
FIRST SUPERVISORY NOTICE

To: The Clarkson Hill Group Plc

**Of: Alexandra House
33 Alexandra Road
Wisbech
Cambridgeshire
PE13 1HQ**

FSA Reference Number: 207520

Dated: 23 November 2010

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the “FSA”) has taken the following action

1. ACTION

1.1. For the reasons listed below and pursuant to sections 43 and 45 of the Financial Services and Markets Act 2000 (the “Act”), the FSA has varied the permission granted to The Clarkson Hill Group Plc (“TCHG”), pursuant to Part IV of the Act (“TCHG’s permission”), by imposing requirements that:

- (1) with immediate effect TCHG may not write any new business in Unregulated Collective Investment Schemes, Venture Capital Trusts and Enterprise Investment Schemes (“high risk products”) (the “First Variation”), and
- (2) with effect from close of business on 3 December 2010, TCHG may not conduct any regulated activities in its permission (the “Second Variation”).

1.2. The FSA has also varied TCHG's permission by including the following further requirements:

- (1) in relation to the Second Variation, TCHG must inform its clients in writing, after 3 December 2010 and before 17 December 2010, that it is no longer permitted by the FSA to conduct any regulated activities in its permission; and
- (2) TCHG must provide to the FSA, on or before 17 December 2010, with a copy of the document sent to clients referred to in paragraph 1.2(1), together with a list of all clients to whom the document was sent.

2. REASONS FOR ACTION

Summary

- 2.1. In relation to the First Variation, the FSA has concluded, on the basis of the facts and matters described below, that TCHG is failing, or is likely to fail, to satisfy the threshold conditions set out in Part 1 of Schedule 6 to the Act (the "Threshold Conditions"). In the opinion of the FSA, TCHG is failing to satisfy Threshold Condition 4 (Adequate resources), in that the FSA has serious concerns that TCHG's capital is inadequate to cover any further liabilities, and that there may be potential consumer detriment by TCHG continuing to write new business in high risk products given the indications of possible mis-selling of such products.
- 2.2. In relation to the Second Variation, the FSA considers that TCHG is failing, or likely to fail, to satisfy Threshold Condition 4 (Adequate resources), in that following the resignation and forthcoming departure at short notice on 3 December 2010 of TCHG's current holder of the controlled function ("CF") CF10 (Compliance and Oversight) (the "Compliance Officer"), it has failed to appoint a suitable individual to perform this controlled function from close of business on 3 December 2010, resulting in TCHG's compliance monitoring and oversight arrangements being materially inadequate from close of business on 3 December 2010. TCHG currently has inadequate capital resources and will from close of business on 3 December 2010 also have inadequate human resources.
- 2.3. The FSA considers, on the basis of those facts and matters, that it is necessary, in order to protect the interests of consumers, for the action specified above to take effect on the dates specified in paragraph 1.1 of this First Supervisory Notice.

Relevant Statutory Provisions

- 2.4. The FSA's regulatory objectives established in section 2(2) of the Act include the protection of consumers.

- 2.5. Section 45 of the Act authorises that the FSA may exercise the following powers:
- (1) to vary an authorised person's permission where it appears to the FSA that such person is failing, or is likely to fail, to satisfy the Threshold Conditions;
 - (2) to vary such a permission by removing a regulated activity from those for which the permission is given; and
 - (3) to include any provision in the permission as varied that could be included if a fresh permission were being given in response to an application under section 40 of the Act, including the imposition pursuant to section 43 of the Act of such requirements as the FSA considers appropriate.
- 2.6. Section 43(1) and (2) of the Act provides that a permission given by the FSA under Part IV of the Act (the "Part IV permission") may include such requirements as the FSA considers appropriate and permits a requirement to be imposed so as to require the person concerned from refraining to take specified action. A requirement may extend to activities which are not regulated activities.
- 2.7. Section 53(3) of the Act provides for variations may be expressed to take effect immediately (or on a specified date) if the FSA, having regard to the ground on which it is exercising its own initiative power, reasonably considers that it is necessary for the variations to take effect immediately (or on that date).
- 2.8. Paragraph 4(1) of Schedule 6 to the Act sets out Threshold Condition 4, which states:
- "The resources of the person concerned must, in the opinion of the Authority, be adequate in relation to the regulated activities that he seeks to carry on, or carries on."

Relevant Handbook Provisions

- 2.9. In exercising its power to vary a Part IV permission, the FSA must have regard to relevant provisions in the FSA Handbook of rules and guidance (the "Handbook"). The main considerations relevant to the action specified are set out below.

Relevant Principle

- 2.10. Principle 4 (Financial prudence), as set out in the FSA's Principles for Businesses (the "Principles"), in the Handbook requires that a firm maintain adequate financial resources.

Relevant Rules and Guidance

Performance of the compliance oversight function

- 2.11. The guidance in SYSC 3.2.7G(1) of the Senior Management Arrangements, Systems and Controls (“SYSC”), which is part of the Handbook, states that:

“Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to have a separate compliance function. The organisation and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the *firm's* relevant records as well as ultimate recourse to its *governing body*.”

- 2.12. SYSC 3.2.8R requires that:

“(1) A firm which carries on designated investment business with or for retail clients or professional clients must allocate to a director or senior manager the function of:

- (a.) having responsibility for oversight of the firm's compliance; and
- (b.) reporting to the governing body in respect of that responsibility.

(2) In (1) "compliance" means compliance with the rules in:

- (a.) COBS (Conduct of Business);
- (b.) COLL (Collective Investment Schemes sourcebook); and
- (c.) CASS (Client Assets)”

- 2.13. Section 10.7 of the Supervision Manual (“SUP”), which forms part of the Handbook, sets out the controlled functions that are designated as “Required functions”. SUP 10.7.8R specifies that the Compliance oversight function (CF10) is the function of acting in the capacity of a director or a senior manager who is allocated the function set out in SYSC 3.2.8R referred to in paragraph 2.11 and is a Required function.

Capital resources

- 2.14. TCHG is a personal investment firm, which is classified as an exempt Capital Adequacy Directive (“CAD”) firm.
- 2.15. FSA Rule 13.1.4R in the Interim Prudential Sourcebook: Investment Businesses (“IPRU(INV)”), which is part of the FSA Handbook, requires that:

“A *firm* must at all times:

- (1) have and maintain capital resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter; and
- (2) be able to meet its liabilities as they fall due.”

2.16. In particular, TCHG is required to comply with IPRU(INV)13.5.1DR, the Expenditure Based Requirement (the “EBR”) for a personal investment firm, which requires that:

- “(1) [deleted]
- (2) An exempt CAD *firm* which is not permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount;
 - (3) Financial resources which taking into account all the *special adjustments* amount to 4/52 of its relevant annual expenditure calculated in accordance with *rules* 13.5.2; or
 - (4) financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rules* 13.5.2; or
 - (5) financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.”

Relevant Regulatory Guidance

2.17. Guidance on the Threshold Conditions is set out in Chapter 2 of the Part of the Handbook entitled Threshold Conditions (“COND”).

Guidance concerning Threshold Condition 4: Adequate resources (paragraph 4, Schedule 6 to the Act) – COND 2.4

2.18. COND 2.4.1UK reproduces the relevant statutory provision that the resources of the person concerned must, in the opinion of the FSA, be adequate in relation to the regulated activities that he seeks to carry on, or carries on.

2.19. COND 2.4.2G(2), in giving guidance on the interpretation of “adequate resources”,

defines the term “adequate” as meaning sufficient in terms of quantity, quality and availability, and “resources” as including all financial resources, non-financial resources, capital, provisions against liabilities, holdings of or access to cash and other liquid assets, human resources and effective means by which to manage risks.

- 2.20. COND 2.4.4G(2)(a) and COND 2.4.4G(3) requires the FSA only to take into account relevant matters including, but not limited to, whether there are any indications that the firm will not be able to meet its debts as they fall due and matters which are material in relation to the regulated activities for which the authorised person has permission.

Other Relevant Regulatory Provisions

- 2.21. The FSA’s policy in relation to the use of its enforcement powers is set out in the Enforcement Guide (“EG”).

The FSA’s policy for varying a firm’s Part IV permission on the FSA’s own initiative

- 2.22. EG 8.1B states that when it considers how it should deal with a concern about a *firm*, the FSA will have regard to its *regulatory objectives*, and the range of regulatory tools that are available to it and will have regard to the responsibilities of a *firm’s* management to deal with concerns about the *firm* or about the way its business is being or has been run and the principle that a restriction on a *firm* should be proportionate to the objectives the FSA is seeking to achieve.
- 2.23. EG 8.5 refers to examples of circumstances in which the FSA will consider varying a *firm’s Part IV permission* because it has serious concerns about a *firm*, or about the way its business is being or has been conducted include where the firm appears to be failing, or appears likely to fail, to satisfy the *Threshold Conditions* relating to one or more, or all, of its *regulated activities*, because the firm’s material and financial resources appear inadequate for the scale or type of regulated activity it is carrying on.

The FSA’s policy for exercising the own-initiative power in urgent cases

- 2.24. EG 8.6 specifies that the FSA may impose a variation of permission so that it takes effect immediately or on a specified date if it reasonably considers it necessary for the variation to take effect immediately (or on the date specified), having regard to the ground on which it is exercising its *own-initiative power*.
- 2.25. EG 8.7 states that the FSA will consider exercising its own-initiative power as a matter of urgency where:

- (1) the information available to it indicates serious concerns about the firm or its business that need to be addressed immediately; and
 - (2) circumstances indicate that it is appropriate to use statutory powers immediately to require and/or prohibit certain actions by the *firm* in order to ensure the firm addresses these concerns.
- 2.26. EG 8.8 gives examples of the circumstances in which the FSA will consider exercising its own-initiative power urgently, including where there is information indicating significant loss or other adverse effects for consumers, where action is necessary to protect their interests (EG 8.8(1)) and where there are circumstances suggesting a serious problem within a firm or with a firm's controllers that calls into question the firm's ability to continue to meet the threshold conditions (EG 8.8(4)).
- 2.27. EG 8.9 includes among the factors which will determine whether the urgent exercise of the FSA's own-initiative power is an appropriate response; the extent of any loss or risk of loss or other adverse effect on consumers; the financial resources of the firm including where the firm may be required to pay significant amounts of compensation to consumers, and the steps the authorised person has taken or is taking to address the issues.
- 2.28. EG 8.9(9) adds that the FSA must take into account the impact that the use of the FSA's own initiative powers will have on the firm's business and on its customers. The FSA will take into account the (sometimes significant) impact that a variation of permission may have on a firm's business and on its customers' interests, including the effect of a variation on the firm's reputation and on market confidence. The FSA will need to be satisfied that the impact of any use of the own initiative power is likely to be proportionate to the concerns being addressed, in the context of the overall aim of achieving its regulatory objectives.

Facts and matters relied on

- 2.29. TCHG is an independent financial advisor which became authorised by the FSA on 2 May 2002 to conduct designated investment business. TCHG was permitted to conduct regulated home finance from 31 October 2004 and insurance mediation business from 14 January 2005 respectively. TCHG is listed with the AIM market and currently has a market capitalisation of £740,000. TCHG operates nationwide through a number of branches and has approximately 300 advisors (229 of which are registered as the holder of the CF30 function) and has around 70,000 clients.

Compliance and oversight function (CF10)

- 2.30. In September 2009, a skilled persons report was produced in relation to TCHG (the

“Report”). The Report looked at, amongst other matters, TCHG’s compliance monitoring programme, its complaints procedure, its financial promotions and corporate governance. A significant number of recommendations were made by the skilled person in the Report which required immediate remedial steps to be taken by TCHG.

- 2.31. TCHG subsequently appointed, with the FSA’s approval, the Compliance Officer to perform the compliance and oversight (CF10) function to, amongst other things, oversee the implementation of the recommendations made by the skilled person in the Report and to ensure that TCHG’s overall compliance monitoring and oversight arrangements were effective. The Compliance Officer was also responsible for monitoring the suitability of advice on new business being written by TCHG.
- 2.32. On 19 November 2010, the Compliance Officer notified the FSA that he would be terminating his role with TCHG and he would leave on 3 December 2010. As at the date of this Notice, TCHG has failed to appoint a suitable replacement compliance, the FSA has not approved any other individual at TCHG to perform the CF10 function and the FSA has not received evidence which demonstrates that a suitable individual will be appointed by 3 December 2010.

Capital resources deficit

- 2.33. On 28 May 2010, TCHG notified the FSA that it had a regulatory capital resources deficit of approximately £588,000. TCHG later notified the FSA that, to rectify the deficit, it was proposing to sell all or part of the business to another authorised firm (the “Prospective Purchaser”) and that a substantive offer was likely to be received on or before 8 November 2010.
- 2.34. As part of the due diligence process undertaken by the Prospective Purchaser, the advisers to the Prospective Purchaser identified that there appeared to be a significant number of cases where TCHG had given unsuitable advice to clients.
- 2.35. Given these serious concerns, in July 2010 the FSA undertook its own review to determine the suitability of TCHG’s advice. The FSA selected 17 transactions for review from a total of 138 transactions in certain types of investments (listed in paragraph 1.1(1) above), where a total of £8.4 million had been invested by clients between June 2008 and May 2010. Based on the sample review, the FSA deemed a very high proportion of these cases to be unsuitable, leaving TCHG potentially being liable for up to £4.8 million in redress to consumers. This estimated figure is a speculative assessment based on the extrapolation of the sample files considered and taking into account liabilities which are likely to be covered by the professional indemnity insurance policies.
- 2.36. In TCHG’s Retail Mediation Activities Return (“RMAR”) for the period ended 30 September 2010, it reported that its regulatory capital deficit had increased to £622,456. TCHG has failed to rectify, or demonstrate that it is able to rectify, this

deficit other than through the investment by the Prospective Purchaser. TCHG has also failed to demonstrate that it will be able to make sufficient provisions for redress payments for unsuitable advice which may have been given, in the event that the prospective purchase does not proceed.

Conclusions

2.37. The facts and matters described above lead the FSA, having regard to its regulatory objectives, to the following conclusions:

- TCHG has failed to maintain adequate compliance monitoring and oversight arrangements in place by failing to appoint a suitable individual to perform the CF10 compliance oversight function after the departure of the Compliance Officer on 3 December 2010;
- TCHG is in breach of IPRU(INV) 13.1.4R by failing to maintain a positive amount of capital at all times;
- these failings are material in relation to the regulated activities for which TCHG has permission and it therefore fails to satisfy Principle 4 (Financial prudence) of the Principles and Threshold Condition 4 (Adequate resources);
- the risk of loss or other adverse effect on existing and future consumers because of TCHG's failings causes the FSA to have serious concerns about TCHG such that the exercise of the FSA's own-initiative powers to impose requirements on TCHG's permission are appropriate and proportionate responses to those concerns;
- the First Variation of TCHG's permission should take immediate effect to address the FSA's serious concern that its capital is inadequate to cover any further liabilities it may incur by continuing to conduct new business in the products specified in paragraph 1.1 above, and
- the Second Variation of TCHG's permission should take effect at the close of business on 3 December 2010 to address the FSA's serious concern that TCHG's capital resources are inadequate and that its compliance and oversight arrangements will be inadequate after this time.

3. DECISION MAKER

3.1. The decision which gave rise to the obligation to give this First Supervisory Notice was made by the Chairman of the Regulatory Decisions Committee.

4. IMPORTANT

- 4.1. This First Supervisory Notice is given to TCHG in accordance with section 53(4) of the Act, and is served on TCHG at the principal place of business last notified to the FSA. The following statutory rights are important.

The Tribunal

- 4.2. TCHG has the right to refer the matter to which this First Supervisory Notice relates to the Upper Tribunal (the “Tribunal”). Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, TCHG has 28 days from the date on which this First Supervisory Notice is given to it to refer the matter to the Tribunal.
- 4.3. A reference to the Tribunal is made by way of a reference notice (Form FTC3) signed by TCHG (or on TCHG’s behalf) and filed with a copy of this First Supervisory Notice. The Tribunal’s address is: The Upper Tribunal, Tax and Chancery Chamber, 45 Bedford Square, London WC1B 3DN (telephone 020 7612 9700; email financeandtaxappeals@tribunals.gsi.gov.uk).
- 4.4. Further details are contained in “Making a Reference to the UPPER TRIBUNAL (Tax and Chancery Chamber)” which is available from the Upper Tribunal website:

<http://www.tribunals.gov.uk/financeandtax/FormsGuidance.htm>

- 4.5. TCHG should note a copy of the reference notice (Form FTC3) must also be sent to Lehong Mac at the FSA at the same time as filing with the Tribunal.

Representations

- 4.6. TCHG has the right to make written and oral representations to the FSA (whether or not it refers this matter to the Tribunal). If TCHG wishes to make written representations, it must do so by 29 December 2010 or such later date as may be permitted by the FSA. Written representations should be made to the Regulatory Decisions Committee and sent to Michelle Broadhurst, Regulatory Decisions Committee Professional Support Services. The Regulatory Decisions Committee Professional Support Services’ address is: 25 The North Colonnade, Canary Wharf, London E14 5HS. If TCHG wishes to make oral representations before the notice takes effect, please inform Michelle Broadhurst in writing of your intention to do so by 26 November 2010 otherwise please let us know before 6 December 2010. If TCHG does not notify the FSA by 6 December 2010, it will not, other than in exceptional circumstances, be able to make oral representations.

Confidentiality and publicity

- 4.7. TCHG should note that this First Supervisory Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). TCHG should also note that section 391 of the Act

requires the FSA when the First Supervisory Notice takes effect, to publish such information about the matter as it considers appropriate. The FSA will publish the First Supervisory Notice when it is appropriate to do so.

FSA contacts

- 4.8. If TCHG has any questions regarding the procedures of the Regulatory Decisions Committee, it should contact Michelle Broadhurst (direct line: 020 7066 2724), Regulatory Decisions Committee Professional Support Services at the FSA.
- 4.9. For more information concerning this matter generally, TCHG should contact Lehong Mac (direct line: 020 7066 5742 / email: lehong.mac@fsa.gov.uk), Enforcement and Financial Crime Division at the FSA.

Tim Herrington
Chairman, Regulatory Decisions Committee