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**FINAL NOTICE**

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To: **Principal Mortgage Services Limited**

FSA

Reference

Number: **303168**

Address: **County House, St. Marys Street, Worcester**

Date: **18 June 2012**

**1. ACTION**

1.1. For the reasons given in this notice, the FSA hereby:

- (1) censures publicly PMSL for breaching the Principles; and
- (2) cancels the permission granted to PMSL pursuant to Part IV of the Act for failing to meet Threshold Conditions 4 and 5.

1.2. PMSL entered into liquidation on 19 November 2010. Were it not for PMSL's financial circumstances, the FSA would have imposed a financial penalty of £70,000 on PMSL in respect of the breaches identified. This would have been a significant financial penalty for a firm which made an annual profit of between £500 and £20,000 during the relevant period, and reflects the seriousness of the misconduct.

## 2. SUMMARY OF REASONS

- 2.1. Prior to its liquidation, PMSL was a small mortgage intermediary based in the West Midlands. During the relevant period, it advised approximately 738 customers to take out interest only mortgages with a mortgage accelerator plan it had developed called the Flexible Repayment Plan (FRP), which was operated by PMSL's sister company, FRL. PMSL charged customers an up front fee of £995 for the FRP, in addition to a broking fee of around 1% of the mortgage, and FRL charged an ongoing annual administration fee of £60. PMSL paid a proportion of the £995 fee to FRL.
- 2.2. The FRP operated as a means by which customers could make capital repayments on their interest only mortgages. Customers would pay the monthly interest on the mortgage directly to the lender, and pay an additional amount into the FRP. These additional monthly payments would be collected and held in an account operated by FRL, and would be transferred to the customer's lender at selected annual intervals.
- 2.3. The FRP was an unregulated product but the advice PMSL gave to customers about it was regulated advice, as it was inextricably linked to advice given to customers to take out regulated interest only mortgages. The FSA considers that the FRP was the main reason PMSL recommended customers to take interest only mortgages.
- 2.4. PMSL provided marketing material to customers purporting to demonstrate the benefits of taking an interest only mortgage with the FRP, and individual personalised illustrations purporting to show the savings the customer would make by taking out an interest only mortgage with FRP as compared to their current mortgage arrangement, or a repayment mortgage.
- 2.5. PMSL failed to pay due regard to the interests of customers and treat them fairly, in breach of Principle 6, in that:
  - (1) it promoted the FRP to customers at the first meeting with them, before assessing whether taking out an interest only mortgage with the FRP was suitable for their particular circumstances. There was no evidence of any research being undertaken to determine whether a repayment or interest only mortgage was most suitable for the customer; any evidence of research, or product sourcing, on the customer files related solely to interest only mortgages; and
  - (2) it recommended interest only mortgages with the FRP to customers who could have achieved the benefits purportedly associated with the FRP directly from their lender. Most customers could have made capital repayments directly to the mortgagee without incurring any fees or charges, thus saving the £995 initial fee and £60 annual administration charge for the FRP. PMSL did not explain to customers that they could overpay their mortgages directly to the lender, without incurring the costs of the FRP.
- 2.6. PMSL breached Principle 6 as its primary motivation was to sell the FRP regardless of whether the customer would genuinely benefit from taking an interest only mortgage with the FRP and, as such, it failed to have due regard to the interests of its customers and treat them fairly.

2.7. PMSL also failed to pay due regard to the information needs of its customers and communicate information to them in a way which was clear, fair and not misleading, in breach of Principle 7. Specifically:

- (1) The illustrations provided to customers purporting to compare the cost of the customer's current mortgage with PMSL's recommended interest only mortgage and FRP showed the customer would benefit from a reduced monthly payment, overall savings on the interest paid on the loan and/or a reduction to the mortgage term, if they took out the interest only mortgage with FRP. However, the illustrations did not compare like with like. The interest savings were, in fact, due to the lower interest rate on the new mortgage compared to the customer's current mortgage and/or consolidating a high interest loan with the new mortgage. The FRP in itself could not generate any savings for the customer, but this was not apparent in the illustrations provided to PMSL's customers.
- (2) The FRP was presented to customers verbally by PMSL as the "best way to repay" a mortgage. PMSL told customers the FRP was "cheaper than a standard repayment mortgage" and would repay their mortgage more quickly. These statements were unfounded.
- (3) PMSL did not adequately explain to customers why taking an interest only mortgage with the FRP was purportedly more beneficial than a repayment mortgage or an interest only mortgage without the FRP. PMSL could not demonstrate from its records that customers were told that (a) they could overpay their mortgage directly to the mortgagee without the FRP, or (b) overpaying an interest only mortgage directly to the lender, or taking out a repayment mortgage, may offer better value for money as customers would not have to pay the FRP fee and annual administration charge.
- (4) The illustrations purported to show reduced monthly repayments for the customer, but did not clearly highlight that the stated reduction was for the first year only, as the repayments would need to increase significantly over the term of the mortgage in order to repay the mortgage within the term. Although illustrations mentioned that the monthly repayments were subject to a 3.5% indexation, the manner of presenting this information was confusing as the illustrations also highlighted in bold letters that the customers' monthly payments would be reduced.
- (5) The fees charged to customers for the FRP were not clearly disclosed and/or there were inconsistencies in the fees and charges quoted to customers, in that some documents disclosed the cost of the FRP whereas others, which purported to show the total cost of the mortgage, did not.
- (6) PMSL did not disclose to customers, before they took out the FRP, that their monies would be collected and held in a separate unauthorised firm, FRL.
- (7) PMSL misrepresented to customers that their funds would be ring fenced, but failed to make sure this was the case. As a result, customers have lost 45% of

their funds held in the FRP at the time when PMSL and FRL went into liquidation in November 2010.

- 2.8. The FSA considers that customers are likely to have suffered loss as a result of taking out interest only mortgages with the FRP, instead of repayment mortgages or interest only mortgages without the FRP. As PMSL did not complete a review of past business, having agreed with the FSA in August 2010 that it would do so, and as PMSL has since gone into liquidation, there are no figures available as to the extent of the customer detriment caused by PMSL's advice.
- 2.9. The FSA has concluded that the nature and seriousness of PMSL's breaches would warrant a financial penalty of £70,000, were it not for the fact that PMSL is in liquidation.
- 2.10. The FSA has also concluded that PMSL is failing to satisfy the Threshold Conditions. The FSA is not satisfied that PMSL is fit and proper having regard to all the circumstances. It has inadequate financial resources, as it is in liquidation, and is not suitable to undertake regulated activities as it does not have competent and prudent management. Consequently, PMSL is failing to satisfy Threshold Condition 4 (Adequate resources) and Threshold Condition 5 (Suitability).

### **3. DEFINITIONS**

- 3.1. The definitions below are used in this Final Notice:

the "Act" means the Financial Services and Markets Act 2000

"CeMAP" means Certificate of Mortgage Advice and Practice

"DEPP" means the FSA's Decision Procedures and Penalties manual

"EG" means the FSA's Enforcement Guide

"ENF" means the FSA's Enforcement Manual

the "FOS" means the Financial Ombudsman Service

"FRL" means Flexible Repayment Limited

the "FRP" means the Flexible Repayment Plan

the "FSA" means the Financial Services Authority

the "FSCS" means the Financial Services Compensation Scheme

the "Handbook" means the FSA's Handbook of Rules and Guidance

the "Principles" mean the FSA's Principles for Businesses

"PMSL" means Principal Mortgage Services Limited

the "relevant period" means 31 October 2004 to 19 November 2010

the “Threshold Conditions” mean the threshold conditions set out in Part 1 of Schedule 6 to the Act

the “Tribunal” means the Upper Tribunal (Tax and Chancery Chamber)

#### **4. FACTS AND MATTERS**

- 4.1. PMSL was a mortgage intermediary which operated from offices in Worcester between the date of its FSA authorisation on 31 October 2004 and the date it went into liquidation on 19 November 2010.
- 4.2. Mr Terence Harrop was chief executive (controlled function 3) and majority shareholder of PMSL during the relevant period.
- 4.3. During the relevant period, PMSL recommended a mortgage accelerator plan (the FRP) to its customers. The FRP was marketed as a means by which customers could repay the principal amount of their interest only mortgages. The FRP was administered by an unauthorised firm (FRL), which was also controlled by Mr Harrop and which shared offices with PMSL.
- 4.4. PMSL advised customers to take out an interest only mortgage and the FRP. The FRP involved customers making interest payments directly to their mortgagee and paying an additional monthly amount to FRL. FRL would accumulate the customers’ payments in a low interest current account, then transfer the accumulated funds to the customers’ mortgagees at selected intervals to reduce the capital balance.
- 4.5. PMSL charged customers an initial fee of £995 (regardless of the amount of the mortgage), in addition to the broking fee of around 1% of the mortgage. FRL charged an annual fee of £60 to administer the customer’s FRP and received a proportion of the £995 fee from PMSL.
- 4.6. PMSL sourced customers through a network of appointed representatives, who were not authorised to give advice to customers. The appointed representatives met with customers and undertook fact finds. The fact finds were handed to office staff employed by PMSL, one of whom at any relevant time during the relevant period was CeMAP qualified. The office staff generated a recommended regulated mortgage and an illustration purporting to show the benefits of an interest only mortgage with the FRP. The recommendation was then made to the customer by the appointed representative.
- 4.7. PMSL provided a brochure for its appointed representatives to distribute to and discuss with customers at their first meeting, called “Don’t know which way to go for a better mortgage deal?” The brochure listed the purported benefits of the FRP as follows:

*“Your mortgage will be repaid faster than with any other product  
we are aware of.*

*A threefold savings benefit:*

***Reduction in monthly outlay.***

***Reduction in mortgage term.***

***Interest savings over the mortgage term.”***

- 4.8. The brochure suggested that, if customers took out the FRP, they would benefit from each of the “threefold savings” listed. In fact, of 29 customer files reviewed by the FSA where the customer agreed to take out the FRP, only one personalised illustration demonstrated all three savings being achieved by the customer taking out an interest only mortgage with the FRP for the full term of the plan. Only six personalised illustrations demonstrated all three savings being achieved by the customer in year one of the FRP. In addition, the brochure fails to highlight clearly that the stated reduced monthly outlay was for the first year only and would increase significantly over the term of the mortgage, and that indexation meant the repayments would increase significantly over the term of the mortgage.
- 4.9. The appointed representatives also presented a brochure entitled “Working together to save you money” at their first meeting with customers. The brochure set out an illustration entitled “How it works”. The illustration showed the customer paying an amount of interest per month to the mortgagee, which decreased year on year, and an amount of capital repayment per month, which increased to the same extent the interest amount decreased, maintaining the same net monthly payment throughout the term of the mortgage. The illustration suggested that, as more capital was paid off, the interest amount on the remaining capital decreased, and the repayment element could increase to compensate for that.
- 4.10. In practice, however, the FRP did not work like this. In all of the customer files reviewed by the FSA, the amount by which the interest reduced each year was far outweighed by the increase to the capital repayment element needed in order to pay off the mortgage within the term. This resulted in the overall monthly outlay for customers increasing significantly over the term of the mortgage, such that in 20 of 29 customer files reviewed where the customer took the FRP, the monthly outlay more than doubled over the term of the mortgage.
- 4.11. Following the appointed representatives’ first meeting with the customer, PMSL would generate a personalised illustration for the customer purporting to show the benefits of taking an interest only mortgage with the FRP, as compared to the customer’s current situation or, where the customer was not remortgaging, a standard repayment mortgage. The illustrations contained in the 29 FRP customer files gave a misleading impression of the benefits of taking out an interest only mortgage with the FRP.
- 4.12. The illustrations were misleading as they did not compare like with like. They did not compare the best available repayment mortgage with the best available interest only mortgage. The interest rate on the repayment mortgage used as a comparator was generally higher than for the interest only mortgage, accounting for much of the interest saving. Additional savings were often also achieved by consolidating an expensive unsecured loan with the proposed new mortgage. The illustrations stated the purported interest savings generated by the interest only mortgage with FRP in bold, for example: “INTEREST SAVINGS £X”. This suggested that the savings were due to the mortgage arrangement recommended by PMSL but, in fact, the

savings were due to other factors and could have been achieved without incurring the cost of the FRP.

- 4.13. The illustrations also stated in bold the amount of reduction in the monthly outlay, for example: “MONTHLY OUTLAY REDUCED BY £X”. PMSL did not clearly highlight that the reduction is only for the first year of the mortgage term, and that over the course of the term, the monthly outlay must increase significantly year on year in order for the mortgage to be paid off in full, meaning that, in fact, the monthly outlay was only reduced for the initial part of the term. The illustrations stated that the monthly repayments were subject to 3.5% indexation and the increases were shown in a repayment schedule on the second page of the illustration. However, the evidence from customers the FSA spoke to suggests that the impact of this was not clearly explained to customers, many of whom did not appreciate that the stated reduction presented was only for the first year of the term.
- 4.14. PMSL failed to disclose clearly and fairly the fees being charged to customers for the FRP. There were two costs associated with the FRP: the £995 set up fee and the £60 per annum management fee. These fees were disclosed to customers across a series of separate documents, some of which mentioned one or the other of these fees, and some of which mentioned neither. For example, customers might have expected all the costs associated with the mortgage to be listed in the Key Facts Illustration. Whilst this document listed PMSL’s broking fee, the mortgagee’s fee, the solicitor’s and valuer’s fees, it did not mention the £995 FRP fee or the £60 annual management fee.
- 4.15. PMSL did not disclose to customers before the point of sale that their monies would be collected and held by a firm which was not FSA authorised. PMSL’s initial disclosure document stated that PMSL was FSA authorised, implying rights of recourse to the FOS and the FSCS. This gave an element of comfort to customers. The documentation did not clearly state such rights did not apply in respect of services carried out by FRL. In addition, evidence gathered by the FSA suggests that PMSL told its appointed representatives that the customer monies held at FRL would be ring fenced, and that appointed representatives passed this information on to customers. However, the customer funds held at FRL were not adequately ring fenced, and customers were treated as unsecured creditors in the liquidation.
- 4.16. In addition, there is some evidence suggesting that PMSL actively misled a customer to take out the FRP. In June 2010, the FSA received a complaint from a customer stating that PMSL had told him that lenders would not look kindly on his mortgage application unless the FRP was in place. When the customer subsequently sought to cancel the FRP application, PMSL told the customer that the lender had confirmed that the mortgage offer would be withdrawn if the FRP was cancelled. This was not true; the lender had no knowledge of the FRP and it was not a condition of the mortgage offer.

## **5. FAILINGS**

- 5.1. The regulatory provisions relevant to this Final Notice are referred to in the Annex.

5.2. PMSL failed to pay due regard to the interests of customers and treat them fairly, in breach of Principle 6, in that:

- (1) PMSL promoted the FRP to customers at the first meeting with them, before assessing whether taking out an interest only mortgage with the FRP was suitable for their particular circumstances. Appointed representatives discussed the “benefits” of the FRP, as set out in the “Don’t know which way to go for a better mortgage deal?” brochure, with customers at their first visit to the customer.
- (2) The FRP was promoted to nearly all PMSL’s customers, regardless of their circumstances. Of the 31 customer files reviewed by the FSA, 29 customers agreed to take out an interest only mortgage with the FRP.
- (3) In 21 of the 29 customer files reviewed where customers took out the FRP, there was no evidence of any research being undertaken to determine whether a repayment or interest only mortgage was most suitable for the customer. Any evidence of research or product sourcing contained on the files related solely to interest only mortgages. This suggests a predisposition to recommend to customers an interest only mortgage with the FRP.
- (4) PMSL recommended interest only mortgages with the FRP to customers who could have achieved the benefits purportedly associated with the FRP directly from their lender. Of the 29 customer files reviewed where customers took out the FRP, 25 customers could have made capital repayments directly to the mortgagee without incurring any fees or charges. There is no evidence that lenders required customers to have the FRP, or a similar repayment scheme, in place as a condition of the mortgage. PMSL did not explain to customers that they could overpay their mortgages directly to the lender, without incurring the costs of the FRP.

5.3. The evidence suggests that PMSL’s business model was to promote interest only mortgages with the FRP to customers in all circumstances. PMSL did not pay sufficient regard to whether this arrangement was the most suitable and cost effective for the customer, or whether the customer’s circumstances meant a repayment mortgage was affordable and appropriate. In circumstances where a repayment mortgage was not affordable, PMSL did not propose to the customer the option of taking an interest only mortgage without the FRP and making overpayments directly to the lender. As such, it failed to have due regard to the interests of its customers and treat them fairly.

5.4. PMSL failed to pay due regard to the information needs of its customers and communicate information to them in a way which was clear, fair and not misleading, in breach of Principle 7, in the following key ways:

- (1) PMSL provided illustrations to customers purporting to compare the cost of the customer’s current mortgage with PMSL’s recommended interest only mortgage and FRP. These illustrations showed the customer would benefit from a reduced monthly payment, overall savings on the interest paid on the loan and/or a reduction to the mortgage term if they took out the FRP. The



illustrations gave the misleading impression that the FRP arrangement generated these savings, when any such savings were, in fact, due to the lower interest rate on the new mortgage compared to the customer's current mortgage and/or loan consolidation. The FRP in itself could not generate any real savings for the customer, but this was not apparent in the illustrations provided by PMSL to customers. The FSA spoke to six PMSL customers who took out the FRP, all of whom believed that the interest savings were, either wholly or in part, due to the FRP.

- (2) The FRP was presented verbally to customers by PMSL as the "best way to repay" a mortgage. PMSL told customers the FRP was "cheaper than a standard repayment mortgage" and would repay their mortgage more quickly. These statements were unfounded.
- (3) In all 29 customer files reviewed where an interest only mortgage plus the FRP was taken out, PMSL did not adequately explain why this was more beneficial for the customer than a repayment mortgage or an interest only mortgage without the FRP. There is no evidence on the files demonstrating customers were told that (a) they could overpay their mortgage directly to the mortgagee without the FRP (which would have been an acceptable method of repayment as far as lenders were concerned), or (b) overpaying an interest only mortgage directly to the lender, or taking out a repayment mortgage, may offer better value for money as customers would not have to pay the FRP fee and annual administration charge.
- (4) The illustrations provided by PMSL purported to show reduced monthly repayments for the customer, but did not adequately highlight that the stated reduction was for the first year only and that indexation meant the repayments would increase significantly over the term of the mortgage. Of the six customers interviewed by the FSA, only two understood that the monthly repayment figure quoted on the illustration was for the first year of the mortgage only, and would need to increase year on year for the mortgage to be paid off within the term.
- (5) In 23 of the 29 customer files reviewed where the customer took out the FRP, the fees being charged to customers for the FRP were not clearly disclosed, in that they were disclosed in some documents, but not in others, and/or there were inconsistencies in the fees and charges quoted to customers.
- (6) The documents provided to customers stated that PMSL was an FSA authorised firm, implying the attendant rights of recourse to the FOS and FSCS, but did not highlight to customers that FRL would be holding their monies and was not an authorised firm. The documentation did not clearly state such rights did not apply in respect of services carried out by FRL.
- (7) PMSL misrepresented to customers that their funds would be ring fenced, but failed to make sure this was the case. In the event, FRL did not adequately ring fence customers' funds, and customers were treated as unsecured creditors in FRL's liquidation.

5.5. In addition, there is some evidence that PMSL pressured a customer to take out an interest only mortgage with the FRP by telling him that the lender required him to take out the FRP, when this was not true.

## **6. SANCTION**

6.1. The FSA's policy in relation to the imposition of a public censure and/or financial penalty is set out in Chapter 6 of DEPP. The relevant sections of DEPP are set out in detail in Annex A. These set out the factors that may be of particular relevance in determining whether it is appropriate to issue a public censure rather than impose a financial penalty. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

6.2. In addition, the FSA has had regard to the provisions of Chapter 7 of EG.

6.3. The principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of regulatory conduct by deterring firms which have committed breaches from committing further breaches, and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant behaviour.

6.4. In determining whether a financial penalty or a public censure is appropriate, the FSA is required to consider all the relevant circumstances of the case.

6.5. As set out below, the circumstances of this case would ordinarily merit the imposition of a financial penalty. However, the FSA considers that, in accordance with DEPP 6.4.2(8)G, there are exceptional circumstances under which PMSL's conduct that would ordinarily attract a financial penalty, could be dealt with by way of a public censure. Specifically, there is evidence that PMSL has insufficient resources to pay a financial penalty as it is in liquidation and therefore has no assets with which to meet any financial penalty imposed upon it. PMSL's breaches are such that the FSA would otherwise have imposed a financial penalty of £70,000.

6.6. The FSA therefore considers that a public censure, rather than a financial penalty, is appropriate.

### ***Why a public censure is appropriate***

#### **The seriousness of the breach in question (DEPP 6.4.2G(3))**

6.9. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the duration and frequency of the breaches, and the number of customers who were affected and/or put at risk of loss.

6.7. The FSA considers the breaches are serious as they involve a failure to act in customers' interests and treat them fairly which affected nearly all customers advised by PMSL over six years.

- 6.8. Over the relevant period, PMSL advised approximately 738 customers to take out interest only mortgages with the FRP when this may not have been in those customers' best interests. It did not give a fair representation of the disadvantages and costliness of this mortgage arrangement as compared with other viable arrangements. PMSL put its own interest and profit above customers' interests.
- 6.9. PMSL's breaches led to customers losing 45% of their monies held in the FRP at the point of liquidation, having been misled by PMSL to believe that their funds would be adequately protected.
- 6.10. In addition, there is evidence of PMSL pressuring one customer to take out the FRP by misleading him to believe that the lender would withdraw its mortgage offer if the FRP was not in place.
- 6.11. The FSA has not identified any mitigating factors which would cause it to view PMSL's breach as less serious.

**Previous action taken by the FSA (DEPP 6.4.2G(7))**

- 6.12. PMSL had not been the subject of any previous FSA investigations.

**The financial impact on the person concerned (DEPP 6.4.2G(8))**

- 6.12. PMSL has breached Principles 6 and 7 and potentially caused customers to suffer loss. The breaches are serious and the FSA would have imposed a financial penalty of £70,000 on PMSL as a result. However, given that PMSL is in liquidation, the FSA considers that it would not be appropriate to impose a financial penalty. In these exceptional circumstances, the FSA is publishing a statement of PMSL's misconduct and issuing a public censure instead.

***Level of financial penalty***

- 6.13. DEPP 6.5.2G sets out a non-exhaustive list of factors which may be relevant to determining the appropriate level of financial penalty. The FSA considers that the following factors are particularly relevant in this case.

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

- 6.14. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, the duration and frequency of the breaches and the loss or risk of loss to consumers.

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

- 6.15. The FSA has found no evidence that the breaches were deliberate. The FSA considers that PMSL's breaches were nevertheless serious as the evidence suggests its business model was to recommend customers to take out interest only mortgages with the FRP, rather than properly assess the customer's circumstances and recommend the most suitable and cost effective mortgage arrangement.

**The size, financial resources and other circumstances of the person on whom the penalty is to be imposed (DEPP 6.5.2G(5))**

- 6.16. The FSA has had regard to the relatively small size of the firm in determining the level of financial penalty. However, the breaches took place over a protracted period and affected a significant number of customers.

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

- 6.17. In determining the level of financial penalty, the FSA has taken into account penalties imposed on other authorised firms for similar behaviour.

**7. PROCEDURAL MATTERS**

**Decision maker**

- 7.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.
- 7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

**Publicity**

- 7.3. 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 PMSL or prejudicial to the interests of consumers.

**FSA contacts**

- 7.4. For more information concerning this matter generally, contact Rachel West at the FSA (direct line: 020 7066 0142 /fax: 020 7066 0143).

**Tom Spender**  
**Project Sponsor**  
**FSA Enforcement and Financial Crime Division**

## **Annex**

### **Relevant regulatory provisions**

#### **1. The Act**

- 1.1. The FSA's regulatory objectives are set out in section 2(2) of the Act and include the protection of consumers.
- 1.2. Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to it to be necessary or expedient for the purpose of protecting consumers.
- 1.3. The FSA has the power, pursuant to section 205 of the Act, to publicly censure an authorised person where it considers that person has contravened a requirement imposed on him by or under the Act.
- 1.4. Section 41 and Schedule 6 of the Act set out the Threshold Conditions which are conditions that the FSA must ensure a firm will satisfy, and continue to satisfy, in relation to the regulated activities for which it has permission.
- 1.5. The FSA is authorised by section 45(1) of the Act to cancel an authorised person's Part IV permission where it appears to the FSA that such a person is failing, or likely to fail, to satisfy the Threshold Conditions.
- 1.6. Paragraph 4(1) of Schedule 6 to the Act sets out Threshold Condition 4 (Adequate resources) which provides that the resources of the person concerned must, in the opinion of the FSA, be adequate in relation to the regulated activities that he seeks to carry on, or carries on.
- 1.7. Paragraph 5 of Schedule 6 to the Act sets out Threshold Condition 5 (Suitability) which provides that the person concerned must satisfy the FSA that he is a fit and proper person having regard to all the circumstances, including: (a) his connection with any person; (b) the nature of any regulated activity that he carries on or seeks to carry on; and (c) the need to ensure that his affairs are conducted soundly and prudently.

#### **2. The Principles**

- 2.1. The FSA has published Principles which apply either in whole, or in part, to all authorised firms. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the FSA's regulatory objectives. A firm may be liable to disciplinary sanction where it is in breach of the Principles.
- 2.2. The Principles relevant to this matter are:
  - (1) Principle 6 – a firm must pay due regard to the interests of its customers and treat them fairly; and

- (2) Principle 7 - a firm must 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.

### **3. Relevant Handbook provisions**

3.1. In exercising its power to cancel a Part IV permission, the FSA must have regard to guidance published in the FSA's Handbook.

3.2. Guidance on the Threshold Conditions is set out in the part of the Handbook entitled Threshold Conditions (COND).

3.3. COND 2.4 - Threshold Condition 4: Adequate resources (paragraph 4, Schedule 6 to the Act)

- (1) 2.12. COND 2.4.1UK(1) states that the resources of the person concerned must, in the opinion of the FSA, be adequate in relation to the regulated activities that he seeks to carry on, or carries on.

- (2) COND 2.4.2G(1) states that Threshold Condition 4 requires the FSA to ensure that a firm has adequate resources in relation to the specific regulated activity or regulated activities which it seeks to carry on, or carries on.

- (3) COND 2.4.2G(2) states that the FSA will interpret the term "adequate" as meaning sufficient in terms of quantity, quality and availability, and "resources" as including all financial resources, non-financial resources and means of managing its resources such as, for example, human resources and effective means by which to manage risks.

- (4) COND 2.4.3G(1) states that when assessing this Threshold Condition, the FSA may have regard to any person appearing to it to be, or likely to be, in a relevant relationship with the firm, in accordance with section 49 of the Act (Persons connected with an applicant); for example, a firm's controllers, its directors or partners, other persons with close links to the firm, and other persons that exert influence on the firm which might pose a risk to the firm's satisfaction of the Threshold Conditions and would, therefore, be in a relevant relationship with the firm.

3.4. COND 2.5 - Threshold Condition 5: Suitability (paragraph 5, Schedule 6 to the Act)

- (1) COND 2.5.1UK reproduces the relevant statutory provision that the person concerned must satisfy the FSA that he is a fit and proper person having regard to all the circumstances, including, among other things, the need to ensure that his affairs are conducted soundly and prudently.

- (2) COND 2.5.2G(1) states that Threshold Condition 5 requires the firm to satisfy the FSA that it is "fit and proper" to have Part IV permission having regard to all the circumstances, including its connections with other persons, the range and nature of its regulated activities and the overall need to be satisfied that its affairs are and will be conducted soundly and prudently.

- (3) COND 2.5.3G(1) states that the emphasis of this Threshold Condition is on the suitability of the firm itself.
  - (4) COND 2.5.4G(1) and (2) states that when determining whether the firm will satisfy and continue to satisfy Threshold Condition 5, the FSA will have regard to all relevant matters including whether a firm: (a) conducts, or will conduct, its business with integrity and in compliance with proper standards; or (b) has or will have a competent and prudent management.
- 3.5. Guidance on the FSA's approach to penalties is set out in DEPP. DEPP came into effect on 28 August 2007. Although the references in this Final Notice are to DEPP, the FSA has also had regard to the appropriate provisions of ENF, which preceded DEPP and applied during part of the relevant period.
- 3.6. The FSA's policy on the imposition and amount of penalties that applied for misconduct taking place before 6 March 2010 was set out in Chapter 6 of DEPP.
- 3.7. DEPP 6.1.2G provides that the principal purpose of imposing a financial penalty or public censure is to promote high standards of regulatory and/or market 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. Financial penalties are therefore tools that the FSA may employ to help it to achieve its regulatory objectives.

*Financial penalty*

- 3.8. DEPP 6.5.1G(1) provides that the FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned.
- 3.9. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act. The following factors are relevant to this case:

*Deterrence: DEPP 6.5.2G(1)*

- 3.10. When determining the appropriate level of financial penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

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

- 3.11. The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached, which can include considerations such as the duration and frequency of the breach, whether the breach revealed serious or systemic weaknesses in the person's procedures or of the management systems or internal

controls relating to all or part of a person's business and the loss or risk of loss caused to consumers, investors or other market users.

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

- 3.12. The FSA will regard as more serious a breach which is deliberately or recklessly committed, giving consideration to factors such as whether the person has given no apparent consideration to the consequences of the behaviour that constitutes the breach. If the FSA decides that the breach was deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case.

*The size, financial resources and other circumstances of the person on whom the penalty is to be imposed: DEPP 6.5.2G(5)*

- 3.13. The degree of seriousness of a breach may be linked to the size of the firm. For example, a systemic failure in a large firm could damage or threaten to damage a much larger number of consumers or investors than would be the case with a small firm: breaches in firms with a high volume of business over a protracted period may be more serious than breaches over similar periods in firms with a smaller volume of business.
- 3.14. In addition, the size and resources of a person may also be relevant in relation to mitigation, in particular what steps the person took after the breach had been identified; the FSA will take into account what it is reasonable to expect from a person in relation to its size and resources, and factors such as what proportion of a person's resources were used to resolve a problem.

*Other action taken by the FSA (or a previous regulator): DEPP 6.5.2G(10)*

- 3.15. The FSA seeks to apply a consistent approach to determining the appropriate level of penalty. The FSA may take into account previous decisions made in relation to similar misconduct.

*Public censure*

- 3.16. DEPP 6.4.2(8)G provides that, in exceptional circumstances, if the person has inadequate means to pay the level of financial penalty which their breach would otherwise attract, this may be a factor in favour of a lower level of penalty or public statement.
- 3.17. DEPP 6.4.2G states that the criteria for determining whether it is appropriate to issue a public censure rather than impose a financial penalty are similar to those for determining the amount of penalty set out in DEPP 6.5. DEPP 6.4.2G further provides that some particular considerations that may be relevant when the FSA determines whether to issue a public censure rather than impose a financial penalty are:
- (1) whether or not deterrence may be effectively achieved by issuing a public censure;



- (2) if the person has made a profit or avoided a loss as a result of the breach, this may be a factor in favour of a financial penalty, on the basis that a person should not be permitted to benefit from its breach;
- (3) if the breach is more serious in nature or degree, this may be a factor in favour of a financial penalty, on the basis that the sanction should reflect the seriousness of the breach; other things being equal, the more serious the breach, the more likely the FSA is to impose a financial penalty;
- (4) if the person has brought the breach to the attention of the FSA, this may be a factor in favour of a public censure, depending upon the nature and seriousness of the breach;
- (5) if the person has admitted the breach and provides full and immediate co-operation to the FSA, and takes steps to ensure that those who have suffered loss due to the breach are fully compensated for those losses, this may be a factor in favour of a public censure, rather than a financial penalty, depending upon the nature and seriousness of the breach;
- (6) if the person has a poor disciplinary record or compliance history (for example, where the FSA has previously brought disciplinary action resulting in adverse findings in relation to the same or similar behaviour), this may be a factor in favour of a financial penalty, on the basis that it may be particularly important to deter future cases;
- (7) the FSA's approach in similar previous cases: the FSA will seek to achieve a consistent approach to its decisions on whether to impose a financial penalty or issue a public censure; and
- (8) the impact on the person concerned. In exceptional circumstances, if the person has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it would only be in an exceptional case that the FSA would be prepared to agree to issue a public censure rather than impose a financial penalty if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include where there is:
  - (a) verifiable evidence that a person would suffer serious financial hardship if the FSA imposed a financial penalty;
  - (b) verifiable evidence that the person would be unable to meet other regulatory requirements, particularly financial resource requirements, if the FSA imposed a financial penalty at an appropriate level; or
  - (c) in Part VI cases in which the FSA may impose a financial penalty, where there is the likelihood of a severe adverse impact on a person's shareholders or a consequential impact on market confidence or market stability if a financial penalty was imposed. However, this does

not exclude the imposition of a financial penalty even though this may have an impact on a person's shareholders.

**4. Other relevant regulatory provisions**

- 4.1. The FSA's policy in relation to exercising its enforcement powers is set in the Enforcement Guide ("EG"), certain provisions of which are summarised below.
- 4.2. Cancelling a firm's Part IV permission on the FSA's own initiative
  - (1) EG 8.1(1) provides that the FSA may use its own initiative power to vary or cancel the permission of an authorised person under section 45 of the Act, where a firm is failing or is likely to fail to satisfy the Threshold Conditions.
  - (2) EG 8.13(1) provides that the FSA will consider cancelling a firm's Part IV permission using its own-initiative powers contained under section 45 of the Act in circumstances where the FSA has very serious concerns about the firm, or the way its business is or has been conducted.