Financial Services Authority

FINAL NOTICE

To: Mr Richard Rhys

Address: 24 Mount Pleasant Close
Hatfield
Herts
AL9 5BL

Individual Ref No: RFR00007

Date: 27 July 2012

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives final notice that it has taken the following action:

1. THE ACTION

1.1 The FSA gave Mr Rhys a Decision Notice dated 20 January 2012 which notified him that, having taken into account his oral and written representations, pursuant to section 56 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose an order prohibiting Mr Rhys from performing any function in relation to any regulated activity carried on by any authorised person, exempt person, or exempt professional firm.

1.2 Mr Rhys referred the matter to the Upper Tribunal (Tax and Chancery Chamber) ("the Tribunal") on 17 February 2012 but, following settlement discussions with the FSA, notified the Tribunal of the withdrawal of the reference on 6 July 2012. The Tribunal

gave its consent to this withdrawal on 26 July 2012.

1.3 The FSA gave Mr Rhys a Further Decision Notice on 6 July 2012 which notified him that, pursuant to section 56 of the Act, the FSA had decided to impose an order prohibiting Mr Rhys from performing any function in relation to any regulated activity carried on by any authorised person, exempt person, or exempt professional firm on the grounds that he is not a fit and proper person in that he lacks competence and capability.

1.4 Mr Rhys confirmed that he would not be referring the matter to the Tribunal and this Final Notice is drafted in the same terms as the Further Decision Notice.

2. SUMMARY REASONS FOR THE ACTION

2.1 Between September 2004 and May 2005, Mr Rhys was a director of MNFA Limited ("MNFA" or "the firm") and was mainly responsible for the investment and business development side of the business. Mr Rhys was also the leading approved person in the marketing and promotion of a scheme called the environmentally beneficial plant scheme (the "EBP Scheme") by MNFA. MNFA's customers invested around £11.6 million in the EBP Scheme that it unlawfully promoted and the majority of investors have subsequently sustained substantial losses.

2.2 On the basis of the facts and matters summarised below, and set out in more detail in section 4 of this notice, the FSA has concluded that the EBP Scheme was promoted in a way that risked it being mis-sold to the investors and Mr Rhys was directly responsible for this. In particular, the FSA has concluded that Mr Rhys:

(1) made statements in order to promote the EBP Scheme that obviously risked misleading investors (and did in fact mislead them), without applying his mind to that risk;

(2) caused MNFA to promote the EBP Scheme without conducting proper due diligence and without complying with the regulatory standards, including the required statutory and regulatory promotional requirements for an unregulated collective investment scheme;

(3) failed to inform himself of and understand the relevant UCIS requirements; and

(4) failed to take any steps to ensure MNFA assessed the suitability of its advice to customers.

3. RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND GUIDANCE

Unregulated collective investment schemes

3.1. An unregulated collective investment scheme is defined in the Glossary to the FSA Handbook of rules and guidance as "a *collective investment scheme* which is not a *regulated collective investment scheme*" ("UCIS").

3.2. Unless a collective investment scheme ("CIS") falls within the narrow Glossary definition of a regulated CIS, it will be a UCIS. Whilst a UCIS does not carry the same level of regulatory oversight as a regulated CIS, it is still subject to regulation, notably around the extent to which it may be marketed and the persons to whom it may be marketed.

3.3. UCIS investments can be attractive as they typically aim to generate high returns and they are not subject to the same restrictions as regulated CIS. For example, the latter are restricted in the underlying assets that can be held and their ability to borrow funds and are required to spread risk, whilst UCIS are not so restricted. The risks typically associated with UCIS investments include many of those that exist with regulated mainstream investments. However, there are a number of additional risks that are often inherent in a UCIS which an adviser should consider when making a recommendation.

3.4. Furthermore, individuals who invest in UCIS have no recourse to the Financial Ombudsman Service ("FOS") or the Financial Services Compensation Scheme ("FSCS") in respect of the UCIS themselves or the providers of those schemes. However, they may have recourse to the FOS or the FSCS in respect of personal recommendations made by authorised firms to invest in UCIS.

3.5. Section 238 of the Act (Restrictions on promotion) states that "An authorised person

must not communicate an invitation or inducement to participate in a [CIS]" although there are exceptions including:

(1) those exemptions set out in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 ("the PCIS Order"). The PCIS Order provides for authorised firms to promote UCIS to individuals if they fall within a particular category of exemption set out in the order. The exemptions tend to be narrow in scope and subject to specific requirements including reasonable checks, disclosure of appropriate warnings, the structure of the underlying fund and the certification of the investor's status. These exemptions pertain to individuals classed as certified high net worth individuals, certified sophisticated investors or self-certified sophisticated investors; and

(2) those exemptions set out in the FSA Handbook, namely COBS 4.12.1R(4) (COB 3 Annex 5 prior to 1 November 2007). In order to be exempt under the COBS rules, the inducement or invitation must be made only to recipients whom the firm has taken reasonable steps to establish are persons in that category or be directed at recipients in such a way as to reduce, as far as possible, the risk of participation in the CIS by persons not in that category. There is no provision for these steps to be taken retrospectively.

Further provisions

3.6. Further detail and guidance in relation to the above is set out in the Annex to this Notice, together with other relevant statutory and regulatory provisions.

4. FACTS AND MATTERS RELIED ON

Background

4.1 Mr Rhys was one of three directors at MNFA and held the significant influence function of CF1 (director) at the firm. MNFA was incorporated as a company in March 2001. Mr Rhys set up the company along with the two other directors. The purpose behind the business of MNFA was initially to offer services involving mortgages and mortgage brokering principally for individuals who were non-domiciled. MNFA concentrated on sophisticated mortgage brokering, in particular,

concentrating on the tax efficient structuring of mortgages. In conjunction with this, the firm also offered a general mortgage brokering business.

4.2 The other aspect of MNFA's business was principally sheltering income from taxation for wealthy individuals working in the City in a professional capacity, which involved selling tax efficient investment schemes to these individuals. Mr Rhys was primarily responsible for this part of MNFA's business.

4.3 MNFA was initially an appointed representative and member of a network but became authorised on its own account on 1 September 2004.

4.4 MNFA was part of a group of companies which were all placed in creditors' voluntary liquidation on 26 January 2009. As a result, MNFA's Part IV permission was cancelled on 24 March 2009.

Film Finance Schemes

4.5 Prior to the EBP Scheme, MNFA had promoted a range of tax mitigation film finance schemes developed by various companies connected with Scotts Atlantic EBP LLP ("Scotts Atlantic") and its Managing Director ("the Scotts' Managing Director").

4.6 Mr Rhys was aware of legal advice received by the Scotts' Managing Director in relation to previous tax mitigation schemes that the film finance schemes were UCISs. MNFA sought advice on the promotion of these schemes from its then principal who also confirmed that they were UCISs and advised MNFA that it was not authorised to promote or advise on UCISs. MNFA's principal therefore recommended that MNFA sell the schemes on an execution only basis.

Scotts Private Client Services Limited fined by the FSA

4.7 On 9 June 2004, Scotts Private Client Services Limited ("Scotts Private Client") was fined by the FSA for its involvement in introducing investors to an unauthorised and apparently unlawful CIS. Scotts Private Client and the Scotts' Managing Director were found to have carried out inadequate due diligence in relation to the regulatory status of the CIS. Shortly thereafter, Scotts Private Client applied to cancel its authorisation and the cancellation was effected on 10 October 2004.

4.8 Mr Rhys was aware of the FSA's action against Scotts Private Client.

The EBP Scheme – an unregulated collective investment scheme

4.9 In late 2004, Mr Rhys discussed with the Scotts' Managing Director the potential for MNFA to be involved in the promotion of the EBP Scheme. The idea behind the EBP Scheme was that Scotts Atlantic would set up three limited liability partnerships ("LLPs") on an identical basis via which investment would be made in environmentally beneficial plant (specifically machinery used to process waste into energy), with each investor becoming a member of an LLP.

4.10 The aim was that investment into these LLPs would provide investors with a secure income whilst also benefiting from the 100% tax rebates that were allowed by new tax legislation relating to environmentally beneficial plant and machinery. It was intended that the majority of the investment would be returned by way of a tax rebate by August 2005. In essence, it was a scheme which aimed to allow investors to obtain tax relief on a given sum at the time of investment but which, over time, would pay tax on future income.

4.11 Mr Rhys failed to consider or obtain advice as to whether the three EBP Scheme LLPs were UCISs despite his awareness of the restrictions around promoting UCISs from his involvement in the film finance schemes. Instead, Mr Rhys stated that he simply relied on assurances given to him by the Scotts' Managing Director that the LLPs in the EBP Scheme were not UCISs, despite the fact that he knew that:

(1) The Scotts' Managing Director and Scotts Private Client had been recently criticised by the FSA for failing to conduct due diligence into the regulatory status of an investment scheme; and

(2) Scotts Atlantic was not an FSA authorised entity (see guidance at Conduct of Business Rules ("COB") COB 2.3.5G which, at the relevant time, stated that a firm might generally rely on any information provided in writing by an unconnected authorised person).

4.12 In fact, each of the three LLPs in the EBP Scheme was a UCIS because each one:

(1) fell within the definition of a collective investment scheme set out in section 235 of the Act (Collective investment schemes); and

(2) was not a regulated collective investment scheme as defined by the FSA Handbook.

4.13 Amongst other criteria under section 235 of the Act, an arrangement will not be a CIS if participants in the arrangement have day-to-day control over the management of the property. In determining that investors in the EBP Scheme did not have day-to-day control over the management of the property, the FSA has taken into account, amongst others, the following factors:

(1) under the terms of the EBP Scheme documentation, whilst investors retained the right to give directions they delegated management of *inter alia* the operation and maintenance of the plant and procurement and recommendation of contracts to specified named third parties at the time of investment and execution of the scheme documentation, without any discussion or consideration of other alternative service providers, i.e. they did not retain day-to-day control over the management of the property; and

(2) the majority of investors held full time jobs, had no experience in relation to the business of processing waste into energy (the underlying business) and were led, by MNFA's promotion of the scheme, to understand that that they would have no involvement in the day-to-day running of the EBP Scheme.

Breach of promotional restrictions under section 238

4.14 As the LLPs were UCISs, promotion of the EBP Scheme was restricted by section 238 of the Act. Mr Rhys was aware of this restriction, at least in part through MNFA's involvement in the film finance schemes.

4.15 Between January and May 2005, MNFA promoted the EBP Scheme in breach of section 238 of the Act. Although Mr Rhys believed that the LLPs in the EBP Scheme were not UCISs, MNFA promoted the EBP Scheme (in letters drafted by MNFA's compliance officer) to investors in terms that:

(1) informed them that the LLP they were investing in was a UCIS;

(2) asked investors to sign a document entitled a "Confirmation of High Net-Worth" in an apparent attempt to take advantage of article 21 of the PCIS Order (Certified high net worth individuals) which, in certain circumstances, provides an exemption from the restriction on the promotion of UCIS in section 238 of the Act (the "section 238 restriction") for promotion to "certified high net worth individuals". However, the requirements of article 21 were not met because:

(a) article 21 is only relevant to the promotion of a UCIS that invests wholly or predominantly in the shares or debentures of an unlisted company, which was not the case in relation to the EBP Scheme; and

(b) MNFA failed to include a risk warning that promotion may expose the individual to a significant risk of losing all of the property invested as required under the relevant legislation.

4.16 Alternatively, MNFA could have sought to comply with COB to be able to promote the scheme to the investors. There is no evidence however that they complied with such requirements or even intended to do so.

4.17 As a result, in promoting the EBP Scheme, MNFA breached section 238 of the Act.

Advised or execution only?

4.18 There were two individuals at MNFA responsible for marketing the EBP Scheme to potential investors, one of whom was Mr Rhys.

4.19 The documentation prepared by MNFA in relation to the EBP Scheme informed investors that:

> *"this business is treated as 'Execution Only', which means that no advice has been sought or given as to the suitability of either the product or the provider and that as a 'High Net-Worth Individual' you accept full responsibility for entering into this transaction"* .

4.20 Scotts Atlantic produced documentation to explain the EBP Scheme to investors but in most cases MNFA (whilst claiming it was acting on an execution only basis) failed

to pass this explanatory documentation to investors until after they had invested. Investors therefore relied on what they were told about the EBP Scheme by Mr Rhys and an employee of MNFA ("the Employee") and in this respect it is notable that MNFA charged each investor a fee for £1,500 for the transaction. MNFA also received commission, totalling around £760,000 for these transactions. The fees and commission charged by MNFA was a clear indication that the product was being sold on an advised basis rather than on an execution only basis.

4.21 Therefore, notwithstanding the claim that MNFA was acting on an execution only basis, Mr Rhys and the Employee did in fact provide advice.

Statements made in the course of providing advice

4.22 In two particular areas, Mr Rhys failed to act with due skill, care and diligence as to the way in which he advised investors:

(1) statements made to investors by Mr Rhys as to the apparent existence of signed contracts for the EBP Scheme from various water companies and another similar environmental beneficial plant being up and running (and similar statements made by the Employee which Mr Rhys must have been aware of) when in fact those contracts were not signed; and

(2) statements made to investors by Mr Rhys as to the apparent guaranteed 100% first year allowance from Her Majesty's Revenue and Customs ("HMRC") when in fact it was not guaranteed (and similar statements made by the Employee which Mr Rhys must have been aware of).

Statements as to the existence of signed contracts about the EBP Scheme and another similar environmental beneficial plant being up and running

4.23 In order for the EBP Scheme to enable investors to reclaim tax for the financial year 2004/2005, evidence had to be provided to HMRC that trading had taken place before the end of the tax year (i.e. before 5 April 2005). For the scheme to be trading, contracts with water companies had to be in place under which the machinery would be leased out to the water companies. One of the biggest risks for the EBP Scheme was to ensure that these contracts were in place.

4.24 Numerous investors have stated that, when the EBP Scheme was being promoted to them in February 2005, they were told by Mr Rhys and the Employee that these contracts were already in place or were verbally in place and about to be signed. In fact, no such contracts were in place or were about to be signed by any water company. Mr Rhys had attended a meeting held between Scotts Atlantic and the manufacturer of the machines in February 2005 at which it was clearly stated that there was no guarantee that these contracts would be in place for the EBP Scheme.

4.25 At the time of promotion, numerous investors were also told by Mr Rhys that another similar environmental beneficial plant was up and running. This implied that the plant was already in use and running successfully. This was misleading as the similar plant was not built and functioning at the time of execution of the EBP Scheme as it had experienced several problems both in relation to the build and assembly of the actual plant and the actual capital allowance relief. The plant was not even built (let alone operating at full capacity) until September 2005.

4.26 Investors should not have been left with an understanding that the similar plant was up and running at that time or with the impression that contracts for the EBP Scheme were already in place (or both). These were important issues for the financial viability of the EBP Scheme and Mr Rhys should have checked their accuracy before making such statements on which investors would clearly rely.

4.27 It is not contended that these assertions were made by Mr Rhys deliberately to investors to induce them to invest into the EBP Scheme, rather that they were made without Mr Rhys applying his mind to the obvious risk that they may have misled investors. This led directly to a risk of the EBP Scheme being mis-sold.

Statements as to the guaranteed full tax rebate from HMRC and the level of risk

4.28 The EBP Scheme was marketed on the basis that it would provide investors with a secure income whilst also benefiting from 100% tax rebates. It was intended that the majority of the investment would be returned by way of a tax rebate by August 2005.

4.29 However, there was a risk the 100% tax rebate was not guaranteed as it depended on HMRC's acceptance that the scheme satisfied certain criteria (including the LLPs entering into contracts) which were not straightforward. In addition, Mr Rhys was

aware that tax avoidance and deferral schemes which used LLPs as their vehicle were being subject to increased scrutiny by HMRC and anti-avoidance legislation.

4.30 Mr Rhys ignored the obvious risk that the tax rebate was not guaranteed and made misleading statements to investors to the effect that it was guaranteed and that a full rebate from HMRC would be granted. The FSA considers that Mr Rhys failed to apply his mind to the obvious risk that the full rebate from the HMRC may not have been granted. Making these statements directly led to a risk of the EBP Scheme being mis-sold.

Responsibility for statements made to clients by the Employee

4.31 The Employee also made statements to investors as to the apparent existence of signed contracts and the guaranteed nature of the tax rebate. Given the similarity of assurances that Mr Rhys and the Employee were giving to investors, the FSA considers that Mr Rhys must have been aware of what the Employee was telling investors.

4.32 The Employee reported directly to Mr Rhys and was managed, monitored and supervised by him. The Employee followed Mr Rhys's instructions and reported back to Mr Rhys on the sale of the scheme. Given Mr Rhys's seniority in the business, and his role as a CF1 director, Mr Rhys could have taken steps to prevent the Employee's misleading statements but he failed to do so (because he was making similar statements himself).

Amount invested into the EBP Scheme

4.33 In total, 73 individuals invested in the EBP Scheme through MNFA. The investors invested approximately £11.6 million in total of their own funds into the EBP Scheme and they paid approximately £760,000 in fees and commission to MNFA.

4.34 However, due to concerns raised by HMRC later in 2005 the investors did not receive a 100% tax rebate and received a rebate equivalent to approximately 25% of their initial capital contribution. As a result, the majority of the investors have sustained losses from their investment in the EBP Scheme.

4.35 The investors submitted complaints to MNFA claiming that the investment into the EBP Scheme was unsuitable. MNFA rejected all the complaints claiming that the investment was unregulated and was conducted on an "execution only" basis.

5. REPRESENTATIONS

Key roles

5.1. Mr Rhys said that the key roles were played by himself, the Scotts' Managing Director and the compliance officer of MNFA. Mr Rhys was a director of MNFA, his particular role being that of business development. He gave no regulated advice and at no time was any part of the compliance function delegated or assigned to him although he did make a note of what someone approved to perform the investment adviser for MNFA said to the investors.

5.2. At the time when Mr Rhys claims to have relied on the Scotts' Managing Director and the authorised companies associated with him in relation to the EBP Scheme, the Scotts' Managing Director was an approved person. Scotts Atlantic was experienced in these matters and had taken legal advice from both internal and external lawyers. Mr Rhys stated that it was therefore reasonable to rely on their representations and in doing so Mr Rhys was confident that he had discharged his regulatory responsibilities correctly.

5.3. Mr Rhys also relied on the FSA provisions COB 2.3.3R, COB 2.3.4E and 2.3.5G relating to 'Reliance on others' (see the Annex paragraphs 2.12 to 2.14).

5.4. The companies were appointed by the partners of the EBP Scheme to provide project management services.

5.5. The compliance officer of MNFA also performed the apportionment and oversight function. At no time was any doubt cast on his capability.

The EBP Scheme

5.6. Relying on the Scotts' Managing Director and the scheme documentation, Mr Rhys believed that the EBP Scheme was not a UCIS. The offering document to the scheme indicated that the partners in the LLPs would have control over the affairs of the

LLPs. The Members' Agreement provided that the partners would not be required to become involved in operational matters. They could outsource many aspects of the business but retain control by monitoring performance of them.

5.7. There was no basis that the partners lacked time or experience in waste management to fulfil their obligations. Neither was that assessment relevant to assessing day to day control. As a matter of fact, partners were actively involved in the day to day activities. Many of the investors were sophisticated and highly intelligent professionals holding controlled functions in their firms.

5.8. The FSA had ignored the scheme documentation and the activities of the partners. Although some of the partners may not have been cognisant of the activities that were going on, it was the function of the Member Consents to allow a limited number of partners to conduct the business of the partnerships. The fact that other partners may have had no interest in what was going on should not lead to the conclusion that the partners were not exerting control on a day to day basis. The partners exerted control over the business by managing the service providers.

5.9. Mr Rhys said that he believed that the EBP Scheme did not turn into a UCIS in practice because the participants did have day to day control. If it did turn into a UCIS he should not be held accountable for that.

Statements made to investors

5.10. Mr Rhys said that he did not make statements to any investor as to the existence of contracts where the information did not come directly from either the Scotts' Managing Director or one other person. Mr Rhys said that he relied on a very bullish comfort letter and other documents which have been lost due to difficulties with the server. Whilst some of the statements may have been incorrect Mr Rhys did not fabricate statements to lure investors into making investments.

5.11. Although the marketing material was clear on the expected tax relief, it came to light later that the implementation of the EBP Scheme was not sufficient for the partnerships to be considered trading. However, after some negotiation with HMRC they agreed to give tax relief to the investors. Had the scheme been implemented appropriately, and the valuation of the plant credible, HMRC could have been

satisfied and given tax relief of at least 50%. Given the tax relief agreed with HMRC and the value of assets retained by the partnership, Mr Rhys did not believe that the investors had suffered loss.

5.12. Although there was insufficient evidence to demonstrate that the investors had received the scheme documentation, the investors themselves could not prove that they did not receive the appropriate documentation. In particular, Mr Rhys said that it was inconceivable that a group of over 70 sophisticated, highly intelligent professionals would execute the documents without reviewing the documentation including the Execution Only letter, which they also had to sign.

Competence and capability

5.13. Mr Rhys said that the question was 'Who was responsible for compliance oversight?' He was not responsible for compliance and that no part of it had been delegated to him.

5.14. In any event, all the sales had been execution only.

Prohibition

5.15. If the allegations were found proved, prohibition would not be a proportionate response having regard to the provisions in that part of the FSA Handbook known as the Fit and Proper test for Approved Persons (known as 'FIT).

6. FINDINGS

Key roles

6.1. Whilst Mr Rhys accepted his role of business development, he denied any responsibility for anything else, notwithstanding his position as a director of MNFA. As a director, his responsibilities would have included in particular being satisfied that it was reasonable in all the circumstances to rely on the advice of others in relation to the status of the EBP Scheme and in the effective discharge of the compliance function.

6.2. Mr Rhys himself made it clear that he understood that the question whether a scheme was a UCIS was a difficult and complex one. However, he failed to provide sufficient

evidence to show that he did more than accept that the scheme was not a UCIS. He relied on legal advice given to another party which he had not seen and there was no evidence, for example, to show that he asked for that legal advice or the basis on which the advice was given.

6.3. It was also for Mr Rhys to satisfy himself that, even if the scheme documentation was sufficient in its preparation to justify the position that the EBP Scheme was not a UCIS, it depended on the operation of the scheme to ensure that it remained that way. However, Mr Rhys sought to distance himself from accountability on the grounds that he was not the compliance officer, despite the fact that the compliance officer was accountable to him.

6.4. Mr Rhys sought to rely on the provisions in COB relating to 'Reliance on others' (see the Annex paragraphs 2.12 to 2.14). However, in doing so, Mr Rhys failed to give sufficient evidence to demonstrate that it was reasonable in the circumstances to do so. Also, having regard to COB 2.3.5G ("A *firm* may generally rely on any information provided to the *firm* in writing by (1) an unconnected *authorised person* …"), Mr Rhys failed to explain how the firms associated with the Scotts' Managing Director were unconnected to MNFA or that at the relevant time Scotts' Managing Director was no longer operating through an authorised firm.

The EBP Scheme

6.5. The FSA accepts the representation that if the EBP Scheme was to avoid being a UCIS, the participants had to have day to day control of the operation of the scheme. Given that the scheme related to waste management, that the participants were generally professional people of high net worth working in financial services, and that there were in the region of 70 of them, the onus of demonstrating that they did have day to day control was high. From the evidence before it, the FSA is satisfied that the participants did not have day to day control.

6.6. For example, one of the meetings relied upon to demonstrate day to day control, through having oversight of the performance of the prime service provider, was an informal meeting of the LLPs on 10 January 2007 chaired by four participants, with the Scotts' Managing Director, the LLP secretary and Mr Rhys in attendance.

However, the minutes themselves indicated that "… the meeting was informal and therefore no major decisions could be made at this stage …". The process for official meetings were explained at the meeting and included 14 days notice; a right to attend and to receive information relating to the meeting; a right to vote to by proxy; and a right to not turn up or not respond at all. Any non-responses would follow the decision of the Chairman.

6.7. Based on the evidence before it, the FSA is satisfied that the EBP Scheme was a UCIS.

Statements made to investors

6.8. In the circumstances where a person has a responsibility not to promote unregulated investments (except in limited circumstances), the person has a positive duty to satisfy himself that he is compliant with the rules relating to financial promotion. Mr Rhys failed to satisfy the FSA that he took sufficient steps to satisfy himself that his statements in relation to the EBP Scheme were compliant with the rules relating to financial promotion – which he maintains did not apply in the first place.

Competence and capability

6.9. The question for the FSA was not whether Mr Rhys performed the compliance function but whether he had responsibility, either alone or with others, for ensuring that the statutory and regulatory requirements relating to collective investment schemes were complied with. If he did, the next question was whether he discharged that duty.

6.10. For the reasons given earlier, the FSA is satisfied that Mr Rhys, as a director of MNFA, did have that responsibility and that he failed to discharge it. It is clear that Mr Rhys was very alive to the risks he was taking, and permitting therefore MNFA to take. Rather than rely on the advice given to Scotts Atlantic, Mr Rhys should have taken reasonable steps himself, on behalf of MNFA, or ensured that such steps were taken to satisfy himself and MNFA that the regulatory requirements were met. In the absence of demonstrating that he had taken those steps, the clear inference to be drawn is that Mr Rhys disregarded the duties placed upon him.

6.11. Mr Rhys also disregarded the risks attached to a failure to have regard to the suitability provisions of the FSA Handbook. Given the complexity of the legal position, it was not adequate to claim that the relationship with the investors was execution only thereby avoiding the need to consider the suitability of advice.

6.12. The evidence relating to the documentation in the sales process is conflicting and on balance the FSA accepts that some at least of the documentation was given to the investors despite the claims by some that this was not so. It is unsatisfactory, however, that the FSA is unable to be persuaded that the documentation provisions were satisfied even allowing for evidential difficulties arising from the server. This is particularly the case bearing in mind that Mr Rhys is saying that the basis of the arrangement as evidenced by the documentation was 'execution only' and that this was a key element in considering the relationship of MNFA to the investors.

6.13. Mr Rhys recognised the complexity of the financial products which were being promoted. He was well aware of the significant sums of money being invested. He knew of the risks of non-compliance both in the setting up of the EBP Scheme and in the operation of it. He was aware that participants would be relying on what was being said to them, whether by himself, others within MNFA or externally.

6.14. Taking all of these factors into account, the expectation would be that Mr Rhys should take considerable care to ensure compliance with the statutory and regulatory requirements and to be able to demonstrate that he had done so. In the absence of compelling evidence that he had satisfied himself, and continued to satisfy himself, on relevant matters, FSA finds that Mr Rhys failed to act competently. The relevant matters included the status of the EBP Scheme and the failure to appreciate the obvious risk of investors being misled in relation to statements made about signed contracts, the operation of similar environmental beneficial plant and the status of the tax rebate.

6.15. In considering his fitness and propriety, the FSA also takes into account the absence of sufficient evidence of the steps taken by Mr Rhys to ensure that the statements made by another individual within MNFA were not misleading. As a director, it was not good enough to distance himself from the need to consider the interests of the

investors by claiming that he had no immediate or direct responsibility for what was being said by others within MNFA to investors.

Prohibition

6.16. In the circumstances, the FSA is satisfied that Mr Rhys is not a fit and proper person and that it is appropriate to impose an order on Mr Rhys in the terms set out earlier in this notice.

7. DECISION MAKER

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

8. IMPORTANT

8.1. This Final Notice is given to Mr Rhys under section 390 of the Act.

Publicity

8.2. Sections 391(4), 392(6) and 391(7) of the Act apply to the publication of information about the matter to which this Final 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 Mr Rhys or prejudicial to the interests of consumers.

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

FSA contacts

8.4. For more information concerning this matter generally Mr Rhys should contact Paul Howick (direct line: 020 7066 7954 or by e-mail: paul.howick@fsa.gov.uk) of the FSA's Enforcement and Financial Crime Division.

Signed:

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Tom Spender

Head of Department
FSA Enforcement and Financial Crime Division

Annex (paragraph 3.6)

RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND FSA GUIDANCE

1. STATUTORY AND REGULATORY PROVISIONS AND POLICY TO IMPOSE A PROHIBITION ORDER

1.1 The FSA's statutory objectives are set out in section 2(2) of the Act. In relation to this case, the most relevant statutory objectives are maintaining confidence in the financial system and the protection of consumers.

Prohibition

1.2 The FSA has the power, pursuant to section 56 of the Act, to make an order prohibiting individuals from performing a specified function, any function falling within a specified description, or any function, if it appears to the FSA that he is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person. Such an order may relate to a specified regulated activity or any regulated activity falling within a specified description or all regulated activities.

Fit and Proper Test for Approved Persons

1.3 The section of the FSA handbook entitled "FIT" sets out the Fit and Proper test for Approved Persons. The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function and FIT is also relevant in assessing the continuing fitness and propriety of an approved person.

1.4 FIT 1.3.1G provides that the FSA will have regard to a number of factors when assessing a person's fitness and propriety. Among the most important considerations will be the person's competence and capability.

Enforcement Guide

1.5 The FSA's approach to exercising its powers to make prohibition orders and withdraw approvals is set out at Chapter 9 of the Enforcement Guide ("EG").

1.6 EG 9.1 states that the FSA's power to make prohibition orders under section 56 of the Act helps it work towards achieving its regulatory objectives. The FSA may exercise this power where it considers that, to achieve any of those objectives, it is appropriate either to prevent an individual from performing any functions in relation to regulated activities or to restrict the functions which he may perform.

1.7 EG 9.4 sets out the general scope of the FSA's powers in this respect, which include the power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual's lack of fitness and propriety is relevant. EG 9.5 provides that the scope of a prohibition order will vary according to the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk posed by him to consumers or the market generally.

1.8 In circumstances where the FSA has concerns about the fitness and propriety of an approved person, EG 9.8 to 9.14 provides guidance. In particular, EG 9.8 states that the FSA may consider whether it should prohibit that person from performing functions in relation to regulated activities, withdraw that person's approval or both. In deciding whether to withdraw approval and/or make a prohibition order, the FSA will consider whether its regulatory objectives can be achieved adequately by imposing disciplinary sanctions.

1.9 EG 9.9 states that the FSA will consider all the relevant circumstances when deciding whether to make a prohibition order against an approved person and/or to withdraw that person's approval. Such circumstances may include, but are not limited to, the following factors:

(1) whether the individual is fit and proper to perform functions in relation to regulated activities, including in relation to the criteria for assessing the fitness and propriety set out in FIT;

(2) the relevance and materiality of any matters indicating unfitness;

(3) the length of time since the occurrence of any matters indicating unfitness;

(4) the particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates;

(5) the severity of the risk which the individual poses to consumers and to confidence in the financial system; and

(6) the previous disciplinary record and general compliance history of the individual.

1.10 EG 9.12 provides a number of examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order or withdraw the approval of an approved person. The examples include serious lack of competence.

Conduct of Business Rules

1.11 Guidance on the Conduct of Business rules is set out in the Conduct of Business manuals of the FSA Handbook.

1.12 At the relevant time, COB 5 set out rules relating to a firm's obligation to ensure suitability of advice.

2. STATUTORY AND REGULATORY PROVISIONS REGARDING UCIS AND SUITABILITY

Section 235 of the Act

2.1 Section 235 of the Act (Collective investment schemes) provides the definition of a collective investment scheme as follows:

(1) In this Part "collective investment scheme" means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

(2) The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions (our emphasis).

(3) The arrangements must also have either or both of the following characteristics:

(a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;

(b) the property is managed as a whole by or on behalf of the operator of the scheme.

(4) If arrangements provide for such pooling as is mentioned in subsection (3)(a) in relation to separate parts of the property, the arrangements are not to be regarded as constituting a single collective investment scheme unless the participants are entitled to exchange rights in one part for rights in another.

(5) The Treasury may by order provide that arrangements do not amount to a collective investment scheme—

(a) in specified circumstances; or

(b) if the arrangements fall within a specified category of arrangement.

Section 238 of the Act

2.2 Section 238 of the Act (Restrictions on promotion) provides restriction on promotion of collective investment schemes.

(1) An authorised person must not communicate an invitation or inducement to participate in a collective investment scheme.

(2) But that is subject to the following provisions of this section and to section 239.

(3) Subsection (1) does not apply in relation to—

(a) an authorised unit trust scheme;

(b) a scheme constituted by an authorised open-ended investment company; or

(c) a recognised scheme.

(4) Subsection (1) does not apply to anything done in accordance with rules made by the Authority for the purpose of exempting from that subsection the promotion otherwise than to the general public of schemes of specified descriptions.

(5) The Treasury may by order specify circumstances in which subsection (1) does not apply.

(6) An order under subsection (6) may, in particular, provide that subsection (1) does not apply in relation to communications—

(a) of a specified description;

(b) originating in a specified country or territory outside the United Kingdom;

(c) originating in a country or territory which falls within a specified description of country or territory outside the United Kingdom; or

(d) originating outside the United Kingdom.

(7) "Communicate" includes causing a communication to be made.

(8) "Promotion otherwise than to the general public" includes promotion in a way designed to reduce, so far as possible, the risk of participation by persons for whom participation would be unsuitable.

(9) "Participate", in relation to a collective investment scheme, means become a participant (within the meaning given by section 235(2)) in the scheme.

Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001

2.3 Article 21 of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 provides for a specific exemption for "certified high net worth individuals". Article 21 of the PCIS Order which was in force from September 2004 until 3 March 2005 provides as follows:

(1) If the requirements of paragraphs (4) and (5) are met, the scheme promotion restriction does not apply to any communication which—

(a) is a non-real time communication or a solicited real time communication;

(b) is made to a certified high net-worth individual;

(c) relates only to units falling within paragraph (6);

(d) does not invite or induce the recipient to enter into an agreement under the terms of which he can incur a liability or obligation to pay or contribute more than he commits by way of investment.

(2) "Certified high net-worth individual" means any individual—

(a) who has a current certificate of high net worth; and

(b) who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

"I make this statement so that I am able to receive promotions of units in unregulated collective investment schemes where such promotions are exempt from the restriction in section 238 of the Financial Services and Markets Act 2000. The exemption relates to certified high net worth individuals and I declare that I qualify as such. I accept that the schemes to which the promotions will relate are not authorised or recognised for the purposes of that Act. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on this kind of investment".

(3) For the purposes of paragraph (2)(a) a certificate of high net worth—

(a) must be in writing or other legible form;

(b) is current if it is signed and dated within the period of twelve months ending with the day on which the communication is made;

(c) must state that in the opinion of the person signing the certificate, the person to whom the certificate relates either—

(i) had, during the financial year immediately preceding the date on which the certificate is signed, an annual income of not less than £100,000; or

(ii) held, throughout the financial year immediately preceding the date on which the certificate is signed, net assets to the value of not less than £250,000;

(d) must be signed by the recipient's accountant or by the recipient's employer.

(4) The requirements of this paragraph are that the communication is accompanied by an indication—

(a) that it is exempt from the restriction on the promotion of unregulated schemes (in section 238 of the Financial Services and Markets Act 2000) on the grounds that the communication is made to a certified high net worth individual;

(b) of the requirements that must be met for a person to qualify as a certified high net worth individual;

(c) that buying the units to which the communication relates may expose the individual to a significant risk of losing all of the property invested;

(d) that any person who is in any doubt about the units to which the communication relates should consult an authorised person specialising in advising on participation in unregulated schemes.

(5) In determining an individual's "net assets", no account is to be taken of—

(a) the property which is his primary residence or of any loan secured on that

residence;

(b) any rights of his under a qualifying contract of insurance; or

(c) any benefits (in the form of pensions or otherwise) which are payable on the termination of his service or on his death or retirement and to which he is (or his dependents are), or may be, entitled.

(6) A unit falls within this paragraph if it is in an unregulated scheme—

(a) which is not operated by the person who has signed the certificate of high net worth referred to in paragraph (2)(a); and

(b) which invests wholly or predominantly in the shares in or debentures of an unlisted company.

(7) "Unlisted company" has the meaning given in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001(1).

2.4 The PCIS Order was amended on 3 March 2005. Article 21 of the amended PCIS Order in force from 3 March 2005 until May 2005 provides as follows:

(1) If the requirements of paragraphs (4) and (7) are met, the scheme promotion restriction does not apply to any communication which–

(a) is a non-real time communication or a solicited real time communication;

(b) is made to an individual whom the person making the communication believes on reasonable grounds to be a certified high net worth individual;

(c) relates only to units falling within paragraph (8); and

(d) does not invite or induce the recipient to enter into an agreement under the terms of which he can incur a liability or obligation to pay or contribute more than he commits by way of investment.

(2) "Certified high net worth individual" means an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement complying with Part I of the Schedule1.

(3) The validity of a statement signed for the purposes of paragraph (2) is not affected by a defect in the form or wording of the statement, provided that the defect does not alter the statement's meaning and that the words shown in bold type in Part I of the Schedule are so shown in the statement.

(4) The requirements of this paragraph are that either the communication is accompanied by the giving of a warning in accordance with paragraphs (5) and (6) or, where because of the nature of the communication this is not reasonably practicable,–

(a) a warning in accordance with paragraph (5) is given to the recipient orally at the beginning of the communication together with an indication that he will receive the warning in legible form and that, before receipt of that warning, he should consider carefully any decision to participate in a collective investment scheme to which the communication relates; and

(b) a warning in accordance with paragraphs (5) and (6) (d) to (h) is sent to the recipient of the communication within two business days of the day on which the communication is made.

(5) The warning must be in the following terms–

"Reliance on this promotion for the purpose of buying the units to which the promotion relates may expose an individual to a significant risk of losing all of the property or other assets invested.".

But, where a warning is sent pursuant to paragraph (4)(b), for the words "this promotion" in both places where they occur there must be substituted wording which clearly identifies the promotion which is the subject of the warning.

(6) The warning must–

(a) be given at the beginning of the communication;

(b) precede any other written or pictorial matter;

(c) be in a font size consistent with the text forming the remainder of the communication;

(d) be indelible;

(e) be legible;

(f) be printed in black, bold type;

(g) be surrounded by a black border which does not interfere with the text of the warning; and

(h) not be hidden, obscured or interrupted by any other written or pictorial matter.

(7) The requirements of this paragraph are that the communication is accompanied by an indication–

(a) that it is exempt from the restriction on the promotion of unregulated schemes (in section 238 of the Act) on the grounds that the communication is made to a certified high net worth individual;

(b) of the requirements that must be met for an individual to qualify as a certified high net worth individual;

(c) that any individual who is in any doubt about the units to which the communication relates should consult an authorised person specialising in advising in participation in unregulated schemes.

(8) A unit falls within this paragraph if it is in an unregulated scheme which invests wholly or predominantly in the shares in or debentures of one or more unlisted companies.

(9) "Business day" means any day except a Saturday, a Sunday, Christmas Day, Good Friday or a day which is a bank holiday under the Banking and Financial Dealings Act 1971 in any part of the United Kingdom.

(10) "Unlisted company" has the meaning given in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001."

Conduct of Business Rules – promotion of unregulated collective investment schemes

2.5 COB 3 set out rules and other provisions relating to financial promotion.

2.6 COB 3.11 sets out exemptions from the restriction on promoting unregulated collective investment schemes under section 238 of the Act.

2.7 Under COB 3.11.2R a firm may communicate an invitation or inducement to participate in an unregulated collective investment scheme if the communication falls within COB 3 Annex 5 R.

2.8 Under COB 3, Annex 5 a firm may communicate an invitation or inducement to participate in an unregulated collective investment scheme without breaching the restriction on promotion in section 238 of the Act if the promotion is to a category of persons and promoted in a particular way.

2.9 A Category 1 person is a person who is already a participant in a UCIS or a qualified investment scheme; or a person who has been in the last 30 months a participant in an

unregulated collective investment scheme or a qualified investment scheme. Promotion of that specified collective investment scheme is permissible.

2.10 A Category 2 person is a person for whom a firm is required to take reasonable steps to ensure that their investment in that particular collective investment scheme was suitable and who is an established or newly accepted customer of the firm or of a person in the same group as the firm. Financial promotion of any such collective investment scheme is permissible.

Conduct of Business Rules – reliance on others

2.11 COB 3 set out rules and other provisions relating to the extent to which a firm could rely on others.

2.12 COB 2.3.3R provided that a firm will be taken to be in compliance with any rule in COB that requires a firm to obtain information to the extent that the firm can show that it was reasonable for the firm to rely on information provided to it in writing by another person.

2.13 COB 2.3.4E provided that in relying on COB 2.3.3 R, a firm should take reasonable steps to establish that the other person providing written information is (a) not connected with the firm; and (b) competent to provide the information. Compliance with this tended to indicate compliance with COB 2.3.3R; contravention indicated contravention with COB 2.3.3R.

2.14 COB 2.3.5G provided that a firm may generally rely on any information provided to the firm in writing by (1) an unconnected authorised person or (2) a professional firm unless the firm is aware, or ought reasonably to be aware, of any fact, or facts, that would give reasonable grounds to question the accuracy of any such information.