
FINAL NOTICE

To: Square Mile Securities Limited
Of: America House
No 2 America Square
London
EC3N 2LU

Date: 10 January 2008

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

1. ACTION

1.1. The FSA gave Square Mile Securities Limited ("Square Mile")("the Firm") a Decision Notice on 8 January 2008 which notified Square Mile that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("FSMA"), the FSA had decided to impose a financial penalty of £250,000 on Square Mile for breaches of the FSA's Principles for Businesses ("the Principles") in relation to advising on and arranging the sale to customers of certain higher risk securities. In particular, Square Mile failed to:

- (1) conduct its business with integrity in breach of Principle 1;
- (2) pay due regard to the interests of its customers and treat them fairly in breach of Principle 6;
- (3) pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading in breach of Principle 7;

- (4) take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment in breach of Principle 9; and
 - (5) take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in breach of Principle 3.
- 1.2. In addition to the Principle breaches, Square Mile also breached the rules in the part of the FSA Handbook ("the Handbook") entitled Conduct of Business ("COB") 5.2.5R and 5.4.3R, set out in paragraphs 3.4 and 3.5 below. For the avoidance of doubt, the COB Rules, as they were then known, were the applicable regulatory requirements in force at the time.
- 1.3. Square Mile confirmed on 20 December 2007 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.4. Accordingly, for the reasons set out below and having agreed with Square Mile the facts and matters relied on, the FSA imposes a financial penalty on Square Mile in the amount of £250,000.
- 1.5. The FSA considers that Square Mile's failings warranted a financial penalty of £1.5 million but this has been reduced as Square Mile agreed to settle at an early stage of the FSA investigation and therefore qualified for a 30% (stage 1) reduction of the financial penalty under the FSA's executive settlement procedures. The FSA has also taken into account Square Mile's present financial circumstances and the fact that it will have to pay for independent approval of its transactions and new account openings, appointment of a skilled person and any appropriate redress payable.

2. REASONS FOR THE ACTION

- 2.1. The breaches of the Principles and COB outlined above relate to a number of serious failures committed by Square Mile whilst advising and arranging for customers to purchase higher risk securities issued by five new or emerging smaller capitalised companies ("the Securities") between March 2006 and May 2006 ("the Relevant Period").
- 2.2. During the Relevant Period, the conduct of Square Mile fell below the standards expected under the regulatory system for the following reasons:
 - (1) Square Mile established a remuneration and rewards system that incentivised its investment advisers ("advisers") to put the interests of Square Mile first, to the detriment of its customers. It established a highly pressurised sales environment in which it used unacceptable sales practices that were not appropriate for recommending higher risk securities. Consequently, Square Mile's customers were not treated fairly and/or were subjected to undue pressure to purchase Securities which they could not afford or were reluctant to purchase. Square Mile advisers also, on occasion, dishonestly failed to seek the customer's consent to proceed with particular purchases;

- (2) Square Mile failed to take reasonable steps to ensure that customers understood the risks of the Securities. For example, customers were not always provided with sufficient risk warnings when purchasing the Securities;
- (3) Square Mile failed to pay due regard to the information needs of its customers and communicate clear, fair and not misleading information about the Securities by making false representations and/or providing inaccurate and incomplete information in conjunction with ambiguous personal and speculative opinions. Square Mile failed to provide full explanations about the significant risks associated with the Securities and/or made statements which otherwise obscured, diminished or unfairly distorted the risks (and other characteristics) of the Securities. As a result, there was a likelihood, or a reasonable possibility, that customers were misled and/or formed erroneous impressions about the Securities;
- (4) Square Mile failed to keep its information about its customers under regular review and failed to obtain sufficient personal and financial information about them before making recommendations to purchase the Securities. It also failed to take reasonable care to ensure the suitability of its advice and it recommended the Securities to customers despite them not being demonstrably suitable for some of those customers;
- (5) Square Mile failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. It failed to establish and maintain robust systems, controls and operational procedures that were appropriate for its business of dealing and advising in relation to higher risk securities. In particular it failed to:
 - (a) implement and maintain appropriate senior management arrangements and internal reporting lines;
 - (b) implement effective compliance arrangements and conduct adequate sales monitoring;
 - (c) identify that some of the information it provided to its advisers was non-public information and implement systems and controls to manage the use and dissemination of such information;
 - (d) adopt adequate information systems to record sufficient personal and financial information about customers that could be accessed and used to assess the suitability of its recommendations; and
 - (e) implement effective training and competence arrangements. Further, the limited arrangements it did have failed properly to assess whether its advisers were, and remained, competent.

The seriousness of Square Mile's misconduct

- 2.3. The FSA regards Square Mile's failings as particularly serious in view of the following considerations:

- (1) Square Mile recklessly established a high pressure sales business to recommend higher risk securities and adopted unacceptable sales practices and methods that undermined the requirements of the regulatory system;
- (2) Square Mile's customers were entitled to rely on Square Mile to take reasonable steps to ensure the suitability of its advice, and to be treated fairly. Its customers should not have been subjected to inappropriate sales practices which actively encouraged and pressured them to make immediate investment decisions about higher risk securities based on information that was inaccurate, incomplete and misleading. The use of such practices presented a real and significant risk of customers being misold the Securities;
- (3) Square Mile's customers were exposed to the risk of loss as Square Mile failed to assess the competence of its advisers or provide appropriate training for them, knowing that customers would rely on their apparent skills, knowledge and expertise;
- (4) Square Mile's breaches may have serious financial consequences for customers who purchased the Securities. During the Relevant Period, 624 different customers were charged a total of £3,990,532 for the Securities. All of the Securities were higher risk and/or illiquid and have decreased in value since they were purchased from Square Mile; and
- (5) the failings were widespread and impacted at all stages of Square Mile's sales process of recommending securities in smaller capitalised companies. The cumulative impact of the failings represented a significant risk to the FSA's objectives of securing the appropriate degree of protection for consumers and maintaining confidence in the financial system. The FSA has also had regard to the undertakings Square Mile has provided to the FSA as outlined in paragraph 6.11 below.

The decision to impose a financial penalty

- 2.4. In determining the level of the financial penalty, the FSA has recognised some measures taken by Square Mile which mitigate the seriousness of the failings. In particular, Square Mile engaged an independent consultant to review its operations, produce a report and assist in the implementation of changes to its systems, controls and training and competence arrangements. The independent consultant's report was provided to the FSA on 10 May 2007. The FSA has also had regard to undertakings provided by Square Mile as set out in paragraph 6.11 below.

3. RELEVANT STATUTORY PROVISIONS

- 3.1. The FSA has power under section 206(1) of FSMA to impose a financial penalty, of such amount as it considers appropriate, if an authorised person has contravened a requirement imposed on him under FSMA.
- 3.2. The procedures to be followed in relation to the imposition of a financial penalty are

set out in sections 207 and 208 of FSMA.

- 3.3. The Principles, as set out in the FSA's Handbook, are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule making powers as set out in FSMA.
- 3.4. By virtue of COB 5.2.5R, which was in force during the Relevant Period, before a firm gives a personal recommendation concerning a designated investment to a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about the customer relevant to the services that the firm has agreed to provide. During the Relevant Period, COB 5.2.11G indicated, amongst other things, that information collated for a private customer should, at a minimum, provide an analysis of the customer's personal and financial circumstances leading to a clear identification of their needs and priorities, combined with attitude to risk.
- 3.5. By virtue of COB 5.4.3R, which was in force during the Relevant Period, a firm must not make a personal recommendation to a private customer unless it has taken reasonable steps to ensure that the customer understands the nature of the risks involved. COB 5.4.4E indicates what reasonable steps should include which, in the case of Square Mile, involved the provision of either the penny share risk warning (COB 5.4.7E and COB 3.9.17G(12)) or the non-readily realisable investment risk warning (COB 5.4.7E) to private customers. The version of COB 5.4.5E in force during the Relevant Period stated that compliance with COB 5.4.4E may be relied on as tending to establish compliance with COB 5.4.3R.

4. BACKGROUND

The Firm

- 4.1. Square Mile was incorporated on 25 February 1999 under the name Halewood International Futures Limited. On 2 March 2006, it changed its name to Square Mile Securities Limited.
- 4.2. Square Mile has been authorised by the FSA since 1 December 2001, having previously been regulated by the Securities and Futures Authority (from 5 October 1999). Square Mile is an authorised person under FSMA with permissions granted for the regulated activities of advising, dealing in investments as principal and agent, arranging deals in investments, arranging safeguarding and administration of assets, causing dematerialised instructions to be sent and making arrangements.
- 4.3. Square Mile is an agency stockbroking firm. Its current business specialises in offering derivative products and advising and dealing in securities that have been, or intend to be, admitted to trading on the Alternative Investment Market ("AIM") and PLUS Market. These markets specialise in providing primary and secondary trading services for smaller capitalised and/or emerging companies ("small cap securities").
- 4.4. Square Mile began advising and dealing in small cap securities in July 2003. Since

that date, it has adopted a strategy of using focussed mail shots, financial promotions and Square Mile promotional materials to target customers and generate its customer base. The mail shots and financial promotions purported to offer free independent research reports. Once customers returned a consent form included with the mail shot a research report was sent and a trainee adviser telephoned the customer to open an account. The customer would then be referred to a "senior adviser" who would recommend that they purchase small cap securities. Contact with customers was conducted almost exclusively by telephone.

- 4.5. During the Relevant Period, Square Mile employed approximately 64 individuals who held a combined total of 75 controlled functions. This included 11 individuals who held significant influence functions, 36 who held Controlled Function 21 (investment adviser) and 23 who held Controlled Function 22 (trainee investment adviser).

FSA Supervisory Visit

- 4.6. The FSA's Small Firms Division visited Square Mile between 21 June 2006 and 26 June 2006 and conducted a focussed on-site review of its small cap business. The visit revealed concerns with Square Mile's practices in respect of selling small cap securities, the information provided to customers and its systems and controls. As a result, the matter was referred to the FSA's Enforcement Division.

The Securities

- 4.7. The Securities sold by Square Mile were all admitted, or intended to be admitted, to trading on either AIM or PLUS.
- 4.8. During the Relevant Period, Square Mile recorded a total of 1,585 sales of small cap securities to 922 different customers, from 18 different issuers. However, the FSA's investigation focussed on the Securities as set out in paragraph 2.1, which accounted for 896 (57%) of all its sales in the Relevant Period and involved 624 customers.
- 4.9. The FSA's findings are based on the results of a detailed review of recorded telephone calls and customer records in respect of 55 transactions in the Securities during the Relevant Period ("the transactions reviewed").
- 4.10. The findings in this Notice regarding Square Mile's sales practices relate only to advising and recommending the Securities during the Relevant Period. However, the investigation identified that the failings in Square Mile's systems and controls had been present since 2003.

5. BREACHES OF THE REGULATORY REQUIREMENTS

Breach of Principle 1

- 5.1. By reasons of the facts and matters set out in paragraph 5.2 to 5.15 below, Square Mile breached Principle 1.

Establishing a business and creating a high pressure sales environment that undermined the regulatory requirements and disadvantaged its customers

- 5.2. Square Mile recklessly established a business that specialised in recommending higher risk securities, knowing that the securities presented particular and higher risks for customers. Square Mile also knew that its customers would rely upon its judgment and recommendations when deciding to purchase higher risk securities. Regardless, Square Mile recklessly failed to:
- (1) conduct its own research and/or due diligence on the small cap securities that it recommended and it did not have established criteria for the securities it selected and recommended to customers apart from selecting securities that it believed would "appeal" to its customers. Instead, Square Mile relied only on the services of the supplier of the securities as it assumed that they had conducted sufficient due diligence; and
 - (2) obtain and communicate sufficient and reasonable information about the business, expected performance and associated risks of the small cap securities it recommended (what limited information it did have was disseminated to its advisers and, via them, to its customers).
- 5.3. The probable or possible consequences of Square Mile's conduct were that it could not demonstrate that it understood and/or appreciated the characteristics, including the particular and higher risks, of each small cap security that it recommended. Square Mile did not consider the specific risks when selecting securities nor did it communicate the risks to customers. As such, Square Mile recklessly exposed its customers to the risk of being treated unfairly by making recommendations that were unsuitable and by providing inadequate and misleading information to its customers.
- 5.4. Despite knowing that the small cap securities presented particular and higher risks for customers, Square Mile provided its advisers with insufficient information about the securities they were recommending. As a result, advisers sought to supplement this limited information, which was neither monitored nor endorsed by Square Mile. Therefore, Square Mile recklessly failed to consider and/or mitigate the risk that its advisers would make statements to customers beyond the limited information provided to them and, in many instances, beyond the publicly available information.
- 5.5. By creating and failing adequately to control a high pressure sales driven environment which rewarded high volume selling Square Mile recklessly disregarded the requirements under the regulatory system. Substantial pressure was placed on advisers to generate sales including threats that they would lose their jobs and/or their customer base if they did not achieve the required sales.
- 5.6. Square Mile was aware that its advisers were adopting high pressure and unacceptable sales tactics when recommending small cap securities to customers. In addition, Square Mile had reason to doubt the conduct and practices of its advisers as it knew that its customers were not being provided with risk warnings and continued to make recommendations despite customers having already purchased securities of a total that

exceeded their agreed level of exposure to risk ("risk capital level"). Indeed, Square Mile actively discouraged its advisers from providing customers with information about the associated risks and/or negative aspects of investing in higher risk securities. In particular, it held meetings to discuss "*sales techniques*" and reinforce the requirement to make sales. This occurred despite the knowledge that Compliance had raised concerns about the "*rather exaggerated sales pitch*" of advisers and the failure to explain risks to customers.

- 5.7. Square Mile was also aware that its advisers were communicating misleading information about the securities it recommended and the services that it offered. In particular, an email sent from the Compliance Department during the Relevant Period stated, amongst other things, that advisers must "*stop using past performance as a selling tool*" and that Compliance had "*listened to calls where [advisers were stating that] our 20 analysts are excited about the said deal*" when Square Mile did "*no[t] have a registered analyst let alone 20*".
- 5.8. As a result, Square Mile knew of, and/or recklessly failed to appreciate, the risks that it was not conducting its business in compliance with regulatory standards and that there was a risk that its customers were not being treated fairly, that due regard was not being paid to their information needs and that its recommendations may not have been suitable.
- 5.9. Square Mile senior management knew that the Firm had not taken reasonable care to understand and/or address the regulatory requirements in all aspects of its small cap securities business. Square Mile and its senior management had reason to doubt that reasonable steps had been taken to organise and control its affairs responsibly and effectively and to implement appropriate systems, controls and procedures to manage the risks in respect of the sale of small cap securities. In particular, they knew that there were no controls to manage the use of non-public information by the Firm and its employees, that there were serious failings in assessing the suitability of small cap securities for its customers, and that its training and competence arrangements were inadequate. Senior management were also unaware of the compliance requirements applicable to this aspect of the Firm's business. Square Mile recklessly neglected to implement adequate systems and controls and it was also careless, inattentive and lacking in awareness of whether or not its business was being conducted in accordance with regulatory standards.
- 5.10. For the above reasons, Square Mile did not conduct its business with the degree of integrity expected under the regulatory system and the various and numerous instances of serious misconduct, taken together, seriously undermined its ability to comply with the Principles and the FSA's Rules.

Failure to seek customers' consent to proceed with contract notes for purchasing of securities

- 5.11. Square Mile advisers conducted business dishonestly in seven of the 55 transactions reviewed in that a purchase of the Securities was recorded in a customer's name without the consent or instructions (written or verbal) from that customer. Despite not obtaining consent, advisers recorded a purchase of the Securities by completing a

trade ticket in the name of the customer. After the purchase was recorded, the customers received contract notes requiring payment and a customer debt was established in Square Mile's financial records.

- 5.12. Square Mile acted recklessly by failing to investigate this misconduct despite members of senior management knowing or being aware of "*rumours*" that it was occurring. As a result, Square Mile advisers engaged in dishonest business practices and Square Mile itself failed to ensure that its customers were not exposed to the risk of being sold securities they did not want, and were not subject to demands for payment for securities they had not purchased.
- 5.13. Square Mile's advisers have confirmed that trade tickets were written out without instructions from customers. One adviser alleged that approximately one in every ten trade tickets written out by Square Mile advisers was not supported by customer agreement and this was referred to internally as "*writing up rubbish*" with senior advisers who were expected to lead the sales entering into organised "*pacts*" to co-ordinate the writing of unauthorised trade tickets. Some advisers stated that writing out unauthorised trade documentation without the authorisation of the customer was driven by the motive to relieve, in the short term, the requirements to sell securities and get management "*off their backs*".
- 5.14. This dishonest conduct, by these advisers, posed a significant risk to Square Miles' customers as they could have been charged for the purchase of securities they did not consent to. By way of example:
 - (1) One 89 year old customer had at least £75,000 charged to his account from five transactions entered without his consent. At the time of these transactions he had an agreed risk capital limit of only £25,000, yet, by the end of May 2006, Square Mile ended up selling the customer securities at a cost of £398,000.
 - (2) One 79 year old customer had at least £129,000 charged to his account from 13 transactions entered without his consent. At the time, the customer had an agreed risk capital limit of only £10,000, yet, by the end of May 2006, Square Mile ended up selling to the customer securities at a cost of £284,000.
- 5.15. The abovementioned conduct, by these advisers, lacked integrity as it was dishonest. Such conduct seriously undermines the protection and fair treatment of customers and confidence in the financial services industry.

Breach of Principle 6

- 5.16. By reasons of the facts and matters set out in paragraphs 5.17 to 5.31 below, Square Mile breached Principle 6.

Establishing a reward and remuneration system and sales driven environment that led to advisers putting the interests of Square Mile ahead of the interests of its customers

- 5.17. Square Mile established a remuneration and reward system which, in combination

with a highly pressurised environment, encouraged and incentivised its advisers to sell securities without having regard to the quality of the recommendations and advice and the interests of its customers.

- 5.18. Square Mile monitored its sales progress by recording and continuously updating on a whiteboard the total value of the securities available to be sold that day. It was expected that advisers would sell these amounts. Substantial pressure was applied by Square Mile on advisers to meet the daily figures and, on occasion, advisers were required to stay late in order to achieve them.
- 5.19. Square Mile advisers were paid a low base salary relative to their overall employment income with the majority of their remuneration coming from monthly commissions of between 5% and 10% of the value of the securities they had sold (and which were paid for by the customers). Sales of securities issued by less established companies or those traded on PLUS (being the less liquid market) paid the higher rates of commission. Advisers were, therefore, not only incentivised to sell as many securities as possible but also to sell securities paying the higher commission. In addition, the remuneration package of the Square Mile employee who had day to day operational oversight over the conduct of the advisers was based largely on the overall sales performance of the small cap securities business of Square Mile and the achievement of the expected sales figures.
- 5.20. This internal pressure and the incentives to sell led to the unfair treatment of customers by Square Mile advisers. The lack of regard for the interests of customers was noted by advisers. For example:
 - (1) one adviser acknowledged that *"in terms of the impact on the client...I won't know directly but we just give the client the stock that we get told to give them"*; and
 - (2) another acknowledged that *"when you're under pressure, you don't always [and] you can not always say the correct thing [to customers] or [you are not] always balanced"*.
- 5.21. Square Mile operated a remuneration system that was based on achieving expected sales figures (and therefore rewarded volume selling) and which paid higher commission in respect of selling riskier securities in a high pressure environment without adequate controls. The FSA considers this to be a serious failing as it was likely to encourage advisers to attempt to meet the required figures without regard to the fair treatment of customers. Despite the conflict between an adviser who is motivated to achieve the set figures and a customer who wants recommendations that are suitable and free from bias, Square Mile applied substantial pressure on its advisers to obtain the set figures and failed to assess the quality of the advice provided to customers.
- 5.22. Square Mile failed to recognise the negative impact that its commission structure and high pressure environment was having both on its advisers' behaviour and the fair treatment of its customers.

Placing undue pressure on customers and adopting unacceptable sales practices

- 5.23. In all 55 transactions reviewed, when selling the Securities advisers used unacceptable sales practices that applied undue pressure on customers to make immediate investment decisions. As a result, customers were not given a fair and reasonable amount of time that was free from bias and pressure to consider the securities recommended.
- 5.24. Some Square Mile advisers used a tactic of revealing to customers that they knew of an upcoming investment opportunity to which the customer would have to act quickly to secure it. The advisers informed the customer they would be contacted again when the opportunity crystallised. A subsequent call would then be made by a "senior adviser" who would make a highly pressurised recommendation and actively encourage the customer to complete an immediate purchase of the Securities before the opportunity was lost. However, in reality there was no real urgency as Square Mile had already been recommending the Securities for a number of months prior to the Relevant Period and would continue to do so after the transaction. For example:
- (1) a new customer was told by an adviser that he was going into a meeting about an investment "*which is doing exceptionally well at the moment*" and that he "*can't say too much at the moment [but] the last time they brought a company to the market it went up seven-fold*". The customer asked to be contacted again and the adviser agreed that he would "*get back to [the customer] when I've got something pretty special*". Five days later the customer was called and reminded about the "*new opportunity*" previously discussed. The adviser stated that he had been given the "*green light*", it was a "*pretty special*" opportunity, there was "*a very limited allocation but [the adviser was] pretty confident this is going to be a good one*". Despite the customer stating he was not in a position to make the purchase, the adviser told the customer that the "*the allocation is going to be gone fairly soon. I need you to pick something up in this company*" and "*don't make the silly mistake of not picking up something*". In a further two calls, pressure was applied to the customer to purchase one of the Securities and he finally agreed to purchase 71,809 shares in one of the Securities for a price of £3,375. At the time of the recommendation, Square Mile had been selling the Security for 16 months and continued to sell it for a further two months after this transaction.
- 5.25. These sales practices subjected customers to pressure that was unnecessary, as Square Mile had been selling the securities for some time before and continued to do so, and unfair treatment, as they were incorrectly advised that unless they made an investment decision within the short time frame given by the adviser the opportunity to invest would be lost. Customers were also led to believe that they were one of a restricted group of customers to whom a limited number of the Securities was being offered.
- 5.26. The transactions reviewed also revealed that advisers put considerable pressure on customers to purchase larger amounts of the Securities than the customer had indicated that they wanted to purchase or pressured them into considering selling other assets to fund a purchase of the Securities. For example:

- (1) whilst recommending one of the Securities to a 67 year old customer, the adviser stated "*well, the market's booming*" and "*I expect to see some very, very big gains on this one*". The customer explained that he had no money and that he did not want to invest. In particular, the customer went on to state that "*...I told you at the outset I haven't got huge wads of dosh to put into diverse stock*" and that he was "*not persuaded... to take what [he had] that's liquid to put into stocks and shares*". Regardless of this, the adviser asked the customer to invest £5,000 and the customer again confirmed that he "*...wasn't convinced*" that he wanted to invest. Again the adviser urged the customer to purchase one of the Securities by reassuring him that his "*...persistence [was] only coming about because [he was] so confident about this particular company*" and that he had already shown existing investors "*close to 100% return already*". Despite the customer again confirming his lack of liquidity, the adviser recommend an investment of £3,000, which the customer again declined. Despite the customer's lack of available funds, the adviser continued to urge the customer to invest until he agreed to purchase £2,000 of the Securities. Upon receiving this confirmation from the customer, however, the adviser tried to encourage an investment of £2,700. As a result, the customer purchased 40,000 shares in one of the Securities for £2,160; and
- (2) during an introductory call to establish a 68 year old new customer's financial position, the customer explained to the adviser that he was a "*completely new investor*", he did not "*understand the stock market*", was a cautious investor and did not have "*much money*" to purchase one of the Securities (the customer disclosed on his account opening form an income of £10,000 and liquid assets of £65,000). The adviser recommended that the customer sell his existing securities in a company listed on the London Stock Exchange ("LSE") to fund the purchase of a higher risk security listed on PLUS. The customer was told that the securities were "*very, very profitable*". None of the associated risks were discussed and the adviser stated that their LSE securities were "*just going to go down and down and down*". As a result, the customer purchased 111,111 shares in one of the Securities for £6,000.

5.27. The transactions reviewed revealed that Square Mile advisers placed undue pressure on customers when encouraging them to purchase the Securities despite the customer having expressed reluctance or uncertainty, or otherwise hesitated, regarding the purchase. For example:

- (1) a customer who was involved in dealing with the estate of a recently deceased spouse was contacted by Square Mile to purchase one of the Securities. The customer explained his difficult personal circumstances and asked for more time to consider the recommendation. The adviser called the customer five hours later and, despite being told by the customer "*...I'm no nearer to solving it I am afraid*", encouraged and pressured the customer to invest £3,000 in the Securities and offered him additional time to settle the trade; and
- (2) another customer was contacted on at least eight occasions during which he indicated reservation and unease about purchasing one of the Securities. The customer stated to the adviser "*It's making me a bit shaky...*", "*oh crickey [sic]*,

I don't know whether I'm going to be able to do it" and "...well, I'll have to think about it for the moment ...I'm not going to make any hasty decision" and "I'm certainly not comfortable with [investing] £4,000". The customer also explained that the total of his investment was "...creeping up and up and I'm not seeing anything back". Despite these reservations, the adviser continued throughout the call to pressure the customer until the customer agreed to locate funds and invest £2,000 on the condition that the adviser agreed that it would be the last time he would be asked by Square Mile to invest. In particular, he stated "If I give you this capital does that now, you know, put a stop on, on the investments for a while?" However, a Square Mile adviser recommended further small cap securities to the customer three weeks later.

5.28. Square Mile advisers also made multiple telephone calls over consecutive days to particular customers applying pressure on them to invest with Square Mile when they had previously indicated they had no available funds and/or they were not in a position to invest. Advisers disregarded statements made by customers that they were not interested in investing in small cap securities and the Securities. For example:

(1) one customer was contacted 13 times in eight days. Despite telling the adviser he had only £5,000 in cash, he was sold £7,000 of small cap securities and was told this was the last recommendation that would be made. He was then called a further four times over the next two days about this security and was pressured into buying another £3,000 of it. In addition he was then contacted another eight times over the five day period about two of the Securities. Despite the customer expressing his clear reluctance to purchase any more, he was sold 85,106 shares in one of the Securities for £4,000. The effect of the pressure created by the repeated calls was that the customer was sold £14,000 of small cap securities in five days, even though he had made clear his reluctance to purchase them and his limited financial position.

5.29. As a result of these practices, customers were unduly pressured by Square Mile to purchase the Securities without regard to their interests.

5.30. The failures set out above are serious as undue pressure was placed on customers to make higher risk investment decisions quickly without time to consider the risks of the Securities. Customers were not treated fairly as they were exposed to poor and inappropriate sales practices and exposed to unnecessary risks.

5.31. The abovementioned failings are particularly serious as the detriment and impact on customers was high and, by not acting effectively and efficiently to remedy these failings, customers were exposed to extremely unfair treatment.

Breach of Principle 7 and COB 5.4.3R

5.32. During the Relevant Period, advisers were required to provide a risk warning in accordance with COB 5.4.3R ("the Required Risk Warning"). However, by reasons of the facts and matters set out in paragraph 5.33 below, Square Mile breached COB 5.4.3R. In addition, by reason of the facts and matters set out in paragraphs 5.33 to 5.47, Square Mile failed to pay due regard to the information needs of its customers

and communicate information in a way that was clear, fair and not misleading in accordance with Principle 7.

Failure to take reasonable steps to provide the Required Risk Warning and pay due regard to the information needs of customers regarding the risks of the Securities

5.33. Square Mile was required to take reasonable steps to ensure that customers understood the Securities (which presented particular and higher risks to customers) and the nature of the associated risks. This includes providing customers with the Required Risk Warning, which Square Mile failed to provide in 47 of the 55 transactions reviewed. The Required Risk Warning would have made customers aware, amongst other things, of the following:

- (1) there may be a restricted market for the Securities in that it may be difficult to deal in the Securities or obtain reliable information about their value; and/or
- (2) that there is an extra risk of losing money when purchasing securities of some smaller companies; there is a big difference between the buying price and the selling price of these securities meaning if they have to be sold immediately the customer may get back much less than they paid for them; and the price of the securities may change quickly and it may go down as well as up.

5.34. In addition, Square Mile provided inadequate and unclear information to customers which distorted the overall balance and content of the recommendation. In particular, in instances where Square Mile communicated some form of information about the risks of the Securities, it was neither clear nor fair and was misleading. For example:

- (1) in 29 of the 55 transactions reviewed, the references made to risk were largely cursory and the material risks were disregarded or obscured. For example, one customer was told that small cap securities are *"high growth, but it's classified as high risk"*;
- (2) in 18 of the 55 transactions reviewed, advisers made statements that undermined, detracted or contradicted any reference made to risk or made speculative forecasts of significant increases in the price of the Securities. The cumulative effect of this was highly misleading as customers were not made aware of the real risks and prospects of the Securities. For example, a Square Mile adviser told a 66 year old customer, who purchased the Securities for 4.7 pence per share, that they would provide *"just the standard risk warning"* and stated *"...our stocks are a high degree of risk"*. These statements did not sufficiently explain the higher and particular risks and characteristics of the Securities. The failure to provide an adequate risk warning was exacerbated when the adviser stated the *"downside [to the Securities is] limited to your initial investment, upside unlimited"*. The higher and particular risks of the Securities were again diminished by the adviser stating that a previous Square Mile recommendation had returned 700%; and
- (3) in 20 of the 55 transactions reviewed, advisers did not explain that the Securities were long term investments. As a result customers may not have properly considered whether an investment of a longer term nature was

suitable for their own particular circumstances and needs.

- 5.35. These failures are particularly serious because of the higher risk nature of the Securities and the sparse and infrequent trading in the Securities in the market during the Relevant Period.

Failure to communicate information regarding the business of the Securities in a way that is clear, fair and not misleading

- 5.36. Square Mile customers were provided with inaccurate and erroneous information about the companies issuing the Securities. In 40 of the 55 transactions reviewed, misleading statements were made about the business and/or finances of the Securities' issuers. For example:

- (1) customers were advised that the issuing company of one of the Securities had an established and profitable business when, in fact, it was a 'cash shell' company;
- (2) customers were advised that the issuing company of one of the Securities had been in business for several years when, in fact, it had just been admitted to trading on an exchange and had no trading history;
- (3) customers were advised about the issuing companies entering into new industries, making acquisitions and expanding its businesses when there was no basis to support such statements; and
- (4) customers were provided with speculative and incorrect information about the issuing companies' finances and profitability.

- 5.37. As a result, customers invested in the Securities on the basis of information that was inaccurate, incomplete and which potentially left them with a misleading impression of the issuers' business.

Failure to communicate information about the expected performance of the Securities in a way that is clear, fair and not misleading

- 5.38. Square Mile communicated exaggerated and unsupported information about the future performance of the Securities. A feature of 26 of the 55 transactions reviewed was prominent statements about future high returns, based apparently on the advisers' own unsubstantiated opinions. Such statements misled customers about the anticipated performance of the Securities. For example:

- (1) a 78 year old customer, who had trouble recalling the adviser's name and previous conversations he had held with advisers, was told that the price of the security had "gone up 50% in one month. It went from 3 ½ pence to six pence...and within the next two to five years it may be about 40 or 50 pence". No publicly available information indicated or anticipated such an increase; and
- (2) another customer was told if they purchased the Securities at 4.7 pence per

share and they invested £5,000 there was a potential return of "*15 to 20 grand over the next 12 to 36 months*". The figures provided to the customer indicated an expected increase in the share price of between 300% and 400% from the selling price. No publicly available information indicated or anticipated such an increase.

5.39. The transactions reviewed revealed that Square Mile advisers exaggerated the potential performance of the Securities by making speculative and baseless predictions. Performance predictions were provided to customers that were inconsistent and, in many instances, different rates of expected return were given during different recommendations about the same security, demonstrating that there was no reasonable basis for making such predictions. As an example, on one particular day, three Square Mile advisers quoted three different predicted returns for one of the Securities, ranging from the equivalent of 363% to 826%.

5.40. As a result of these practices, customers were left with unrealistic expectations about the potential performance of the Securities which they might, as a result of the representations, reasonably have believed were achievable.

Communicating unfair, unclear and misleading information to customers about the past performance of unrelated securities

5.41. In 17 of the 55 transactions reviewed, Square Mile made unfair and misleading claims about significant increases in the price of securities it had previously recommended. Not only is the past performance of any security no indicator of future performance but, in this case, the references were made to securities that had no direct business, financial or commercial factors in common with the Securities being recommended and, in any event, sometimes the statements were untrue. For example:

(1) a new customer, who was 68 years old and retired, was told during the course of a recommendation that "*the last 10 recommendations, we've [Square Mile] had seven winners...OK*"..."*You know we are a profit making entity*". However, the adviser concerned later acknowledged to the FSA that only one out of fifteen securities sold by Square Mile had performed well; and

(2) one customer was told that the last time Square Mile received small cap securities from a particular stock provider they "... *went up by 130% over 12 months, and the one before that....went up 200% over 12 months.*" The adviser then told the customer that such a rate of return was achievable for one of the Securities. These statements were misleading as they placed emphasis on the past performance of unrelated securities without stating either that it might not be achieved in this case or that previous recommendations had not performed as predicted.

5.42. The abovementioned conduct is serious as Square Mile required its customers to make investment decisions about higher risk securities about which the information, statements and representations it made were unclear, unfair, and misleading. Advisers only provided customers with examples of small cap securities that had performed well and failed to provide balanced information about small cap securities that had not

performed as predicted. This conduct may have unduly influenced the investment decisions of customers as their confidence and trust was built on a series of misrepresentations and inaccurate information.

Failure to communicate information about the skills and experience of its advisers and its services in a way that is clear, fair and not misleading

5.43. Square Mile provided unfair and misleading information to customers about the skills and experience of its advisers and the services that it offered. In 12 of the 55 transactions reviewed, certain advisers ascribed skills and experience to themselves which they did not possess and said that Square Mile provided services which, in practice, it did not provide. In particular:

- (1) a new customer who was 68 years old and retired was told, amongst other things, that the adviser was "...one of the top guys" and that "*I look at everything in the financial markets, whether it's a blue chip share, contracts for differences or small cap. I look at absolutely everything for my clients*". In fact, the business of Square Mile involved the offer of only a limited choice of small cap securities at any one time, for example, securities issued by two to four different companies and quoted on only two exchanges. In this case, the customer was persuaded to purchase 64,815 shares of one the Securities for £3,500; and
- (2) a customer who described himself as a "*completely new investor*", "*very cautious*" and did not have "*a lot of money*" was told on four occasions by an adviser, who they had not dealt with before, that they had been in the financial services market "*nine years*". In fact, at the time of making the statements, the adviser had been in the industry for only five years. In this case, the customer was persuaded to purchase 111,111 shares of one the Securities for £6,000.

5.44. The abovementioned conduct is serious as it is misleading and unfair. It implied a degree of thoroughness behind Square Mile's securities recommendations which, in practice, did not exist. As a result, customers may have had more confidence than they otherwise would have had in the recommendations made by advisers and may have invested in the Securities as a result.

Communicating misleading information about the professional and technical services of Square Mile

5.45. Square Mile provided exaggerated and misleading information to customers about its professional and technical services, in particular its use of research analysts. Even though Square Mile did not employ or engage an analyst to provide technical assistance in identifying and assessing the Securities, in 18 of the 55 transactions reviewed, advisers attributed their recommendation and/or the past success of recommending profitable securities to the involvement of an analyst. For example:

- (1) a new customer was told that Square Mile had spent "*6.8 million*" on research and "*...that's what separates us from any of the other companies out there*". In fact, this figure was grossly inflated and misleading as Square Mile had only spent about £25,000 on research services that year; and

- (2) one customer was told *"I'll tell you why I'm excited about this one mate, very simply, I have worked with this analyst many, many times before, and he's given me some of the biggest winners."* Another customer was told that *"our analysts are very, very bullish"*.
- 5.46. It was acknowledged to the FSA that such statements were used as a *"selling tool"*. This occurred despite an email being sent to all sales staff during the Relevant Period instructing them to stop advising customers that Square Mile uses the services of analysts when in fact *"we [Square Mile] do not have a registered analyst let alone 20"*. The email went on to say that call monitoring had revealed that some advisers were telling customers that *"our 20 analysts are excited about the said deal"* and the practice was unacceptable.
- 5.47. These statements are unfair and misleading, as they implied there was a level of diligence and research behind Square Mile's securities selection which, in practice, did not exist. As a result, customers may have had more confidence than they otherwise would have in the statements made by advisers about the potential performance and prospects of the Securities.

Breach of Principle 9 and COB 5.2.5R

- 5.48. By reason of the facts and matters set out in paragraphs 5.49 to 5.56 below, Square Mile breached COB 5.2.5R. By reason of the facts and matters set out in paragraphs 5.57 to 5.60 below, Square Mile breached Principle 9.

Failure to obtain sufficient personal and financial information about its customers

- 5.49. Square Mile was required to take reasonable steps to obtain, and ensure it was in possession of, sufficient personal and financial information about customers before making personal recommendations. Without sufficient information Square Mile could not ensure that its recommendations were suitable for the needs, objectives, and financial situation of its customers and appropriate for their risk appetite. However, in 49 of the 55 transactions reviewed, Square Mile failed to seek up to date information about the customers' personal and financial circumstances before making a recommendation.
- 5.50. Further, it was common practice at Square Mile for trainee advisers to contact prospective customers and solicit their interest in small cap securities offered by Square Mile. If the customer agreed to listen to a recommendation about small cap securities the junior adviser collated limited personal information before referring them to a "senior adviser". The information collated did not provide an analysis of a customer's personal and financial circumstances and nor were advisers clear on the customers' investments needs and attitude to risk. Despite this, the "senior adviser" would make a recommendation on the basis of this limited information.
- 5.51. Only after the "senior adviser" had made a recommendation and the customer provisionally agreed to purchase higher risk securities were detailed 'know your client' enquiries made by completing a pro-forma account opening form. The form required the adviser to obtain information about a customer's employment status, annual income, total assets and liabilities, their attitude to risk and agreed risk capital limit,

previous securities dealing experience and any investment restrictions.

- 5.52. By failing properly to record and assess sufficient information about the personal and financial circumstances of the customer prior to a recommendation it was impossible for advisers adequately to assess the suitability of their recommendations.
- 5.53. Square Mile also failed to keep its information held by the Firm about customers under regular review. In 51 of the 55 transactions reviewed, Square Mile failed to ensure that the information it held about its customers' personal and financial circumstances was accurate and sufficient to enable a suitable recommendation to be made.
- 5.54. Even when customers disclosed new information or changes in their personal and financial information, that were relevant to their personal circumstances and could affect the current or future recommendations, Square Mile failed to enquire about and/or record the information. In 23 of the 55 transactions reviewed, despite the customers providing relevant personal and financial information, it was disregarded.
- 5.55. Further, Square Mile did not take reasonable steps to ensure its advisers had access to accurate and up to date information about its customers. In particular:
 - (1) Square Mile did not provide its advisers with information about customers' agreed risk capital levels and/or their trading and cash payment histories. Access to such information is vital as it helps advisers ensure that their recommendations are suitable for the customer concerned; and
 - (2) Square Mile advisers only had access to electronic diary records that summarised previous telephone contact with customers but did not record personal and financial information.
- 5.56. By failing to take reasonable steps to ensure its advisers were in possession of sufficient personal and financial information Square Mile was unable to demonstrate that their recommendations were based on a proper assessment of a customer's needs, objectives and financial situation.

Failure to assess suitability prior and/or whilst recommending securities to customers

- 5.57. Square Mile failed to take reasonable care to ensure that its recommendations were suitable for customers. In particular, when making recommendations, it failed to take reasonable steps to obtain adequate personal and financial information and consider the customer's attitude to risk. For example, in eight of the 55 transactions reviewed, a recommendation was made despite the customer indicating that they were risk averse.
- 5.58. Square Mile failed adequately to consider the financial circumstances of its customers and whether they could afford the Securities. In 19 of the 55 transactions reviewed, customers' concerns about their ability to afford the Securities were disregarded and they were subjected to undue pressure to complete the purchase.
- 5.59. Square Mile also failed to consider and adhere to the customers' agreed risk capital

level. For example:

- (1) a recommendation to purchase £24,500 of the Securities was made to a customer with an income of £100,000, net assets of £220,000 and an agreed risk capital level of £25,000. At the time of the recommendation the customer had already purchased securities costing £205,017. Although the client agreed to the purchase, which increased their total investment to £229,517, the adviser failed to seek the customer's consent to trade above the agreed risk capital level and did not obtain financial and personal information from the client to determine if the purchase was suitable; and
- (2) a recommendation to purchase £2,000 of the Securities was made to a 68 year old retired customer with an annual income of £15,000, net assets of £220,000 and an agreed risk capital level of £1,725. The customer agreed to the purchase which caused the total cost of their Square Mile holdings to increase to £6,500. The adviser did not seek personal or financial information from the customer to determine whether the trade, which further increased their exposure above the agreed risk capital level, was suitable.

- 5.60. As a result of the above, Square Mile failed to take reasonable care to ensure its recommendations were affordable and/or within the customer's attitude to risk. This conduct is serious because it led to Square Mile making recommendations that were not suitable for customers, especially those that could not afford to invest.

Breach of Principle 3

- 5.61. By reasons of the facts and matters set out in paragraphs 5.62 to 5.83 below, Square Mile breached Principle 3.

Failure to take reasonable care to establish clear and appropriate senior management responsibilities and reporting lines

- 5.62. Square Mile did not take reasonable care to maintain clear and appropriate apportionment of significant responsibilities amongst senior management so that its business and affairs could be adequately monitored and controlled. The apportionment of responsibilities and duties amongst senior management was unclear and there was no formal division of duties. The lack of a clear delineation between individual senior manager's responsibilities meant that: dealing with matters of concern was determined by availability; reporting lines were informal and poorly defined; and senior managers were unable to demonstrate a complete understanding of their roles and responsibilities. For example, Square Mile was not aware until after the FSA Supervision visit in June 2006 that it did not have the required apportionment and oversight officer (controlled function 8) appointed between June 2003 and August 2006. As a result, regulatory issues went unaddressed.
- 5.63. Square Mile's Board of Directors met on an intermittent basis and, despite the requests made by Compliance to attend, the Board only began to have regular meetings with input from Compliance in July 2006 (following the FSA Supervisory visit). Before that there was no fixed agenda for Board Meetings and the Board did not receive formal reports of compliance work, nor were compliance related matters discussed.

Although Compliance attended management committee meetings these were sporadic and compliance related matters were not always discussed.

Failure to take reasonable steps to implement adequate risk management systems

5.64. Square Mile failed to take reasonable steps to establish and maintain an adequate risk management system to identify, monitor and manage the risks of the Firm. In particular, it failed to:

- (1) conduct ongoing risk assessments of the business conducted by the Firm to identify and assess the risks to its business and the risks to its customers from the sale of higher risk small cap securities;
- (2) establish robust operational procedures to manage, control and mitigate any identified risks; and
- (3) establish and maintain appropriate compliance policies and procedures that were adequate to manage and control its regulated business.

5.65. Square Mile's overall reporting and recording of compliance risks was limited and inadequate. Despite knowing that it was operating a high risk business and recommending high risk securities to private customers, it did not establish arrangements to ensure that adequate and regular compliance and risk management information was provided to the Board of Directors. Compliance reporting was largely conducted by way of informal discussions, which were ad hoc, undocumented and reactive. There was no formal regulatory or compliance reporting to the Board; issues and risks were only addressed and discussed if and when they arose. As a result, Square Mile was unable adequately to identify, monitor and manage the regulatory risks its business faced. The compliance issues that were raised (regarding the failure to provide risk warnings and inappropriate sales practices) were not acted upon efficiently and effectively. As a result, Square Mile failed to manage, control and mitigate the risks facing its business and its customers as and when they arose.

Failure to implement appropriate compliance processes and procedures

5.66. Prior to the FSA Supervision visit, Compliance had limited input into how Square Mile conducted its regulated business. In particular, Compliance would have to raise issues of regulatory concern on a number of occasions before they were addressed and/or changes were implemented. The failure to act efficiently and effectively on Compliance's recommendations and concerns was not sufficient for Square Mile to manage adequately the regulatory risks it faced. In particular, Square Mile failed to take reasonable steps to:

- (1) define the authority and responsibilities of the Compliance function and ensure that these were recognised and understood within the Firm;
- (2) establish robust compliance and operational procedures that were sufficiently tailored to its regulated business and contained all of the applicable FSA requirements for its business;

- (3) establish a manual of compliance procedures and code of conduct setting out the standards expected of its staff, including its advisers. A Compliance Manual was only implemented between late 2003 and early 2004 (and it contained substantial sections that were irrelevant). Furthermore, there is no evidence of any alterations or modifications to the manual to reflect legal and regulatory changes;
 - (4) put procedures in place to ensure that the Compliance Manual was available to employees and that they were aware of and understood their individual responsibilities when conducting business; and
 - (5) review and assess the effectiveness of its compliance arrangements.
- 5.67. Up to date compliance procedures are important as they demonstrate to the FSA how a firm monitors its compliance with regulatory requirements and how it will address any compliance breaches if and when they arise. By failing to establish compliance arrangements, incorporating clearly defined compliance and operational procedures supported by robust compliance monitoring, Square Mile could not ensure it was conducting that business in compliance with regulatory standards.

Failure to take reasonable care to monitor small cap securities recommendations and sales adequately

- 5.68. Although Square Mile started selling higher risk small cap securities in July 2003, it did not establish and implement a sales monitoring programme until late 2004 / early 2005. Despite knowing that its small cap securities business posed higher risks to customers, Square Mile failed to devote adequate resources to its Compliance department and to design and implement a sales monitoring programme in a timely fashion. In particular:
- (1) the sales monitoring work conducted by Square Mile prior to late 2004 was limited to the review of customer complaints only and most sales transactions, involving the sale of higher risk securities, were not assessed by Compliance; and
 - (2) Square Mile was not able to identify, and therefore remedy, any failure to adhere to regulatory standards or its own, albeit basic, compliance and procedural standards.
- 5.69. The sales monitoring arrangements that were implemented in or about late 2004 involved a monthly review and assessment of 10 sales transactions. This was wholly inadequate because:
- (1) the review represented only a very small proportion of calls made by advisers;
 - (2) Square Mile failed to assess the content of recommendations against all regulatory requirements, was unable to assess the accuracy of the statements made by advisers and failed to review the suitability of the recommendations;
 - (3) the findings were not considered in combination with any previous monitoring

work and complaints data;

- (4) there was no comprehensive assessment or analysis of Compliance findings to identify and understand the continuing and/or re-occurring failures to meet regulatory requirements;
- (5) there was no established arrangement for the identified failings of individual advisers to be reported to line management in order for there to be an assessment of competence and, where necessary, the identification of remedial training; and
- (6) there were no established arrangements for the formal reporting of findings to senior management until April 2006 or to provide for the periodic review of results to determine if any unacceptable trends or risks had been identified.

5.70. Square Mile failed to conduct monthly sales monitoring work between November 2005 and March 2006, which meant that it did not take reasonable steps to ensure it was complying with the regulatory requirements. This failure was only rectified between May and June 2006 when it started a programme of retrospective sales monitoring. The retrospective review revealed the following serious and recurring issues:

- (1) the failure of advisers to provide customers with risk warnings;
- (2) advisers making unbalanced recommendations to customers;
- (3) advisers using sales practices that placed undue pressure on customers to purchase securities;
- (4) advisers making factually incorrect statements about the role of analysts in Square Mile's selection of the Securities;
- (5) advisers referring to, or making positive representations about the past performance of securities during recommendations; and
- (6) in some calls there was no clear consent or instruction given by the client to proceed with the trade being recommended and subsequently entered by Square Mile.

5.71. The failure promptly to identify and address the abovementioned concerns through corrective action enabled poor practice to promulgate and become embedded within the small cap securities business of Square Mile.

5.72. In April 2006, after the failures in the monthly sales monitoring had been identified, Compliance implemented an additional programme to monitor, on a daily basis, the quality of telephone recommendations. Despite this additional monitoring, deficiencies in the sales practices were still present as the work again revealed serious issues about advisers failing to provide risk warnings to customers.

5.73. As a result of its wholly inadequate systems and controls, Square Mile was unable

promptly or properly to monitor and manage the risks in its small cap securities business. Further, even when issues of regulatory concern were raised, such as the failure to provide risk warnings, these went uncorrected and customers continued to be exposed to unacceptable sales practices and the risk of unsuitable recommendations.

Failure to take reasonable care to organise its affairs responsibly and implement systems and controls regarding the use of non-public information

- 5.74. Square Mile failed to take reasonable steps to identify in the information it provided to its advisers about the Securities that which was not publicly available. It had inadequate systems and controls to manage the use and dissemination of non-public information which it obtained. In particular, Compliance was not aware of any information about the Securities, public or otherwise.
- 5.75. Square Mile had no procedures in place to guide advisers regarding how non-public information could be used nor were its advisers provided with an explanation of what Square Mile regarded as non-public information. For example, advisers were provided with presentations about the Securities where a mix of public and non-public information was disclosed to them and particular advisers presumed that any information they were given was publicly available and could be disclosed to customers. There were also no controls in place to restrict the use of such information by advisers. On one occasion information that was distributed to advisers for information purposes only and was expressly not to be used as a "sales tool" was disclosed to customers.

Failure to take reasonable care to organise its affairs responsibly and effectively

- 5.76. Square Mile did not provide its advisers with sufficient information about the Securities to enable them to make an appropriate recommendation. Advisers received and relied on basic summary information that did not adequately explain the business and history of the issuers and/or the specifics of the Securities. This information was at times outdated, inaccurate and incorrect. In particular instances, advisers had to seek further information about the Securities to assist their understanding. Square Mile also failed to have procedures governing the approval or monitoring of the information or scripts that advisers used to formulate recommendations. As a result, Square Mile was not able to control and monitor the sources and accuracy of the information before it was provided to customers. These failings were exacerbated by its advisers elaborating on the limited information given to them by expressing their own largely unsubstantiated opinions (as previously stated in paragraphs 5.4 and 5.38 to 5.40 above).
- 5.77. Square Mile failed to establish real time and accessible information systems to record 'know your client' information. As stated above in paragraphs 5.49 to 5.60, at the time of making recommendations advisers did not have access to adequate know your client information to assess suitability. This was particularly important as customers did not always deal with the same adviser.

Failure to establish training and competence arrangements

- 5.78. Square Mile failed to implement a training and competence programme that was adequate for its business. Whilst Square Mile's Compliance Manual contained sections on some of the relevant regulatory requirements, Square Mile did not implement and/or adhere to them as it failed to establish robust operational procedures that measured the regulatory knowledge and skills of its advisers. As a result, it failed to identify, assess and remedy any gaps in the knowledge and skills of its advisers.
- 5.79. Square Mile did not maintain records to show that it regularly and effectively assessed the training needs of its employees or that it set development timescales. It also failed to adhere to its own internal procedures which required that all training must be documented.
- 5.80. Square Mile did not have a structured induction programme and new advisers were not made aware of their individual training needs or regulatory responsibilities upon joining Square Mile. The limited training that Square Mile did provide consisted mainly of informal staff briefings that were unstructured and were orientated mainly towards sales practices. There was no formal training that was sufficiently focused on regulatory and compliance requirements. As a result Square Mile failed to take reasonable care to organise training that was timely, planned and appropriately structured and evaluated.
- 5.81. Square Mile failed to implement procedures to ensure that the competence of its advisers was assessed and maintained. It did not have adequate competence assessment criteria that were clearly understood by its advisers and their supervisors. There were no formal statements of competence or technical briefing papers to assess an adviser's competence. In practice, advisers were reclassified from trainee adviser (CF 22) to investment adviser (CF21) without assessment or tests.
- 5.82. As a result of the collective failings in its training and competence arrangements, Square Mile did not take reasonable steps to assess whether sales advisers had the requisite knowledge, skills, understanding and integrity to carry out their roles and advise private customers on the purchase of higher risk securities.
- 5.83. Despite these weak systems and controls, inadequate training and competence assessment procedures, and lack of compliance monitoring, Square Mile relied on its advisers to ensure that recommendations made to customers complied with the regulatory requirements. This reliance was inappropriate and unwarranted and the consequence was that Square Mile exposed its customers to unacceptable sales practices and the risk of unsuitable recommendations.

6. RELEVANT GUIDANCE ON PENALTY

- 6.1. The FSA's general approach in deciding whether to take action and the imposition and amount of penalties is set out in Chapter 6 of the Decision Procedure and

Penalties Guide ("DEPP"), which is part of the Handbook of Rules and Guidance. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating, generally, to firms and approved persons, the benefit of compliant behaviour (DEPP 6.1.2G).

- 6.2. In determining whether a financial penalty is appropriate and proportionate, the FSA will consider all the relevant circumstances of the case. DEPP 6.5.2G sets out guidance on a non-exhaustive list of factors that may be of relevance in determining the amount of a financial penalty.
- 6.3. In deciding to take the action, the FSA considers the factors outlined in paragraphs 6.4 to 6.13 to be particularly relevant.

Deterrence: DEPP 6.5.2G (1)

- 6.4. In determining the appropriate level of penalty, the FSA has had regard to the need to promote high standards of regulatory conduct by deterring those who have committed breaches from committing further breaches and to help to deter others from committing similar breaches.

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

- 6.5. The FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached and the number and duration of the breaches. For the reasons set out below the FSA considers that the breaches are of a serious nature:
 - (1) the failings were the result of serious and widespread weaknesses in Square Mile's systems and controls. It failed to maintain a clear and appropriate apportionment of senior management responsibilities;
 - (2) key compliance arrangements and controls in relation to training, treating customers fairly and compliant sales processes were not implemented. This meant that there was a lack of key safeguards to ensure the proper application of the FSA Rules and Principles and the protection of consumers was not safeguarded; and
 - (3) it sold a significant amount of the Securities during the Relevant Period and when problems were identified it failed promptly and efficiently to set upon a course of remedial action.

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

- 6.6. Square Mile acted recklessly for the following reasons:
 - (1) it knew that it had established a business which presented particular and higher risks to customers and it failed to implement the necessary systems and controls and efficiently to address compliance issues as and when they arose;

- (2) it knew that there was reason to doubt particular actions and sales practices used by its advisers but failed to take reasonable steps to address these risks; and
- (3) it knew that there was reason to doubt that reasonable steps had not been taken to organise and control its affairs responsibly and effectively, and to implement appropriate systems, controls and procedures to manage these risks.

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

- 6.7. The FSA has taken into account Square Mile's financial resources. For the 12 months ending 30 June 2007, Square Mile reported operating losses of £445,069 (£265,109 profit – 2006) on turnover of £6,750,238 (£8,770,116 – 2006).
- 6.8. There is no evidence to suggest that Square Mile is unable to pay the financial penalty.

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

- 6.9. The FSA has had regard to the £947,307 gross commissions it earned from recommending the Securities during the Relevant Period.

Conduct following the breach: DEPP 6.5.2G (8)

- 6.10. Square Mile engaged an independent consultant to review its operations, produce a report and assist in the implementation of changes to its compliance arrangements and systems, and training and competence. The independent consultant's reports were provided to the FSA. However, Square Mile had not of its own accord committed to a sufficient course of remedial action in relation to consumers that have been impacted by its misconduct.
- 6.11. Square Mile has also committed to undertakings which include the following:
 - (1) implementing changes regarding senior management who were operationally responsible for particular areas of the business, including the appointment of two non-executive directors and the removal from executive functions of two other directors;
 - (2) a review by a Skilled Person (appointed under section 166 of FSMA) of Square Mile's current systems, controls and sales practices. The Skilled Person's recommendations must be acted upon by Square Mile, with an implementation report to be provided to the FSA;
 - (3) a risk based review by the Skilled Person to identify the following:
 - (i) those customers who paid for securities which they did not agree to purchase; and
 - (ii) those transactions where an unsuitable recommendation was made with

a view to the payment of redress by Square Mile where appropriate.

- (4) a programme of remedial work including writing to all its customers advising them of the FSA's findings and providing complaints information and, in respect of customers who purchased the Securities in the Relevant Period, writing to them setting out clear fair and not misleading information about the Securities they purchased; and
- (5) that it will voluntarily vary its permissions, granted pursuant to Part IV of FSMA, to impose requirements to:
 - (a) obtain independent approval of all transactions and the opening of any new client accounts; and
 - (b) restrict its sales of securities (other than sales on an execution only basis) to a maximum of £48,000 per individual customer.

prior to the completion of a plan for the programme of remedial work.

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

- 6.12. Square Mile has not previously been the subject of disciplinary action by the FSA.

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

- 6.13. The FSA seeks to ensure consistency when it determines the appropriate level of penalty. The FSA has in the past taken action against firms for similar failings and these have been taken into consideration in setting the level of penalty against Square Mile.

7. DECISION MAKERS

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

8. IMPORTANT

- 8.1. This Final Notice is given to Square Mile in accordance with section 390, of FSMA.

Manner and time for payment

8.2. The financial penalty must be paid in full by Square Mile to the FSA by no later than 31 January 2009 and by way of four instalments as follows:

- (1) £100,000 by 31 January 2008;
- (2) £50,000 by 31 July 2008;
- (3) £50,000 by 31 October 2008; and
- (4) £50,000 by 31 January 2009

If the financial penalty is not paid

8.3. If all or any of the financial penalty is outstanding on 1 February 2009, or if all or any of any instalment is outstanding on the day after the instalment is due, the FSA may recover the outstanding amount as a debt owed by Square Mile and due to the FSA.

Publicity

8.4. Sections 391(4), 391(6) and 391(7) of FSMA 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 Square Mile or prejudicial to the interests of consumers.

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

FSA contacts

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

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Georgina Philippou
Head of Department
FSA Enforcement Division