.3.5(1)R and Principle 9.

Failing to take into account suitability concerns arising from affordability

5.26. In five out of the sample of 30 MHS recommendations reviewed, brokers continued with share recommendations even though clients stated during calls that they could not afford to make another investment, or were not currently liquid, or simply said that they did not wish to make an investment. In four out of the five transactions, the customer finally agreed to make an investment.

5.27. In one call between a broker and a customer, the customer stated:

> *"…I would liquidate some holdings to do that. … Because right now I'm totally just not liquid at all. … So there's just no way I can put my hands on anything."*

but a recommendation was still made.

5.28. In another call which resulted in a completed trade, the customer told the broker that he cannot invest any more money other than that which he has already invested with MHS but the broker continued and stated:

"…we need to have a little piece in this one … so that I can, you know, hopefully show you some profits, you know, sooner rather than later, yeah? … Um…what's…let's look at something that we can pick up, so at least we've got something in here."

5.29. In failing to ensure that the customers could afford the recommended shares at the time the customer agreed to invest, there was a significant risk that customers were sold shares that did not fit in with their financial circumstances and needs and were unsuitable investments recommended in breach of COB 5.2.5R, COB 5.3.5(1)R and Principle 9.

Failure to give clear, complete and accurate advice and information in the course of selling shares

Failure to communicate clear and accurate information regarding the business of the companies promoted and lack of balance in the description of the risks attached to the companies' shares.

5.30. In most of the recommendations reviewed by the FSA, customers received an offer for subscription document together with the MHS terms of business and an application form after they had initially agreed to make an investment during the sales call. The customer's initial decision to invest was therefore based on the details included in the oral recommendation given by brokers. Despite MHS selling higher risk shares, MHS brokers' recommendations were not balanced because the brokers put forward only positive points about the shares. The customer was left to evaluate the negative points through information given in the subscription document and to form their own overall view of the investment. Customers would usually only be able to do this after they had verbally agreed to purchase the security.

5.31. Risks specific to individual companies that were set out in the offer for subscription documents available to the broker, and that related to the companies' activities and trading history, were not mentioned by the brokers in any of the calls relating to the 30 MHS recommendations reviewed. Some risks specific to the individual companies were clearly set out in the offer for subscription documents. However in the majority of cases, these documents were sent out to the customer along with the application forms after the sales call in which the shares were recommended and the customer made an initial agreement to make an investment in the shares.

5.32. In total, in 25 out of the 30 MHS recommendations reviewed, brokers made exaggerated or misleading claims during calls to customers in general terms about MHS, private equity and AIM listed shares. These claims related, amongst other

things, to MHS's success in selecting companies that make a successful application for listing on a market and the experience and track record of directors of the companies.

5.33. MHS gave its customers an unbalanced description of the shares during the recommendation to purchase which gave undue emphasis to the positive factors in favour of a purchase, although it did provide written documentation subsequent to the recommendation and oral agreement. This failure to give clear and accurate information about the shares was in breach of COB 5.4.3 R and Principle 7 as MHS failed to take reasonable steps prior to the recommendation to ensure that customers understood the nature of the risks involved and failed to pay due regard to the information needs of customers.

Failing to give clear and accurate information about the future listing prospects of the companies

5.34. 24 of the 30 MHS recommendations reviewed by the FSA related to private equity shares and the remaining six trades related to a company whose shares were admitted to AIM prior to recommendation by MHS. For 14 out of the 24 MHS recommendations relating to private equity shares, brokers either gave assurances that the company would list by making statements referring to 'when' the company would list rather than 'if and when' it would list. In one call the broker assured the customer that MHS "would not touch" the shares unless the company was going to list in the near future. Brokers did not make it clear to the customers on what basis such statements were made. However, the written documentation provided to customers contained no such assurance on listings.

5.35. Assurances that the companies would list were not consistent with the offer for subscription documents relating to each investment which clearly stated that the companies were not, in that offer, making an application for listing and that applications to list on the AIM or OFEX (now PLUS) in the future were not a certainty. One example was a company recommended to the customer on the basis that MHS had not had a single company that had not yet come onto the market (when actually not one MHS promoted company had listed to date).

5.36. The claims and assurances not only contradicted the terms of the offer, but led to a real risk that customers would purchase shares in the belief that they would have an

exit strategy that they could use to realise their investment in the short to medium term. The information given to customers as to the prospects of the shares being listed on a market and admitted to trading was misleading in breach of Principle 7.

Failing to give clear and accurate information concerning future performance of shareholdings

5.37. In 24 out of the 30 MHS recommendations reviewed, brokers gave indications that share prices would increase either during a further round of fundraising or upon listing on a recognised investment exchange, or stated that the company was being deliberately undervalued at the current offer price and a higher price was inevitable upon a revaluation. When discussing price increases during sales calls, brokers did not make it sufficiently clear to customers that price increases were uncertain. In 17 out of the 24 recommendations in which brokers indicated the price of the shares would increase, the broker did not refer to the source of such a statement, such as company presentations. Consequently, the customers were unable to form their own view as to the validity of such statements.

5.38. Price increases indicated by brokers during recommendations were often significant ranging from a 50% profit on the offer price to the shares increasing by 100-200% in value.

5.39. For example, a senior broker made statements about price increases for one company's shares to a customer in a call on 7 August 2006:

> *"Okay, now because of obviously a shorter term view at the end of the day, obviously the profits will probably, we believe, be a little bit lower, do you know what I mean, okay? But obviously [Company Y's] looking at sort of, you know, potentially doubling 2 ½ times the price. Here, to be honest with you [X], I would be happy with about 50%. Do you see what I mean? … That's not to say they won't be more than that, but I would try to remain a bit conservative, [X], do you know what I mean?"*

5.40. The misleading claims as to the shares' likely future performance meant that customers were not given clear, fair and not misleading information about the future performance of the shares, as the clear impression was given to customers that there would be an increase in the value of the shares without also giving sufficient information as to the possibility of a decrease in value in breach of Principle 7.

Failing to give clear and accurate information about the risks relevant to higher risk shares.

5.41. MHS failed to take reasonable steps prior to or at the time of the recommendation and oral agreement to ensure that its customers understood the nature of the risks associated with the investments they were recommending.

5.42. At the start of the Relevant Period its brokers did not have an approved risk warning which they could provide to customers which would set out the risks involved in the types of shares sold by MHS. In the recommendations reviewed by the FSA, MHS brokers failed to give any sort of risk warning in 10 out of 30 recommendations. Four of these recommendations related to new customers who would have had only a limited opportunity to receive risk information from MHS at a previous date.

5.43. In 15 out of the 20 recommendations where some form of risk warning was given during the recommendation process, the warning was undermined by the broker. This undermining of the risk warning meant that the customer may not have properly understood the risks involved in the transaction.

5.44. Examples of this undermining include a senior broker telling a customer that it is MHS's job to mitigate risk:

> *"It is a high risk investment, um…you know, it's our job to mitigate risk by doing, er…the due diligence and making sure that, you know, it is going to do well when it comes onto the market."*

5.45. Another example is a junior broker telling a customer:

> *"So, you know, what we're trying to do is to identify companies that will be a) you know, profitable for our clients, and b) we try to mitigate the risk involved for our clients as well. Therefore, we're taking a calculated and educated risk at the most."*

5.46. These statements were commonly made despite the fact that MHS did not carry out any due diligence itself but relied on that undertaken by another regulated firm. MHS gave the customers the clear impression that regardless of the risks inherent in higher risk shares, MHS research and due diligence mitigated those risks.

5.47. MHS relied on the customer to read the written risk warnings contained in documentation such as the MHS Terms of Business and the offer for subscription

documents. MHS Terms of Business included a section entitled 'Risk Warning Notice' which provided generic risk information relating to 'Penny Shares', 'Non-readily Realisable Investments' and 'Stabilisation' together with a statement that a customer should not deal in these products unless they understood the nature of the security they were investing in and the extent of their exposure to risk.

5.48. However, in relation to the recommendations reviewed, 18 of the 30 actual or potential customers were new to MHS and usually received Terms of Business together with the CIF only after they had verbally agreed to make an investment. From the review of recommendations, the actual or potential customers were only sent the offer for subscription document prior to the sales call in which the recommendation was made when they explicitly requested it. Customers were sent the offer for subscription documents, which included the application to subscribe, after they had verbally agreed to make an investment in the shares.

5.49. Consequently, in the context of ensuring that a customer understood the risks associated with the shares offered by MHS before a broker made a recommendation, any verbal risk warning given by the broker during the recommendation to purchase would have been the most important warning given to the customer. However, written risk warnings were provided after the recommendation and oral agreement.

5.50. MHS failed to provide clear, balanced and accurate information about the risks associated with the shares during the recommendation and provided misleading information about the extent to which MHS mitigated those risks. This meant that MHS failed to take reasonable steps to ensure that its customers understood the nature of the risks involved in the purchase of such higher risk shares at the time of the recommendation and oral agreement and failed to pay due regard to the information needs of its customers in breach of COB 5.4.3R and Principle 7.

Placing undue pressure on customers and the use of inappropriate sales practices

Giving a false impression of the demand for and availability of the shares

5.51. MHS brokers commonly made references to the availability of shares running out and often pressured customers to make quick decisions to invest in order to secure an allocation before MHS ran out of stock. 11 out of the 30 recommendations reviewed, customers were told that shares were running out; this created a misleading suggestion

that the shares were in great demand. In fact, MHS continued to sell the shares after the calls reviewed and there were often no grounds for suggesting that the shares would not be available. In six calls, the brokers told customers that they were waiting for a new stock to come in or that the stock had just come in when in fact, MHS were already selling the stock.

5.52. The review of 30 MHS recommendations identified a number of the senior brokers placing the customers on hold during sales calls in order to build "excitement" with the customer. In 11 out of the 30 MHS trades reviewed, the holds were used at least once and lasted between 7 seconds and 37 seconds. The holds were supposedly used to check prices and availability of shares. The impression was given that the brokers might not be able to secure the investment for the customer or that the shares may no longer be available at the price per share discussed during the call. However, the shares recommended during the calls were private equity investments and the offers were made at fixed prices and were not dependent upon any changes in a bid-offer spread because of movements in the market; there were also often no grounds for suggesting that the shares would be unavailable.

5.53. As the shares may still have been available (and in the case of the private equity shares the price would not change) if customers took some time to consider the recommendation, the effect of suggesting otherwise put undue pressure on the customers and did not treat them fairly in breach of Principle 6.

Contacting reluctant customers and making recommendations above desired trade levels

5.54. MHS brokers employed a practice whereby some customers who had previously said "no" to MHS were called and passed on to senior brokers for recommendations because they believed that there were many people who were "going to waste". This meant that consumers who had expressed a clear reluctance to invest with MHS were being contacted with a view to being sold shares.

5.55. In five out of the 30 MHS recommendations reviewed, brokers recommended trade sizes which exceeded the customer's previously stated preferred trade size. The trade size recommended to a customer was based on the customer information obtained by the junior broker before the customer was handed over to a senior broker for the

recommendation. However, if the senior broker thought that he could successfully recommend the customer to purchase more than his preferred trade size then he would do so even though the customer was expressing reluctance to trade at that level. A customer was still required to submit an application form and acknowledge they had reviewed the written documentation.

5.56. By recommending investments despite rejection of the invitation to invest by customers and by making recommendations in excess of the customers' agreed trading levels, MHS risked customers investing in shares that they did not really want and investing more of their share portfolio in higher risk shares than they were comfortable with and accordingly MHS failed to pay due regard to the customers' interests and treat them fairly in breach of Principle 6.

Management and controls

Failing to implement appropriate compliance processes and procedures

5.57. MHS failed to have appropriate systems and controls in place, in particular in relation to its compliance arrangements.

5.58. Reliance was placed on the compliance department by the senior management to fulfil the compliance aspects of their roles. Although the Firm had a formal compliance monitoring programme this was not implemented adequately until October 2006. Although there was a compliance report made to the Board of Directors every month, no material adverse compliance issues were reported to the Board or recorded in the Firm's Breaches Register, despite the prevalence of the issues identified by the FSA.

5.59. The monitoring of brokers' telephone calls was inadequate in its extent and its effectiveness. There was a target of up to only 10 calls per week to be monitored, despite there being at least 15 brokers, who were new to MHS, making telephone calls all day. The monitoring process was inadequately recorded, with there being evidence of only seven calls recorded as having been monitored between May and September 2006. The Firm has indicated that other, informal, monitoring took place. Despite the call monitoring identifying deficiencies in the brokers' conduct, this was not reported to the Board, nor did MHS management take sufficient steps to resolve these deficiencies.

5.60. Consequently, this lack of adequate procedures and monitoring meant that the existence and/or prevalence of issues picked up on by the FSA in this report were frequently not detected by the compliance team or senior management. When issues were detected it was common that no action was taken to rectify the situation, or the action taken was not sufficiently effective.

Failing to implement an effective training and competence regime

5.61. New employees were provided with some compliance training when they joined MHS. This included a requirement to read MHS's compliance manual. However, after this induction process, further compliance training was limited to informal discussion and compliance issues being discussed at daily morning meetings, with the training which was provided being focussed on selling procedures. Similarly, although monthly assessments were made regarding the competence of MHS brokers, these only related to sales performance.

5.62. As a result, MHS failed to implement a training and competence programme that effectively encompassed compliance issues and that was adequate for its business.

5.63. By failing to establish effective training and compliance arrangements, MHS could not ensure it was conducting that business in compliance with regulatory standards in breach of Principle 3.

RELEVANT GUIDANCE ON PENALTY

5.64. The FSA regards the decision to impose a financial penalty as a serious sanction. In determining whether a financial penalty is appropriate and, if so, its level, the FSA is required to consider all the relevant circumstances of the case. The FSA considers that the following factors set out in the Decision Procedure and Penalties Manual ("DEPP") are particularly relevant in this case.

Deterrence (DEPP 6.5.2 G(1))

5.65. 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.

The nature, seriousness and impact of the breach in question (DEPP 6.5.2 G(2))

5.66. In determining the appropriate sanction, the FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached, the number and duration of the breaches, and to the number of customers who were exposed to risk of loss. For the reasons set out at paragraph 2.3 above the FSA considers that the breaches identified in this case are of a serious nature.

The extent to which the breach was deliberate or reckless (DEPP 6.5.2 G(3))

5.67. The FSA has not determined that MHS deliberately contravened regulatory requirements or was reckless.

The size, financial resources and other circumstances of the firm (DEPP 6.5.2G(5))

5.68. In determining the level of penalty, the FSA has been mindful of the size and financial situation, including the regulatory capital position, of the Firm. MHS made a loss for in its financial year to 30 September 2007 of £227,150 (2006: loss of £800,858). The Firm's net assets were £1,046,992 as at 30 September 2007 (£1,274,142 in 2006).

5.69. There is no evidence to suggest that MHS cannot pay the level of financial penalty imposed on the Firm.

Conduct following the breach (DEPP 6.5.2 G(8))

5.70. After MHS was informed by the FSA of its concerns the Firm co-operated fully with the FSA and indicated its willingness to take all reasonable steps to satisfy the FSA that it will seek to comply with the regulatory requirements on an on-going basis. MHS engaged external compliance consultants and undertook a complete review of its sales process.

Disciplinary record and compliance history (DEPP 6.5.2 G(9))

5.71. MHS has not been the subject of previous disciplinary action.

Other action taken by the FSA (DEPP 6.5.2 G(10))

5.72. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour.

6. DECISION MAKER

6.1. The decision which gave rise to the obligation to give this notice was made on behalf of the FSA by Margaret Cole and Lesley Titcomb, being Settlement Decision Makers for purposes of the FSA's settlement decision procedure (DEPP 5).

7. IMPORTANT

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

7.2. The financial penalty must be paid in full by MHS to the FSA in three instalments; the first of £40,000 within 14 days of the date of the Final Notice, the second of £40,000 on or before 31 October 2008 and the third of £42,500 on or before 31 March 2009.

7.3. If the financial penalty is not paid as set out above, the FSA may recover the outstanding amount as a debt owed by MHS and due to the FSA.

Confidentiality and publicity

7.4. 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 it considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such information would, in the opinion of the FSA, be unfair to MHS or prejudicial to the interests of consumers.

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

FSA contact

7.6. For more information concerning this matter generally, you should contact Stephen Robinson of the Enforcement Division of the FSA (direct line: 020 7066 1338).

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Georgina Philippou
Head of Department
FSA Enforcement Division