
FINAL NOTICE

To: **MICHAEL ROYDEN**

Of: **Thorntons Law LLP
Whitehall House
33 Yeaman Shore
Dundee
DD1 4BJ**

Date: **22 September 2010**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the “FSA”) gives you, Michael Royden, final notice about the imposition of a financial penalty.

1. PENALTY

- 1.1. The FSA gave you a Decision Notice on 21 September 2010 which notified you that pursuant to section 66 of the Financial Services and Markets Act 2000 (the “Act”), the FSA had decided to impose a financial penalty of £10,500 on you in respect of a breach of Statement of Principle 7 of the FSA’s Statements of Principle and Code of Practice for Approved Persons (the “Statements of Principle”).
- 1.2. You confirmed on 1 September 2010 that you would not be referring the matter to the Upper Tribunal (Tax and Chancery Chamber).
- 1.3. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on you of £10,500.

- 1.4. You have agreed to settle at an early stage of the FSA's investigation and have, 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 £15,000 on you.

2. REASONS FOR THE PENALTY

- 2.1. The FSA has concluded, on the basis of the facts and matters described below, that you have breached the Statements of Principle, and that it is appropriate to impose a financial penalty on you.

- 2.2. Specifically, between November 2007 and August 2008 (the "relevant period"), whilst an approved person at Thorntons Law LLP ("Thorntons"/the "firm") in significant influence functions, as the partner responsible for compliance oversight, you failed to take reasonable steps to ensure that Thorntons complied with regulatory requirements, in connection with the giving of advice in relation to the selling of structured products backed by Lehman Brothers ("Lehmans"), in breach of Statement of Principle 7, in that you:

- (1) failed to inform yourself adequately of the risks arising from the firm's recommendations to customers to invest in Lehmans-backed structured products;
- (2) delegated day-to-day compliance tasks to others without adequately assessing their ongoing competence to perform the role, or adequately monitoring their performance;
- (3) failed to obtain any external opinion with regards to compliance assessment of the suitability of advice provided by Thorntons to customers to invest in Lehmans-backed structured products;
- (4) failed to put in place adequate systems and controls to collate sufficient management information about Lehmans-backed structured products;
- (5) failed to ensure that in all cases relating to Lehmans-backed structured products the firm's written procedures were adhered to by advisers, in particular to ensure that Thorntons kept appropriate records of customers' circumstances and investment objectives and of product research; and
- (6) failed to take reasonable steps, again through effective file review processes, to ensure that suitability letters sent to customers in relation to Lehmans-backed structured products were clear, fair and not misleading.

- 2.3. These failings were serious as they meant that Thorntons' compliance function ("Compliance"), for which you were responsible, failed to identify unsuitable advice that was provided to customers by advisers in relation to structured products backed by Lehmans during the relevant period, as well as the advisers' associated record-keeping and communication failures. Thorntons' customers were thereby exposed to a serious risk of financial loss. That risk crystallised and customers suffered such loss when Lehmans entered insolvency.

2.4. In deciding the appropriate disciplinary sanction, the FSA recognises the following factors which mitigate the seriousness of the findings:

- (1) you ensured that Thorntons took a proactive approach to ensure that its customers were kept informed about the situation regarding their investments in structured products backed by Lehmans following Lehmans' insolvency. In addition, Thorntons made changes to its suitability letters to explain the counterparty risk following the collapse of Lehmans and prior to the FSA's visit;
- (2) you ensured that Thorntons made further changes to its systems and controls, record-keeping, training and competence and compliance arrangements after it was visited by the FSA. Thorntons also instructed an external compliance consultant to undertake a review of the systems and controls relevant to its sales procedures;
- (3) you have been open and co-operative with the FSA's investigation; and
- (4) you ensured that Thorntons agreed promptly to make appropriate redress to any customers identified as having received unsuitable advice by a skilled person imposed by the FSA.

2.5. The scope of the FSA's investigation was concerned with your competence as an approved person in relation to the sale of Lehmans-backed structured products sold by Thorntons. The investigation did not relate to your competence as a corporate lawyer.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

The relevant statutory and regulatory provisions, to the extent not set out in the body of this Notice, are set out in the Annex to it.

4. FACTS AND MATTERS RELIED ON

BACKGROUND

4.1. The Lehmans-backed structured products referred to in this Notice were investment vehicles whose value was linked to an index or an asset class for a fixed period of time, and which used derivatives to provide a return based on the performance of the asset class/index over the period, usually with a full or partial guarantee of return of capital at maturity. The capital guarantee was provided by Lehmans.

4.2. The risks relating to these types of structured products included:

- (1) investment risk – investment returns and in some cases the return of capital were dependent on the performance of market indices;
- (2) credit risk – the capital guarantee and investment returns were subject to counterparty risk; and

- (3) liquidity risk – the restrictions on the ability to realise the investment during the investment term to meet a need for capital or according to market sentiment.
- 4.3. Further, the nature of structured products, and the risks stated above, highlighted the need for appropriate diversification of customer portfolios to mitigate concentration risk i.e. the risk involved in the customer holding a significant percentage of their investments in one structured product, structured products backed by the same counterparty, or structured investment products as a product type, whether or not (in each case) the relevant products were capital-protected.

The firm

- 4.4. Thorntons is a law firm based in Dundee and provides investment advice to customers under the brand name ‘Thorntons Investment Services’. Thorntons was authorised by the FSA on 1 December 2004 to conduct designated investment business and regulated home finance business and, from 6 April 2007, has also been permitted to conduct regulated business in relation to home reversion plans.
- 4.5. You are a corporate lawyer practicing through Thorntons. You were, during the relevant period, and are the partner of the firm responsible for compliance oversight at Thorntons Investment Services and have been approved by the FSA since 31 July 2006 to perform the following controlled functions at Thorntons:
 - (1) CF4 (Partner);
 - (2) CF10 (Compliance Oversight); and
 - (3) CF11 (Money Laundering Reporting).
- 4.6. You have also been responsible for insurance mediation at Thorntons since 31 July 2006.
- 4.7. One other partner at Thorntons is approved by the FSA to perform the controlled functions of CF4 (Partner) and also CF3 (Chief Executive). There are two additional approved individuals at Thorntons who give investment advice, reporting to you.

Background to the investigation

- 4.8. The FSA visited Thorntons on 12 August 2009 as part of a thematic review of the sale of structured products backed by Lehmans. During the relevant period, Thorntons sold 32 structured products backed by Lehmans to 22 customers. Of the 32 recommendations made by Thorntons, 20 were for products with a guarantee made by Lehmans of return of capital at maturity. These sales of Lehmans-backed structured products represented 2.46% of Thorntons’ income from its regulated business and concerned less than 1% of its regulated client base.
- 4.9. As part of that review, the FSA assessed the quality of advice provided to customers by Thorntons in relation to investments in those Lehmans-backed structured products. The thematic review included the review of 15 customer files containing relevant

recommendations. As part of the subsequent investigation, the FSA also conducted an interview with you on 4 February 2010.

CONDUCT IN ISSUE

- 4.10. As a result of the thematic review and subsequent investigation, the FSA identified a number of significant failings in relation to the quality of advice provided by Thorntons regarding the sale of structured products backed by Lehmans.
- 4.11. Those failings included recommendations which were inconsistent with customers' needs and objectives and attitude to risk.
- 4.12. In some cases this resulted in Thorntons recommending an inappropriately high concentration of customers' savings and investment portfolios being placed in structured products generally. The FSA also highlighted that suitability reports incorrectly presented the capital security of the structured products as absolute, without mention of counterparty risk. There was such risk, even when the products were capital-protected. That risk crystallised and loss resulted.
- 4.13. The FSA also identified significant failings in Thorntons' compliance systems and controls relating to the sale of Lehmans-backed structured products, including lack of record-keeping, insufficient management and compliance oversight of the advice function, failure on the part of Compliance to challenge the investment recommendations of the key relevant adviser due to a lack of technical competence, lack of adequate competence assessment of Compliance staff, insufficient management information and file checks which failed to spot some record-keeping and communication failings and adequately check the suitability of recommendations.
- 4.14. As the FSA-approved CF4 (Partner) of the firm heading up Thorntons Investment Services and in the CF10 (Compliance Oversight) function, you were responsible for taking reasonable steps to ensure that Thorntons adhered to the appropriate standards and requirements of the regulatory system.
- 4.15. The FSA considers that, for the reasons detailed below, your conduct during the relevant period fell below that which the FSA expects of an approved person holding the significant influence functions you held.

Failure to inform yourself sufficiently about Lehmans-backed structured products

- 4.16. You failed, during the relevant period, to take reasonable steps to adequately inform yourself about Lehmans-backed structured products prior to the insolvency of Lehmans.
- 4.17. You did not have experience in financial services prior to taking on responsibility for Thorntons Investment Services. You did not have particular knowledge of structured products prior to the insolvency of Lehmans, nor did you consider it necessary for you to have any such knowledge. You relied on the knowledge of other members of the compliance team and experienced advisers, however, during the relevant period you were unaware what knowledge those individuals had of Lehmans-backed structured

products. You only sought to inform yourself of the nature of those products when the risk of default on the structured products Thorntons had recommended had crystallised as a result of Lehmans' insolvency.

- 4.18. The FSA expects that approved individuals in significant influence functions take steps to ensure that they are aware of the risks arising from their firm's selling and advisory practices and the potential impact of those risks crystallising. Such risks include the risk to customers of receiving unsuitable advice, especially in relation to complex products, from the firm.

Delegation and oversight

- 4.19. You delegated some compliance tasks, including reviewing the suitability of the advice given by the advisers and monitoring compliance with procedures, to a long-standing member of the Compliance team, although you maintained overall responsibility for compliance oversight.
- 4.20. Although you reviewed that individual's performance on an ongoing basis by virtue of your day-to-day contact, you delegated tasks to that individual without having sufficient grounds for believing that person to be competent. In particular, during the relevant period, you were not aware of the knowledge of structured products held by the individual responsible for reviewing the suitability of advice.
- 4.21. You failed to adequately assess the ongoing competence of those to whom you had delegated compliance tasks. There is no evidence that you adequately challenged or tested their performance.

Compliance checking

- 4.22. As the approved person responsible for compliance oversight at Thorntons, you were responsible for ensuring that adequate systems and controls were in place to assess compliance with the requirements of the regulatory system. However:
- (1) the compliance checking which took place was ineffective in that it did not identify every deficiency. For example, it failed to identify that a key risk inherent in structured products was not adequately and consistently disclosed to customers. Specifically, suitability letters to customers did not set out the counterparty risk (i.e. that Lehmans could default) inherent in structured products backed by Lehmans;
 - (2) suitability letters contained misleading phrases including "*100% capital protection*" and "*absolutely no risk to capital*" to describe structured products backed by Lehmans. However, even capital-protected products backed by Lehmans (and not all the products advised on by Thorntons were so protected) were subject to counterparty risk;
 - (3) there was insufficient Compliance challenge to the advice given by the advisers at Thorntons. You did not consider that it was necessary for you to have a particular knowledge of Lehmans-backed structured products sold by Thorntons provided the Compliance team had sufficient knowledge. However,

the individual in the Compliance team responsible for reviewing the key adviser's recommendations did not feel sufficiently knowledgeable about structured products to challenge those recommendations without external assistance and you were not aware of this during the relevant period; and

- (4) although Thorntons would, where necessary, make use of external expertise to challenge recommendations on a technical basis, and whilst Thorntons did approach third parties for advice with regard to structured products following the collapse of Lehmans, you did not consider it necessary to seek any external expertise prior to the collapse of Lehmans for advice specifically with regards to the suitability of recommendations made by Thorntons' advisers in relation to structured products. This was because you were unaware that there was a lack of technical knowledge amongst compliance staff regarding structured products.

Failure to rectify breaches of written procedures

- 4.23. You were responsible for ensuring that the procedures in place at Thorntons with regard to giving advice were followed. However, the FSA's review of 15 customer files identified a number of examples of failures to follow the procedures. These breaches were not adequately rectified by Compliance checking.
- 4.24. For example, Thorntons' procedures manual states "*IF IT IS NOT RECORDED THEN IT DIDN'T HAPPEN*" and that evidence of research should be included on the customer file as this "*confirms the reason for the company, selection of funds...or other relevant research*".
- 4.25. However, product research was not recorded on any of the 15 files reviewed by the FSA. Thorntons' senior adviser acknowledged that he did not retain research on any files during the relevant period, despite being required to do so by Thorntons' procedures. Despite Compliance file checks, there is no evidence that action was taken by Compliance to address this failing.
- 4.26. Thorntons' procedures during the relevant period required that fact finds should: "*clearly demonstrate that the consultant has endeavoured to obtain all relevant information about the customer's personal and financial circumstances and attitudes, including objectives and investment philosophy prior to making a recommendation*".
- 4.27. However, Thorntons' senior relevant adviser has confirmed to the FSA that, during the relevant period, only selected pages of fact finds would be updated in relation to each new recommendation. Compliance failings in relation to the fact finding process had been identified and raised with the adviser but had not been rectified. The FSA's review of 15 customer files found a number of occasions where pertinent changes to customer information were not recorded on the fact find.
- 4.28. You stated that you believed that adequate file checks were taking place to ensure that sales procedures were being adhered to but you were unable to explain why the failings highlighted by the FSA's review had not been identified.

- 4.29. The FSA considers that the fact that these failings were not identified is indicative of a failure in the Compliance monitoring of the files. This is in turn indicative of your failure to effectively oversee the firm's compliance systems and controls. You relied on an inadequate assessment of the individual responsible for conducting the file reviews (as described in paragraph 4.20 above) to give you comfort that those file reviews were taking place.
- 4.30. The FSA acknowledges that in some of these cases you have since informed the FSA that some of the missing information was on file but just not on a fact find. The FSA considers that, regardless, this was still a failure to follow procedures and, importantly, a failure to identify that procedures were not being followed.

Management information

- 4.31. You failed to ensure that Thorntons collated sufficient management information about its recommendations to invest in structured products such that it did not highlight a material increase in recommendations to invest in Lehmans-backed structured products in 2008.

5. CONCLUSION

- 5.1. On the basis of the facts and matters described above, the FSA concludes that your conduct fell short of the regulatory standards required of an approved person performing a significant influence function and that you have breached Statement of Principle 7. The FSA is therefore proposing to impose a financial penalty on you.
- 5.2. The FSA's policy on the imposition of financial penalties relevant to the misconduct as detailed in this Notice is set out in Chapter 6 of the version of its Decision Procedure and Penalties Manual ("DEPP") in force prior to 6 March 2010, which formed part of the FSA Handbook. All references to DEPP in this section are references to that version of DEPP, in force at the relevant time. In determining the appropriate level of financial penalty the FSA has also had regard to Chapter 7 of its Enforcement Guide ("EG").
- 5.3. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour (DEPP 6.1.2G).
- 5.4. The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty. DEPP 6.5.2G set out, at the relevant time, guidance on a non-exhaustive list of factors that might be of relevance in determining the level of a financial penalty. The factors included:

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

- 5.5. Although the FSA found no evidence that the conduct in issue was deliberate or reckless, we have concluded that there was a significant risk to customers arising from

the deficiencies in the monitoring of the suitability of advice and customer communications, and this risk was identified by the FSA, not by you.

- 5.6. While it may be that customers would have invested in the relevant products in any event, they suffered losses as a result of so investing, having received unsuitable advice and inappropriate communications as to those products.

DEPP 6.5.2G(4): Whether the person on whom the penalty is to be imposed is an individual

- 5.7. The FSA recognises that a financial penalty imposed on an individual can have the same deterrent effect as a greater penalty imposed on a firm and has taken account of that possibility in this case.

DEPP 6.5.2.G(6): The amount of benefit gained or loss avoided

- 5.8. The FSA has not determined that you deliberately set out to accrue additional profits or avoid a loss through the way in which you operated the systems and controls and processes at Thorntons.

DEPP 6.5.2G(8): Conduct following the breach

- 5.9. The FSA has taken into consideration your full co-operation with the FSA's investigation

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

- 5.10. The FSA has taken into account the fact that you have not been the subject of previous disciplinary action by the FSA.

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

- 5.11. The FSA has taken into account the results of its action taken against other approved persons for similar conduct.
- 5.12. The FSA, having regard to all the circumstances, considers the appropriate level of financial penalty to be £15,000 before any discount for early settlement.

6. DECISION MAKERS

- 6.1. The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers on behalf of the FSA.

7. IMPORTANT

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

Manner of and time for Payment

- 7.2. The financial penalty must be paid in full by you to the FSA by no later than 6 October 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 7.3. If all or any of the financial penalty is outstanding on 7 October 2010, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

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

FSA contacts

- 7.6. For more information concerning this matter generally, you should contact Mario Theodosiou at the FSA (direct line: 020 7066 5914 / email: mario.theodosiou@fsa.gov.uk).

Tom Spender
FSA Enforcement and Financial Crime Division

ANNEX

RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND GUIDANCE

1. Relevant statutory provisions

- 1.1. The FSA's statutory objectives, set out in section 2(2) of the Act, include the protection of consumers.
- 1.2. The FSA has the power, pursuant to section 66 of the Act, to impose a financial penalty of such amount as it considers appropriate where it appears to the FSA that an approved person is guilty of misconduct and the FSA is satisfied that it is appropriate in all circumstances to take action against the approved person.
- 1.3. An approved person is guilty of misconduct if, while an approved person, he has failed to comply with a statement of principle issued under section 64 of the Act.

2. Statements of Principle and Code of Conduct for Approved Persons

- 2.1. The Statements of Principle and Code of Conduct for Approved Persons (“APER”) sets out the fundamental obligations of approved persons and also conduct which, in the opinion of the FSA, constitutes a failure to comply with a particular Statement of Principle. It also describes factors which the FSA will take into account in determining whether an approved person’s behaviour complies with it.
- 2.2. APER 3.1.3G states, as guidance, that, when establishing compliance with, or a breach of, a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour expected in that function.
- 2.3. APER 3.1.4G states, as guidance, that an approved person will only be in breach of a Statement of Principle when he is personally culpable. Personal culpability arises where an approved person’s conduct was deliberate or where the approved person’s standard of conduct was below that which would be reasonable in all circumstances.

Statement of Principle 7

- 2.4. Statement of Principle 7 is set out in APER 2.1.2P and requires that an approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.
- 2.5. APER 3.3.1E provides that in determining whether or not the conduct of an approved person performing a significant influence function complies with Statements of Principle 5 to 7, the following are factors which, in the opinion of the FSA, are to be taken into account:

- (1) whether he exercised reasonable care when considering the information available to him;
- (2) whether he reached a reasonable conclusion which he acted on;
- (3) the nature, scale and complexity of the firm's business;
- (4) his role and responsibility as an approved person performing a significant influence function;
- (5) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.

2.6. APER 4.7.2E to 4.7.10E provide examples of the types of behaviour that, in the opinion of the FSA, do not comply with Statement of Principle 7. These include:

- (1) failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant standards of the regulatory system in respect of the relevant firm's regulated activities (APER 4.7.3E);
- (2) failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulatory system in respect of the relevant firm's regulated activities (APER 4.7.4E); and
- (3) in the case of an approved person performing a significant influence function responsible for compliance, failing to take reasonable steps to ensure that appropriate compliance systems and procedures are in place (APER 4.7.10E).

2.7. APER 4.7.11G provides, as guidance, that the FSA expects an approved person performing a significant influence function to take reasonable steps both to ensure his firm's compliance with the relevant requirements and standards of the regulatory system and to ensure that all staff are aware of the need for compliance.

3. The FSA's approach to taking disciplinary action

The FSA's approach to taking disciplinary action is set out in Chapter 2 of EG. Imposing financial penalties and public censures shows that the FSA is upholding regulatory standards and helps to maintain market confidence, promote public awareness of regulatory standards and deter financial crime. An increased public awareness of regulatory standards also contributes to the protection of consumers.