FINANCIAL CONDUCT AUTHORITY

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SECOND SUPERVISORY NOTICE

To: **Stargate Capital Management Limited ("SCM") and Stargate Corporate Finance Ltd ("SCF") (together "the Firms")**

Permission Numbers: **191763 (SCM) and 401132 (SCF)**

Dated: **15 November 2017**

ACTION

1. For the reasons given below, having taken into account the representations made by the Firms, pursuant to section 55L(2)(a) and (c) of the Financial Services and Markets Act 2000 ("the Act"), the Authority has decided not to rescind the following requirements which were imposed on the Firms by a Re-issued First Supervisory Notice dated 27 June 2017 ("the First Notice"):

   A. The Firms shall not establish any new Appointed Representative relationships.

   B. The Firms shall not establish any new trading names.

   C. SCM shall:

      i. Cease to be the investment manager of FX Perpetual and cease acting as Alternative Investment Fund Manager ("AIFM") to The Momentum Fund;

      ii. Suspend the acceptance of new investors and of further monies from existing investors for FX Perpetual and The Momentum Fund;

      iii. Not add any new positions to FX Perpetual and The Momentum Fund;

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D. SCM shall cease the provision of any other services of managing investments and/or managing an unauthorised Alternative Investment Fund ("AIF"), except in relation to:

i. Catalyst Stargate EIS Growth;

ii. Catalyst Stargate Green EIS;

iii. Concentric Team Technology EIS; and

iv. Trapezia EIS.

E. All the above requirements shall continue to have effect until the Authority has communicated otherwise to the Firms in writing.

2. The First Notice also imposed certain other requirements on the Firms. The Authority is satisfied that all the requirements imposed by the First Notice were appropriate as at the date of that notice. However, the Authority has decided to rescind the requirements imposed by the First Notice other than the Continuing Requirements, with effect from the date of this notice, because it is satisfied that the Firms have complied with them in full and, therefore, they serve no further purpose.

REASONS FOR ACTION

3. On the basis of the facts and matters described below, the Authority considers that the imposition of the requirements set out in the First Notice was necessary because:

a) The Firms are failing to satisfy the Threshold Conditions for which the Authority is responsible; and

b) It is desirable to exercise the power in order to advance the Authority's consumer protection objective.

4. In particular, it appears to the Authority, on the basis of the facts and matters set out in the First Notice and in this notice that: (a) the Firms are failing to satisfy the effective supervision Threshold Condition; (b) the Firms are failing to satisfy the appropriate resources Threshold Condition because they appear to lack the necessary non-financial resources; and (c) the Firms are failing to satisfy the suitability Threshold Condition.

5. The Authority has also concluded, on the basis of the facts and matters set out in the First Notice and in this notice that, the exercise of the power to impose the Requirements is desirable in order to advance the Authority's operational objective

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of consumer protection (section 1C of the Act) in order to ensure an appropriate degree of protection for consumers.

6. Cumulatively, these failings prompt concern on the Authority's part that the Firms have exercised their power to confer exempt person status upon their Appointed Representatives but have not taken adequate steps to discharge the regulatory responsibilities triggered by exercising that power.

7. In its Written Representations dated 31 July 2017 ("31 July 2017 Reps"), the Firms state, "The Firms consider that we have taken adequate steps to discharge our regulatory responsibilities." However, in the Authority's view it is plain that this is not the case and that moreover, in material respects, the Firms concede this.

DEFINITIONS

8. In this notice:

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

"AIF" means alternative investment fund as defined in the Handbook;

"AIFM" means alternative investment fund manager as defined in the Handbook;

"Appointed Representative" is as defined in section 39(2) of the Act;

"the appropriate resources Threshold Condition" means the threshold condition set out in Paragraph 2D of Schedule 6 of the Act;

"the Authority" means the body corporate known as the Financial Conduct Authority;

"COND" means the Threshold Conditions part of the Handbook;

"the Continuing Requirements" means the requirements set out in paragraph 1;

"the effective supervision Threshold Condition" means the threshold condition set out in Paragraph 2C of Schedule 6 of the Act;

"the First Notice" means the Re-issued First Supervisory Notice dated 27 June 2017;

"EG" means the Enforcement Guide;

"EIS" means Enterprise Investment Scheme as defined in the Handbook;

"the Handbook" means the Authority's Handbook of rules and guidance;

"ICAAP" means a firm's assessment of the adequacy of its capital and financial resources, as required by the ICAAP rules;

"the Firms" means both SCF and SCM;

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"the General Prohibition" means the prohibition under section 19 of the Act by which, no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is an authorised person, or he is an exempt person in relation to that activity;

"Mr Shah" means Mr Paresh Kumar Velji Lakhamshi Shah, Register number PKS01029;

"Principal" has the meaning as used in section 39(1) of the Act;

"the Register" means the Financial Services Register which is accessible using the following link: https://register.fca.org.uk/

"SCF" means Stargate Corporate Finance Ltd (FRN 401132);

"SCM" means Stargate Capital Management Limited (FRN 191763);

"the suitability Threshold Condition" means the threshold condition set out in Paragraph 2E of Schedule 6 of the Act;

"SUP" means the Supervision part of the Handbook;

"the Threshold Conditions" means the threshold conditions set out in Part 1B (Authorised persons who are not PRA-authorised persons) of Schedule 6 to the Act;

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber);

"the Visit" means the visit by members of staff from the Authority's Supervision (Investment Management) Department to the Firms at Mr Shah's home address on 5 January 2017, and

"31 July Reps" means the Firms' written representations in response to the First Notice.

FACTS AND MATTERS RELIED ON

9. SCM has been authorised by the Authority to provide regulated products and services since 1 December 2001, and SCF has been authorised to do so since 17 August 2004. Mr Paresh Kumar Velji Lakhamshi Shah ("Mr Shah") is approved to perform the significant influence controlled functions of CF1 (Director), CF3 (Chief Executive), CF10 (Compliance Oversight), CF11 (Money Laundering Reporting) and CF28 (Systems and controls) at both Firms. At SCM there are two other persons approved to perform the CF1 (Director) controlled function, and at SCF there is one other person approved to perform the CF1 (Director) controlled function.

10. The Firms each hold permissions under Part 4A of the Act to carry on, amongst other regulated activities, the following: advising on investments (except on Pension Transfers and Pension Opt Outs); arranging (bringing about) deals in

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investments; and making arrangements with a view to transactions in investments. SCM also holds permission to manage investments. The Firms' client permissions include both retail and professional clients.

Supervision's visit to and subsequent contact with the Firms

11. On 5 January 2017, staff from the Authority's Supervision (Investment Management) Department ("Supervision") visited the Firms at Mr Shah's home address ("the Visit"). During the visit Mr Shah confirmed that the Firms' place of business was not 71 Queen Victoria Street, London, EC4V 4BE (as recorded on the Authority's Register) but was Mr Shah's home address. This had been the case for some time but despite this the Register was only updated on 30 October 2017.

12. Mr Shah said that he was the only active director at the Firms. He said that of the two other directors at SCM, neither performed an active role: one had lived abroad for a number of years and was no longer involved with the firm; the other director only interacted with the firm every couple of months. He said that the other director at SCF (also one of the directors at SCM) was no longer involved with the firm. During his meeting with the Authority on 5 January 2017, Mr. Shah confirmed that the Register did not correctly reflect the senior management roles within the Firms. Despite this, the Authority has not received a request from Mr Shah to update the Register to reflect the fact that he is the Firms' only active director.

13. After the Visit, Supervision met Mr Shah at the Authority's offices on 8 February 2017 and on 14 March 2017. Supervision also reviewed documents that it had obtained from the Firms. As a result of these interactions and its review of the documents, Supervision identified a number of concerns; in particular, relating to the Firms' governance over its Appointed Representatives and the Firms' use of trading names.

14. In its 31 July 2017 Reps, the Firms state, "The Firms admit to not having adequate documentary evidence of its "governance over its Appointed Representatives" but do not agree that there is any cause for concern relating to its clients. The Firms believe that their use of trading names is appropriate." The Authority is satisfied that the evidence summarised in this notice undermines these assertions.

Governance over Appointed Representatives

15. At the time of the Visit, the Firms had eight Appointed Representatives. SCM was also purporting to provide investment management services to FX Perpetual Strategies; Wealth Fortress DFMs; Momentum Fund and four Enterprise Investment Schemes ("EISs") (Catalyst Stargate EIS Growth; Catalyst Stargate Green EIS; Concentric Team Technology EIS; and Trapezia EIS).

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16. During the Visit, Mr Shah was asked whether the Firms had an assessment of the adequacy of the Firms' capital and financial resources ("ICAAP") in place. It transpired that no such document was in place and that Mr Shah did not know what an ICAAP was. An ICAAP dated 6 February 2017 (and which had therefore clearly been written after the meeting with Supervision), was subsequently provided by Mr Shah to Supervision but this was inadequate and failed even to identify basic and key risks associated with the Firms' Appointed Representatives' business, such as market, credit and operational risks.

17. Apart from the fact that the ICAAP had been created after the meeting with Supervision, it was not fit for purpose as it failed to identify the key risks associated with each of the AR businesses operating under the Firm's permissions. This meant that the ICAAP had potentially incorrectly quantified the Firm's required regulatory capital. Supervision informed Mr Shah of these concerns during its 8 February 2017 meeting with him. In addition, the ICAAP had only briefly recognised the AR business in the operational risk section, where it indicated: *"Operational risk is the risk generated from people, processes, systems or external events. The Firm is a small, closely managed unit, and the Directors believe that they have done all they can to minimise Operational risk. They do however recognise that they have limited control over appointed representative firms and joint venture partners. To minimise this they have put in place regular monitoring of these firms. They believe that they have sufficient human resources to carry on the business and sufficient back up facilities to deal with system or process failures."*

18. The Authority has seen no evidence to support the above statement and considers that Mr Shah's lack of understanding and awareness of the risks that his Appointed Representatives pose suggests that Mr Shah lacks the competency to run a Principal/Appointed Representative business, which in turn puts consumers at risk of harm. The Firms do not therefore appear to have sufficient understanding of the inherent risk within each of its Appointed Representative businesses.

19. In its 31 July 2017 Reps, the Firms do not address these matters directly but refer to, "the comprehensive ICAAP submitted (enclosed, 2 documents in total), which included the identification of risks, was an expectation of business as at that time in February 2017, the Firms were still performing regulatory functions. However, due to the Authority's intervention, the Firms business expectations have been significantly affected going forward, rendering the forecasts inaccurate."

20. The "2 documents enclosed" with the 31 July 2017 Reps, are the SCM ICAAP which had previously been provided to the Authority and a word file named ".*Stargate*

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Corporate Financing Limited word" which is two small grids called the "*ICAAP working Book*" (which appears to be a profit forecast document and a statement of financial position). These had not previously been provided to the Authority. These documents are high level financial views in relation to SCF and therefore similarly do not provide any evidence of any consideration of basic and key risks associated with the Firms' Appointed Representatives businesses.

21. During the Visit, and subsequently, the Firms failed to provide any evidence that they had any meaningful governance arrangements in place to oversee their Appointed Representatives. For example, there was no evidence of:

    - Appointed Representative compliance monitoring plans
    - Appointed Representative call monitoring
    - Appointed Representative client file monitoring
    - Audits of Appointed Representatives
    - Visits by the Firms to their Appointed Representatives' places of business
    - Any requirement by, or provision to, the Firms of management information relating to their Appointed Representatives

22. In the 31 July 2017 Reps, the Firms state "The Firms admit to not having adequate documentary evidence of its "governance over its Appointed Representatives" but do not agree that there is any cause for concern relating to its clients."

23. Mr Shah told Supervision that he communicated with the Firms' Appointed Representatives but that any such calls or meetings were neither recorded nor otherwise documented. In the 31 July Reps, the Firms confirmed that this is correct.

24. Supervision reviewed all take-on due diligence undertaken by the Firms in respect of their Appointed Representatives. This due diligence lacked risk assessments and was "tick-box" in nature. Due diligence conducted on several Appointed Representatives did not include a business plan. Supervision asked Mr Shah to provide documentation relating to all ongoing oversight by the Firms of their Appointed Representatives but, as of the date of this notice, none has been provided.

25. In the 31 July 2017 Reps, the Firms state, "The Firms admit to not having comprehensive due diligence, written risk assessments and business plans, but do have a good level of understanding of the business model of each of its appointed representatives, the Firms have no cause for concern relating to the conduct of its appointed representatives."

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26. On 3 February 2017, Mr Shah informed Supervision that compliance monitoring plans in respect of the Firms' Appointed Representatives were "in active progress", combined with monthly information requests and quarterly compliance reports and declarations. But Supervision have never been provided with any evidence that these arrangements were in place, and was therefore unable to assess their adequacy.

27. In the 31 July 2017 Reps, the Firms state, "The Firms admit to not having compliance monitoring plans, quarterly compliance reports and declarations but do have a good level of understanding of the business model of each of its appointed representatives, the Firms have no cause for concern relating to the conduct of its appointed representatives."

28. However, an example of the Authority's "cause for concern" can be seen in respect of Appointed Representative A. This firm became an Appointed Representative in March 2015.

29. The due diligence supplied by Mr. Shah with respect to its oversight for the start-up of the Appointed Representative A relationship was inadequate and only covered the following:

- passport photo of the director;
- Companies House documentation; and
- a council tax bill

30. No risk assessment has been provided in respect of the take on of Appointed Representative A or any on-going due diligence. Additionally, whilst registering Appointed Representative A as an Appointed Representative, the Firms failed to apply for its director to become a CF1AR & CF30 as required by SUP 12.

31. The Firms had indicated that Appointed Representative A had not undertaken any regulated activity since becoming an AR in March 2015. The Firms had however been receiving around £1,500 a month from Appointed Representative A in fees throughout this period but had not questioned why Appointed Representative A would be willing to suffer this on-going expense while apparently earning no corresponding revenue.

Appointed Representatives' Websites

32. During the Visit, Supervision indicated to Mr Shah a number of concerns regarding the web-sites of some of the Firms' Appointed Representatives and how they were promoting themselves and their activities. Mr Shah was unable to answer a number of these questions and stated that the Firms' compliance consultant had reviewed

these web-sites. However Mr Shah was unable to provide any evidence that any such review had been undertaken, and none has ever been provided

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33. In the 31 July 2017 Reps, the Firms state, "The Firms admit to not having evidence of financial promotions sign offs relating to websites of some of the Firms Appointed Representatives."

34. An example of incorrect information posted at the time of the Visit on one of the Firms' Appointed Representatives' web-sites included "Appointed Representative A", which purported to provide an Oil Managed PAMM Account with current claimed returns of 70% per annum and returns historically as high as 115% per annum. Appointed Representative A's website stated that the product was managed by an oil trader investment manager employed by SCM. Mr Shah confirmed that the oil trader referred to had left SCM in early 2014 and that there had never been an active Oil Managed PAMM Account. He stated that it had been a "conceptual idea" but had never been developed into an actual product offered by the Firms. It is to be noted that Appointed Representative A is an Appointed Representative of SCF which does not itself have the Investment Management Permission, however Mr. Shah has not provided any evidence as to how the "Oil Managed PAMM Account" could have been (or was) operated without breaching the general prohibition, nor that he had given this issue any consideration.

35. A further example in respect of Appointed Representative A's website at the time of the Visit was a statement made in respect of a property investment product where investors would receive a "25% rise in capital growth from day one". Mr Shah was unable to explain how this could be undertaken in practice.

36. In the 31 July 2017 Reps, the Firms state, "The Firms admit to not approving the content of one of the Firms Appointed Representatives websites. The "Oil Managed PAMM Account" was a concept only and did not collect any investment from consumers." This explanation however, does not accord with the wording of the website which gives the impression that this product was already in progress and was achieving spectacular returns.

37. The 31 July 2017 Reps also state, "The Firms admit to not approving the content of one "Appointed Representative A's" website. The investment "25% rise in capital growth from day one" was a concept only and did not collect any investment from consumers."

38. These examples, together with others identified by Supervision during the Visit, give cause for concern that the websites of the Firms' Appointed Representatives

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had not, at the time of the Visit, been properly reviewed by the Firms' compliance consultant for some time, if at all.

39. This failure is acknowledged in the Firms' in the 31 July 2017 Reps, which state, "The Firms admit to not approving the content of some of the "Appointed Representative" websites. The Firms have not breached the general prohibition."

Activities potentially in breach of the general prohibition

40. The Firms were requested on 6 January 2017, to provide take on due diligence for all their Appointed Representative relationships and all ongoing due diligence of its Appointed Representative activities. The Firms provided basic take on due diligence for the majority of its Appointed Representatives on 9 January 2017 but did not provide take on due diligence for Appointed Representative B. The Firms indicated on 9 January 2017, that the Authority's request for ongoing due diligence would follow, however this has not been received for any of the Appointed Representatives. On 16 May 2017, in response to a request by the Authority under s.165 of the Act, the Firms provided the Appointed Representative agreement and a signal provider agreement for Appointed Representative B. A third party service agreement was additionally supplied to the Authority with the 31 July 2017 Reps.

41. With its 31 July 2017 Reps, the Firms provided the following agreements. This is the first time that the Authority has seen these documents and it is the first time that the Authority has been made aware of the relationship between Appointed Representative B and an entity called Firm W:

    a) Service provision Agreement between Appointed Representative B and SCM.

    b) Customer service and support agreement between Firm W and Appointed Representative B.

    c) Application Service Provider (ASP) Agreement between Firm W and Appointed Representative B.

42. The Authority would expect SCM to consider its Appointed Representative's third party service relationships however these agreements do not evidence oversight by SCM over the activities of Appointed Representative B. The Authority has not been provided with any due diligence of the activities of this relationship and whether retail investors have invested and whether they have been fairly treated. It is questionable whether even now, the Authority has been provided with all documents with respect to the Firms, Appointed Representative B and Firm W.

43. In May 2017, Supervision identified a relationship involving Appointed Representative B, SCM and Firm X which raised concerns that regulated activities

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may be being conducted in breach of the General Prohibition. Firm X is neither an authorised firm under Part 4A of the Act, nor is it an Appointed Representative of SCM. Mr Shah explained that Firm X provides research to SCM via Appointed Representative B, and that the research is used to create and offer an SCM/Firm X managed trading service. However Firm X's website indicates that it provides investment strategies as well as research to SCM stating "[Firm X] provides their latest strategies & research to SCM who then in turn manage, control and place trades on your behalf …".

44. Despite these statements on Firm X's website and Mr Shah's assertions that SCM provides management services for Firm X, SCM has not provided Supervision with any contractual agreements evidencing the basis of its relationship with Firm X despite requests from Supervision to do so. This raises concerns that regulated activities may be being conducted in breach of the General Prohibition.

45. In its 31 July 2017 Reps, the Firms state, "The contractual arrangements with Firm X are provided." However no such documents have in fact been provided.

46. The 31 July 2017 Reps further state, "The Firms accept that the website may be misleading." This demonstrates the lack of oversight that SCM had over the activities of Firm X's activities.

47. Mr Shah has been unable to provide any meaningful due diligence to substantiate SCM's purported oversight of Firm X's activities since its inception in April 2016. Supervision originally requested on 6 January 2017, that SCM provide all oversight that had been undertaken on Appointed Representative B. Other than standard take on due diligence, no oversight was provided on Appointed Representative B's activities and third party relationships, including in respect of Firm X. Subsequently, in its 10 May request under section 165 of the Act, Supervision asked SCM to provide all contractual documents between itself, Appointed Representative B and Firm X. SCM only provided its Appointed Representative agreement with Appointed Representative B. As a result, Supervision is unclear as to the precise nature of the relationship between Appointed Representative B, Firm X and SCM.

48. A section 165 request dated 29 May 2017, asked Mr Shah to provide all due diligence undertaken on the SCM / Firm X managed trading services. Mr Shah's response on 2 June 2017 indicated that this had previously been provided. However the only information provided by Mr Shah that could be deemed as due diligence were two brokers' statements for closed and open trades dated 20 July 2016 and 24 October 2016. The Authority does not consider this to be meaningful

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evidence of oversight by SCM. There is therefore no evidence to demonstrate any meaningful oversight of the SCM/Firm X relationship since its inception in April 2016. It is also notable that SCM did not inform the Authority of its relationship with Firm X (via Appointed Representative B) until its 16 May 2017 response to the Section 165 Notice. This is despite the fact that the Authority had previously raised a number of questions with regard to Appointed Representative B.

49. Stargate was also requested to provide a description of the SCM / Firm X Managed Trading Services and a client list through the 29 May s.165 request. Mr Shah's response simply indicated, without giving any additional detail, that "they were an FX managed accounts" and that "the [SCM/Firm X] Managed Trading Services have no investors now." The Authority is therefore unsighted on the true nature of the SCM/Firm X Managed Services and the number of investors involved. Mr Shah's inadequate responses to the s.165 requests has hindered the Authority from fully understanding the nature of the Firm's relationship with Firm X. This further evidences the fact that the Firms, through Mr Shah, are not capable of being effectively supervised by the Authority.

50. The risks to the interests of customers by this apparent failure are aggravated by the potentially unrealistic promises of investment returns made on Firm X's website, including the promotion of investment products with annual performance returns of over 50%. The Firms' acceptance that the "website may be misleading", demonstrates its total lack of oversight of the website's claims.

51. Due to Mr. Shah's limited responses to the Authority's requests, the Authority is unable to evidence that SCM is providing oversight of either Firm X or Appointed Representative B. Therefore SCM may be providing Firm X with regulatory legitimacy by purporting to be the investment manager of the SCM/Firm X Managed Trading Services when in fact Firm X may potentially be undertaking these services. This raises further concerns that regulated activities may be being conducted in breach of the General Prohibition.

52. It is notable that SCM terminated its AR relationship with Appointed Representative B on 19 May 2017 three days after providing its section 165 response to the Authority.

Activities under SCM's investment management permission

FX Perpetual

53. The FX Perpetual fund is purportedly managed by SCM and is described on SCM's website as "an absolute return systematic algorithmic FX trading strategy". The fund trades 25 currency pairs and is marketed as a medium term investment but

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its trading is almost entirely short term in nature. The majority of trades are opened and closed in a matter of days at most, with a number executed on an intra-day basis. It was developed by Firm Y, a firm that is neither authorised under Part 4A of the Act, nor an Appointed Representative of SCM. Firm Y, manages the algorithm, develops the code and provides trade signals to SCM. As of March 2017, there were 67 clients invested with total net funds (after adjustment for uncrystallised losses), of circa £1.67m.

54. The Authority is concerned that Mr. Shah has provided no evidence of appropriate due diligence or oversight of the FX Perpetual fund. In addition, the Authority considers that Mr. Shah (and therefore the Firms) lack the necessary skills and competence to manage the FX Perpetual Fund properly or at all, and that any such management was carried out incompetently.

55. In addition, there are concerns that inadequate processes in relation to prospective investors have meant that clients have invested in the fund in circumstances where the fund may not be suitable for them. There are also concerns as to whether investors in the fund have been treated fairly. The Authority is also concerned that the way in which the fund was operated and managed gives rise to concerns as to whether activities are being conducted which are in breach of the general prohibition.

56. During the Visit, Mr Shah confirmed that he has no algorithmic or coding experience. FX Perpetual's performance calculations are undertaken by Firm Y and are not reviewed by SCM. Mr Shah said that he has the ability to veto trades sent by Firm Y but that he has not done so since taking on investment management responsibilities in July 2015. Mr Shah said that he discussed with Firm Y, foreign exchange market liquidity risks, such as those posed by "Brexit", and that he has challenged the timings of hedges placed on the fund. However to date Supervision has not been provided with any documentation evidencing such discussions.

57. The Authority considers that Mr Shah has been unable to provide any substantive evidence, such as contemporaneous records or documentation, which might reasonably satisfy the Authority that SCM has been sufficiently involved in any aspect of control over the setting of parameters and inputting of information into the algorithmic computer software used to generate the trading signals which are applied to the FX Perpetual accounts. On this basis, Mr Shah has provided no evidence that the signals have been generated by SCM rather than the software itself. The trading activity generated by the signals can thus not be regarded as having been investment managed by SCM, rather than simply the result of fully automated trading generated by the software itself. Accordingly, the Authority is

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concerned that the manner in which these activities are being conducted may be in breach of the general prohibition.

58. Enquiries have established that SCM receives a modest investment management fee of £3000 per month plus a 10% performance fee if applicable. In comparison, since FX Perpetual's inception in March 2015, it has generated in excess of £900,000 in commission rebates for Firm Y. A significant part of this sum is created by the application of a 5 pip mark-up on the booked price of each trade, a pip being the smallest amount by which a currency pair is typically quoted and can change in the interbank market, i.e. in GBP/USD 1 pip is the fourth decimal place and worth USD100 per million GBP traded. Revenue from this 5 pip mark-up is paid by the liquidity provider to SCM as a monthly commission rebate. SCM in turn passes this in full to Firm Y. Firm Y therefore receives 100% of pip mark-up revenue, as well as an investor's subscription fee of 5%, 25% (of a total of 35%) performance fee if applicable, and a 0.5% annual algorithmic rental fee.

59. This distribution of fees, heavily weighted in favour of Firm Y, raises doubts as to whether SCM is genuinely performing the investment management role in respect of FX Perpetual. It indicates, alongside the circumstances described above, that Firm Y may be acting as the investment manager and / or providing investment advice, as well as being the developer and provider, of FX Perpetual, with SCM simply being paid a modest fee to provide regulatory legitimacy.

60. During Supervision's meeting with Mr Shah on 14 March 2017, he stated that SCM performs suitability assessments for FX Perpetual's prospective investors. But he also said that his only consideration for the suitability of the product for the client was whether they could afford to lose their entire investment. Supervision reviewed the client files for 15 (c.25%) of FX Perpetual investors. None contained a suitability assessment, this raising concerns as to its suitability for those clients invested in this high-risk product. No documented suitability assessments have been provided in respect of any of the clients and therefore the Authority considers that these simply do not exist.

61. By way of example:

62. Client B's application form provides details of his assets and investment income. He invested 45% (£115,000) of his available SIPP/Pension assets into FX Perpetual. Client B indicates an aggressive investment approach however he also states that he has little investment experience and exposure. This factor does not appear to have been considered by Mr Shah. It also appears from the application form that SCM has used the total net assets figure to assess suitability, which in

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Client B's case includes two villas in Cyprus and also Client B's own home. These assets amount to approximately two thirds of his total assets. Client B invested his entire SIPP invested pension in FX Perpetual – which represented some 45% of his total pension funds.

63. Client C - invested £80,000 into FX Perpetual, however Client C does not seem to have the available cash to invest as cash deposits are only £25,000. Client C's assets are stated to include two properties, a car, caravan, art, contents and commercial photography equipment. It therefore seems that the FX Perpetual investment may have come from his cash deposits and a £130,000 pension. Therefore the FX Perpetual investment could represent up to 61% of Client C's total pensionable assets.

64. The Authority has obtained a number of iterations of the FX Perpetual brochure. These include two which it has reason to believe are the first two versions. Based on client account opening dates these would have been the versions reviewed by the large majority of FX Perpetual investors. The earlier brochure (which appears to have been used until the end of 2015), highlights that Appointed Representative A is an Appointed Marketing agent for FX Perpetual, which is authorised by the Authority. This is incorrect as Appointed Representative A is as an Appointed Representative and is therefore not authorised itself. This was corrected in the second brochure that appears to have gone live at the beginning of 2016. The second brochure highlights FX Perpetual as a "capital protected managed account".

FX Perpetual's "Basket Stop Reserve" and unrealised losses

65. Supervision raised concerns with Mr Shah relating to the marketing of FX Perpetual and a feature described as a "Basket Stop Reserve" by which Firm Y provides an undertaking that on each annual anniversary of a client's account, if that client has made a loss in the previous year, that client will be entitled to make a claim to Firm Y for reimbursement of those losses.

66. It appears that the "Basket Stop Reserve" has featured strongly in FX Perpetual promotional material. For example a "You Tube" presentation makes the following claims:

    a) A managed account that's designed to virtually eliminate all trading risks.

    b) Eliminate trading risks and provide a smooth return.

    c) **Our** FCA authorised manager trades for you.

    d) The Basket stop facility underwrites **any** net trading losses

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67. However the Basket Stop Reserve is only activated against losses generated by realised trades. Historical unrealised losses are not included for the purposes of the undertaking. For example, losses generated in January 2016 (c. £185,000), and October 2016 (c. £221,000) have not been realised but have been "held open" but fully hedged, meaning that whilst there is no market exposure and thus these losses cannot be recovered, they are not realised and consequently do not trigger the Basket Stop Reserve. As a result, clients who held accounts when the losses were incurred in January 2016 have lost the ability to claim against the Basket Stop Reserve. It is unclear why SCM, as the investment manager, acting in its clients' best interests, would not crystallise these losses so as to enable a potential claim against the Basket Stop Reserve. Firm Y, the creator of the algorithms and the issuer of the undertaking, is clearly conflicted in any decision as to whether to crystallise such long term historic losses.

68. As of 20 March 2017, the unrealised losses in FX Perpetual totalled around £368,000, (around 18% of FX Perpetual's total net assets). As stated above, these unrealised losses primarily relate to CAD/JPY (Canadian Dollar/Japanese Yen) positions hedged on or around 29 January 2016, creating losses in the region of.£185,000 (when the Bank of Japan announced the adoption of negative interest rates), and GBP/USD (Sterling/US Dollar) positions hedged on or around 25 October 2016 (following the "Sterling Flash Crash" earlier in that month), locking in further losses in the region of £221,000.

69. As a marketing tool the Basket Stop Reserve is a facility marketed to provide clients with reassurance with respect to losses, however in reality it appears to have been designed by Company Y in such a way that it is possible for the issuer of this undertaking to avoid paying out on losses via the mechanics of not realising material losses within the product.

70. It appears that the hedging of material and historic losses is being used for no legitimate investment rationale other than as an artificial device to avoid the Firms having to meet contractual obligations to its account holders under the terms of the Basket Stop Reserve and to present a misleading picture to prospective and current investors as to the success and profitability of the fund.

71. Supervision has also established that FX Perpetual has been marketed to potential investors using performance data based on realised trade profit and loss ("P&L") alone, without inclusion of "marked-to-market" unrealised trade P&L. Clearly, had the losses described above been included this would have had a materially negative impact on FX Perpetual's published performance. In addition, until April 2017 (after which SCM implemented changes requested as a result of dialogue with

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Supervision), this affected reporting in client statements and the calculation of performance fees, as both were based on realised P&L only.

72. Prior to April 2017, clients invested in FX Perpetual only became aware of the unrealised hedged losses if and when they requested the redemption of their investment. By way of example, clients who requested such a redemption in January 2017 were informed that their actual investment value would drop by circa 20% from that previously reported in their monthly statements. This was as a direct result of the significant differential between realised and unrealised trades. This was at variance with marketing material and redemption letters for FX Perpetual indicating that unrealised losses on open trades typically averaged at circa 1%.

73. It was not only existing investors who may have been prejudiced. Supervision has reviewed client agreements provided by Mr Shah which indicate that around the time of the losses generated in January 2016, the agreements were amended to require new clients to accept a proportion of the current open but unrealised losses at the point of investment. However this has been inserted as an additional clause in a substantial document and is not sufficiently prominent. Furthermore, even if clients did review and understand this clause, there is no evidence that new investors were made aware of the materiality of the losses that they were expected to accept.

74. An example of the impact on new clients is Client A, who invested in FX Perpetual in March 2016, thereby investing after the January 2016 losses had been generated. Client A then closed this account in January 2017 thereby after the October 2016 losses had been generated. Client A's redemption calculation includes an adjustment of minus 19.8% to the final redemption figure representing what appears to be their pro-rata share of both these unrealised losses.

75. A further example can be seen in respect of Client D who opened his account on 2 February 2016 after the CAD/JPY unrealised losses in January 2016 were generated. His account closed in September 2016 before the October GBP/USD losses. Client D's redemption calculation includes an adjustment to factor in on a pro rata basis, (based on investors at the point redemption), the unrealised losses generated by CAD/JPY, which in total equated to a 10.95% reduction in their final redemption figure.

76. At the meeting on 14 March 2017, Mr Shah was asked to provide the investment rationale for keeping open the substantial loss positions described above. He described this as a "smoothing policy". The Authority considers this explanation to

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be inadequate and demonstrates his inadequate understanding of the FX Perpetual product offering. The Basket Stop Reserve did not represent a smoothing strategy but appears to have been operated solely in the interests of SCM, and to an even greater extent Firm Y and to the detriment of SCM's clients.

77. In fact, smoothing is not an investment strategy at all but simply a process of gradually recovering old losses by offsetting them against current profits subject to such profits being achieved. Such smoothing appears to be primarily designed to work to the benefit of Firm Y which leads the Authority again to conclude that Mr Shah is fully reliant on the investment strategy provided by Firm Y. In effect, "smoothing", when combined with the past reporting of realised P&L only, appears to be a device designed to hide historic material losses from both current and prospective FX Perpetual investors. This has allowed Firm Y to continue to both generate substantial revenue from existing investors and actively market the fund to new investors based on performance data which misrepresents that actually achieved for those existing investors. SCM has also benefitted from this misrepresentation of true performance, but its revenue generation has been considerably less than that of Firm Y.

78. In a letter to Supervision in March 2017, Mr Shah stated that investors "joined FX Perpetual to be informed of overall realised performance rather than position movements in each underlying currency position". It is also the case that SCM had included in its marketing documentation wording to the effect that performance and monthly statements are only generated on realised trades. Supervision nevertheless considers that SCM's treatment of unrealised losses on FX Perpetual and the level of transparency provided to its clients falls well below that which should be expected of a regulated firm.

79. The Authority has been provided with client account lists and trading statements from the executing broker who held the client accounts. The Authority has examined and conducted some analysis of these documents. This analysis demonstrates (for example), that there appears to be no rationale to keeping open the large, fully hedged loss positions and that in fact doing so, has only increased the losses to the clients, as the positions incur a spread cost on roll over fees and JPY losses have increased in GBP terms (the base currency of the investments), as a result of adverse exchange rate fluctuations. The analysis also underlines the significant difference between the reported performance of the fund to investors, and the actual performance of the fund.

80. The Authority's analysis of the 15 client files provided shows that Mr Shah failed to provide all monthly statements. Of the statements that were supplied, the

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Authority is concerned that these appear to contain errors and that some clients in 2016 may have received incorrect redemptions. Mr Shah has accepted that there may be potential errors but states that there have been no complaints. However the Authority considers that this is one of the reasons why a section 166 Skilled Persons Review needs to be undertaken in order to ascertain the true position and any potential need for redress.

81. SCM wrote to its FX Perpetual investors on 17 February 2017 as a result of the Authority's investigation. The communication, whilst indicating the Authority's concerns with respect to SCM's systems and controls, informed its clients that if it undertook a voluntary requirement on its permission, this would almost certainly lead to investor detriment via the closure of open trade baskets, which would be terminated prematurely before they completed their "*highly likely profitable outcome*".

82. As highlighted in the above paragraphs, the historic material open losses on FX Perpetual have been fully hedged, so there is no market exposure, and consequently no potential recovery of these losses (except by gradually offsetting them with any unconnected future trade activity through "smoothing"). At the time of the 17 February 2017 communication, FX perpetual investors were unaware of these historical and material unrealised losses.

83. SCM's comments in the letter refer to their desire that future trading profits will recoup historical losses. However, SCM fails to notify its clients that it cannot guarantee future performance which could generate losses as well as gains. Additionally, FX Perpetual is an FX currency strategy and therefore the trade baskets that SCM refer to are short term trading strategies in nature and can in fact be traded into and readily closed out intraday given the extensive liquidity in the spot foreign exchange market. The SCM client communication appeared designed to mislead clients in respect of the nature of the historical losses and to convince clients that transferring their FX Perpetual account to a new investment manager would be in their best interest. The Authority is concerned that the communication did not provide investors with the appropriate facts in order to enable them to make a considered and balanced judgement with respect to the investment.

84. Through subsequent communication with the Firms, it was agreed that they should send an additional update letter to clients, given the Authority's concerns with respect to the 17 February 2017 letter, but this further letter was not sent due to disagreement between the Authority and the Firms on the drafting. This has now of course been overtaken by events. In a letter to the Authority dated 29 August

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2017, the Firms stated that when notifying their investors of the closing of their position in accordance with the requirements of the Notice, "the notification will express severe misgivings and indicate that the action is being taken under compulsion to comply with an FCA Notice".

85. All the above matters lead the Authority to be concerned that Mr. Shah is not and has not been, providing any meaningful or competent oversight or management of the FX Perpetual Fund and that the role of Firm Y is such as to give rise to concerns as to the role that this Firm is in fact undertaking and whether activities are being conducted in breach of the general prohibition, with SCM providing regulatory legitimacy. Furthermore, the Authority is concerned that the FX Perpetual Fund appears to have been run for the benefit of Firm Y and Mr Shah rather than the investors and there is evidence that customers have not been treated fairly and may well have suffered detriment as a result.

The Momentum Fund

86. SCM is the investment manager for the Momentum Fund which is a relatively small FX fund (assessed by asset value) but is not an algorithmic product. Whilst Supervision has not undertaken a review of the fund, it appears that SCM is providing a similar investment management service to the Momentum Fund to that provided to FX Perpetual and Firm Y. A section 166 review is needed to understand the role played by the Firms in respect of this fund.

87. In its 31 July 2017 Reps, the Firm states, "The Momentum fund and FX Perpetual are entirely different products, SCM manages both under its regulatory permissions as principal, SCM does not understand the FCA's concerns."

The Wealth Fortress DFMs

88. The Wealth Fortress DFMs are five managed account portfolios that are designed to provide retail investors with a choice of risk profiles from "cautious" to "adventurous". SCM is named as the Investment Manager of the Wealth Fortress DFMs and established two Wealth Fortress trading names, "Wealth Fortress DFM" and "Wealth Fortress Perpetual Growth", in December 2016. As with FX Perpetual, the Wealth Fortress DFM funds were designed by Firm Y. The DFMs invest mainly in ETFs (Exchange Traded Funds) making use of algorithms. The five portfolios include investments in property, commodities, emerging markets, and (even in the "cautious" fund) Wealth Fortress Perpetual Growth, an FX algorithmic fund which is a rebranding of the FX Perpetual fund described above. Supervision has evidence that the Wealth Fortress DFMs may have been marketed to retail pension investors for which they may not have been suitable. Supervision has seen no evidence that

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SCM is in practice providing investment management services to the Wealth Fortress DFMs.

89. In the 31 July 2017 Reps, the Firms state that, "Wealth Fortress DFM was a trading name of SCM, the five portfolios were in concept form and were never marketed to any retail or professional consumers. SCM has provided no investment management services as there are no investments to manage."

90. However, on 8 February 2017 the Authority showed Mr Shah a Wealth Fortress pension switching report, generated by Firm Y and provided to the Authority by a SIPP provider. That report contained an investment past performance analysis which compared the prospective investor's current pension investment to that of the Wealth Fortress Cautious DFM portfolio. It was pointed out to Mr Shah that this analysis indicated that the Cautious DFM fund had been running since December 2011. Mr Shah had previously indicated that all five Wealth Fortress DFM portfolios were not yet live. Mr Shah failed to provide the Authority with any explanation as to why the switching report indicated that the Cautious DFM portfolio had been in existence since December 2011, and why as the portfolio manager, SCM was not aware that this comparison analysis was being used to promote investment in the product. The Authority is concerned that incorrect statements and potentially misleading investment returns are being used in promotional material for the purpose of attracting retail pension clients to invest, without the knowledge and sign off of SCM as the investment manager. In addition, the Authority has concerns as to the truth of Mr. Shah's statement that the 5 Wealth Fortress DFM portfolios are "not yet live".

Trading Names

91. At the time of the Visit, Mr Shah stated that two of the trading names listed on the Register as being used by SCM, Wealth Fortress DFM and Wealth Fortress Perpetual Growth, in fact belonged to Individual A. However in emails from Mr Shah to Supervision in February 2017, Mr Shah stated that this was incorrect and that these were trading names used solely by SCM. However, whereas SCM's website has never promoted these funds, Individual A's website has until recently promoted them both. As a result Supervision is concerned that SCM may be providing inappropriate regulatory legitimacy for these trading names which in fact are used by Individual A. SCM withdrew the two trading names from the register on 2 February 2017.

92. In its 31 July 2017 Reps, the Firms state, "SCM did have a website for its trading name "Wealth Fortress DFM" the website was under development. The website has

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been removed from the Internet as SCM has discontinued its original plan to market a retail pension proposition via a panel of IFA's. The website and trading name belong to SCM, neither ever belonged to [Individual A]. [Individual A] has never used the trading name "Wealth Fortress DFM". [Individual A] is a director of Wealth Fortress Tax Ltd, Wealth Fortress Solutions Ltd and Wealth Fortress 1 Ltd, none of these companies conduct any regulated activities."

93. Another trading name listed on the Register as used by SCM at the time of the Visit was Firm Z. Despite it purportedly being used as a trading name, Firm Z is registered at Companies House as an incorporated limited company. It therefore does not appear to be a trading name of SCM. Further, Firm Z's website describes its relationship with the Firms as follows, "Firm Z acts as an introducer and strategy provider to [SCM], which is authorised and regulated by the Financial Conduct Authority … [SCM] acts as the principal and is the investment manager".

94. Whatever Firm Z's true status, SCM has not been able to provide Supervision with any evidence of systems and controls applicable to Firm Z's business, products or clients, or due diligence that SCM has conducted. Accordingly, Supervision is concerned that SCM may be providing inappropriate regulatory legitimacy to Firm Z's business.

95. The only documents that have been provided to the Authority are a Firm Z business plan and a [Firm Z] Global Management ltd Joint Venture agreement which was provided as part of the section 165 request received on 16 May 2017. This is a high level document and sets out the responsibilities of both Firm Z and the Firms. It does not provide details of the joint venture activities.

96. On 9 January 2017, the Firms provided the Authority with take on due diligence for Firm Z. This appears to be only basic information, for example Companies House reports and a standard business plan. The Authority has seen no system and controls that SCM has established to oversee Firm Z's activities, nor any evidence of ongoing oversight by SCM.

97. During the 8 February 2017 meeting, Supervision discussed with Mr. Shah the fact that Firm Z was previously a trading name of Firm V and that the senior management of Firm Z were long standing CF30s at Firm V. It was raised with Mr. Shah that Firm V had a Voluntary Requirement ("VREQ") placed on its permissions by the Authority on 6 October 2016 for it to cease all regulated activities, due to the Authority's identification of conduct concerns with respect to the selling of inappropriate investments to retail clients at both Firm's V and Z. Mr. Shah confirmed that this issue had not been considered by him during the take on of this

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'trading name', however the Authority considers that this issue should have raised concern with respect to the suitability of the relationship and whether consumers' interests may be at risk. Notwithstanding this, the due diligence supplied by SCM to the Authority with respect to its oversight for the start-up of the Firm Z relationship only covered basic and standard information, and did not include a risk assessment.

98. Mr Shah indicated within his response to the Authority's 29 May 2017 s.165 request, that *"the majority of clients….are retail, except all SIPP Trustees and one IFA client. 67 clients have been introduced by Firm Z were originally clients at [Firm V] prior to them having their permissions removed. 10 clients have been introduced directly to SCM*." The Authority is unaware of whether and if so, how many, of Firm V's clients have been transferred to SCM by its relationship with Firm Z.

99. Mr. Shah has provided no evidence that SCM has considered these issues and to date has provided no on-going due diligence undertaken on Firm Z, despite being requested to do so on 6 January 2017. It follows that the Authority cannot therefore satisfy itself that any clients of this joint venture have been treated fairly and / or appropriately. Nor can the Authority be satisfied as to whether Firm Z is in fact undertaking regulated activities for which the Firms provide regulatory legitimacy.

100. The Authority is concerned about the fact that SCM, on the same day that the joint venture agreement between Firm Z and SCM was entered into, also registered a trading name (Trading Name Z) with the Authority which was virtually identical to the name of Firm Z. The Authority is concerned that this was done to provide regulatory legitimacy for Firm Z. SCM withdrew the trading name from the register on 2 February 2017. However recent review of Firm Z's website states:

101. *"[Firm Z] acts as an introducer and strategy provider to Stargate Capital Management Ltd, which is authorised and regulated by the Financial Conduct Authority …..Stargate Capital Management acts as the principal and is the investment manager"*

102. In its 31 July 2017 Reps, the Firms state, "The services of [Firm Z] "an introducer and strategy provider" are not regulated activities. There are no "activities under SCM's investment management permissions. [Firm Z] does not conduct any regulated activities. [Firm Z] is an introducer to SCM, [Trading name Z] is a trading name of SCM, [Firm Z] does not conduct any regulated activities, [Firm Z's] website says "[Firm Z] acts as an introducer and strategy provider to

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regulated fund managers who are authorised and regulated by the Financial Conduct Authority" but it is accepted that the names are similar and may be misleading. SCM does not provide any "regulatory legitimacy to [Firm Z's] business" as [Firm Z] does not conduct any regulated activities."

The Firms' current Appointed Representatives and Managed Funds

103. At the date of the First Supervisory Notice, as recorded on the Register, SCF's only Appointed Representatives were Ownabl Limited and SB Capital Partners and SCM's only Appointed Representatives were Crowd Investments Limited and Red Ribbon Asset Management Plc. Business Edge (NE) Limited was an Introducer to SCF. The following funds, managed by SCM, are Enterprise Investment Schemes which are in "run-off" and no regulatory action is required; Catalyst Stargate EIS Growth; Catalyst Stargate Green EIS; Concentric Team Technology EIS; and Trapezia EIS.

Supervision engagement with the Firms

104. Since the Visit, and over the course of several months thereafter, Supervision corresponded with Mr Shah and his representatives in an attempt to obtain relevant documentation to enable it to understand the Firms' business and the regulatory standards to which they operate. However this engagement with the Firms has not addressed Supervision's concerns. Attempts were then made by Supervision to agree with the Firms a voluntary requirement over their activities, but it was not possible to reach mutually acceptable terms.

105. In its 31 July 2017 Reps, the Firms state that they have, "provided substantial evidence that it acts as the investment manager for FX Perpetual". The firm lists documents that it claims have been provided:

a) Technology Services agreement between SCM and Firm Y. This was received on 3 February 2017. This agreement is dated late December 2016. The Authority was informed that it replaced an earlier agreement.

b) Service level agreement between SCM, Firm Y and Hantec Markets Ltd. In fact this document was only received as part of the 31 July 2017 Reps.

c) Service level agreement between SCM, Firm Y and VIBHS Financial Ltd. In fact this document was only received as part of the 31 July 2017 Reps.

d) SCM brochure. This was received on 6 January 2017.

e) SCM FX Perpetual managed account application form and power of attorney (blank forms). These were received as part of the 31 July 2017 Reps. However the Authority previously requested client files for 15 clients' files which were received on 1 March 2017, actual FX Perpetual managed

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account applications and power of attorney forms formed part of these client files.

f) SCM FX Perpetual monthly investment statements. As above – these were received with the 15 client files.

g) A comprehensive manual on how SCM operates the FX Perpetual algorithms via the cloud. The Authority received commentary, excel spreadsheets and a document called an " internal technical guide" on 1 March 2017, which in reality seems to be high-level internal document on how the product works and seems to be a sales pitch document, but the Authority not seen a "comprehensive manual". Attached to the 31 July 2017 Reps, is a document called "*outsourcing FG16/5- guidance for firms outsourcing to the cloud and other third party IT services*"

h) Example correspondence from SCM that has been sent to one of each of its FX Perpetual account holders at its brokers, Vibhs and Hantec. The Authority has not been provided with any direct emails with respect to these communications.

106. These documents do not affect the Authority's view that there is no evidence that the Firms were conducting any meaningful or competent, due diligence or supervision. The documents may set out something of the theory of the arrangements between the various entities but do not evidence the reality of how the arrangements actually operated in practice.

107. The Authority considers that a section 166 skilled persons report examining the Firms' activities should now be undertaken. Further, that the failings identified at the Firms justified the immediate imposition of the requirements in the First Notice, and justify the Continuing Requirements, in advance of the report being undertaken, completed and considered by the Authority.

108. In its 31 July 2017 Reps the Firms state, "The Firms do not consider that a section 166 report is viable or necessary as it is a quasi fine, During the course of the supervisory investigation the FCA has successfully stripped the Firms of all income from its regulated business activities leaving the firm in an unnecessary stressed financial state. The Firms do not see the merit in a section 166 report as there is no evidence of consumer detriment or any complaints from the Firms' clients." The Authority considers that these statements in fact underline why a s.166 Report is vital and further, why the imposition of Requirements is also necessary, as this statement betrays a fundamental lack of understanding of the many regulatory deficiencies identified.

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The Firms' response to the imposition of requirements

109. Following their receipt of the First Supervisory Notice dated 21 June 2017, by letter dated, 23 June 2017, the Firms informed the Authority that they were able to comply immediately, or by the stated deadline with requirements: A – G; I and item H with respect to the Momentum Fund. However in relation to requirement H – FX Perpetual, the Firms informed the Authority that they were not prepared to comply with the requirements.[1]

110. However by a further letter dated 29 June 2017, the Firms confirmed that they have now complied with all the First Notice requirements and that "with exceptional reluctance…the relationship with FX Perpetual will be brought to an end within the timeframe in the [First] Notice."

The current position of the Firms

111. It appears to the Authority that the Firms have, since the date of the First Notice, complied in full with certain of the requirements in that notice which consist of steps to be taken. For that reason, the Authority has decided to rescind all requirements in the First Notice other than the Continuing Requirements.

RELEVANT STATUTORY AND REGULATORY PROVISIONS

112. The statutory and regulatory provisions relevant to this Second Supervisory Notice are set out in the Annex to this notice.

REPRESENTATIONS

113. The facts and matters set out at paragraphs 9 to 111 above summarise the key representations made by the Firms, and how they have been dealt with. In making the decision which gave rise to the obligation to give this notice, the Authority has taken into account all of the representations made by the Firms, whether or not set out above.

FAILINGS

114. From the facts and matters described above it appears to the Authority that the Firms are failing to satisfy the effective supervision, appropriate resources and suitability Threshold Conditions having regard to all the circumstances. In particular:

Effective Supervision Threshold Condition

a) The Firms are failing to satisfy the effective supervision Threshold Condition because they have been unable to provide the Authority with adequate

[1] The requirements A-I are as described in the Re-issued First Supervisory Notice dated 27 June 2017

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information to enable it to determine whether the Firms are complying with the requirements and standards under the regulatory system for which the Authority is responsible and to identify and assess the impact on its statutory objectives.

b) The Firms have failed to maintain or provide adequate records regarding the extent of their due diligence and oversight of their Appointed Representatives to enable the Authority to determine whether the Firms are complying with requirements and standards under the regulatory system. In particular, whether investment management activities are genuinely being performed by the Firms, rather than by their Appointed Representatives and partner 'trading name' entities operating potentially in breach of the General Prohibition. Absence of record keeping has also hampered the Authority from assessing whether customers are being invested in products which are suitable for them and with due regard to their information needs and that information is communicated in a way that is appropriate to its customers.

c) When the First Supervisory Notice was served on the Firms, the Firms sent a letter to the Authority dated 23 August 2017, in which they "gave notice" that the Firms were refusing to comply with Requirement H (in respect of FX Perpetual) and stated that it was not possible to close down trading positions - which subsequently transpired to be incorrect as the positions were closed and Requirement H was subsequently complied with.

d) The Firms have failed to properly update the Authority's Register regarding active Directors and only recently updated their place of business, with the Register being updated on 30 October 2017.

Appropriate Resources Threshold Condition

a) The Firms are failing to satisfy the appropriate resources Threshold Condition because they appear to lack the necessary non-financial resources, specifically as Mr Shah, the sole active CF1 (Director), and the CF3 (Chief Executive), CF10 (Compliance Oversight), CF11 (Money Laundering Reporting) and CF28 (Systems and controls) at both Firms, does not demonstrate the skills, experience and competence required to properly manage the Firms' affairs.

Suitability Threshold Condition

a) The Firms are failing to satisfy the suitability Threshold Condition because they do not appear to be conducting their affairs in an appropriate manner, having regard in particular to the interests of consumers, and

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because those who manage the Firms' affairs do not appear to have adequate skills and experience, specifically: their failure to provide management information reasonably requested by Supervision to enable a proper understanding of the Firms' affairs, failure to demonstrate adequate oversight of their Appointed Representatives and 'trading name' partner entities in particular in respect of the exercise of the Firms' investment management permissions, and a failure to demonstrate sufficient understanding of the Firms' products to ensure their suitability for their customers.

b) In its 31 July 2017 Reps the Firms state, "In light of the fact that it there is no evidence of consumer detriment or upheld complaints, the Firms admit that evidence of oversight and controls leave much room for improvement, however, are bemused as to why the FCA has not offered the Firms the opportunity to submit proposals to restructure the businesses by either an equity sale to interested parties that would be able to bring the required resources into the business or the sale of the business to a new controller who would bring the required level of resources and qualified personnel to perform the range of control functions consistent with the FCA's principles of regulation." However in the same document, the Firms state, "The Firms do not accept the FCA's assertion that the Firms have breached the threshold conditions." This demonstrates the Firms' fundamental lack of understanding of its obligations under the Threshold Conditions regime.

115. The failures to satisfy the Threshold Conditions justify the imposition of the Continuing Requirements.

Consumer Protection Objective

116. The Authority's objective of consumer protection requires the Authority to ensure an appropriate degree of protection for consumers. In light of the facts and matters explained above, the requirements are also justified in furtherance of this objective. In particular

a) Clients of the Firms may not have been, and future clients may not be, provided with a level of care that is appropriate having regard to the degree of risk involved in relation to their investments with the Firms, because of (amongst other concerns): an absence of sufficient understanding by the Firms of their products to ensure their suitability for the Firms' customers and that they are managed in customers' best interests, and an absence of evidence of adequate customer suitability assessments by the Firms.

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117. In its 31 July 2017 Reps, the Firms state, "The Firms consider this statement to be perverse, SCM informed the FCA that its FX Perpetual clients (having canvassed their written wishes) wanted to remain invested, when canvassed in February 2017 over 95% of the investors wanted to remain invested by switching to an alternative manager who would provide oversight and management skills relating to the continuation of the FX Perpetual algorithms. As a result of the FSA's refusal to enable SCM to find a new manager or continue to manage FX Perpetual client funds the FCA's instruction to SCM to cease trading on the last day of June 2017 has caused consumer detriment. SCM resisted the FCA's invitations to voluntarily cease trading FX Perpetual so as to protect its customers' best interests."

118. In its 31 July 2017 Reps the Firms state, "The Firms do not accept the FCA's assertions that there was any need to step in provide "an appropriate degree of protection for consumers" the Firms position is that the FCA has put the Firms into a state of financial distress unnecessarily and do not agree that there were any risks posed to its clients that they were unaware of."

119. For the reasons set out above, the Authority has concluded that the Firms are in breach of the effective supervision, appropriate resources and suitability Threshold Conditions and that the Firms pose a risk to the Authority's operational consumer protection objective. It has concluded that it is desirable to exercise the Authority's own initiative power to keep in force the Continuing Requirements, in order to secure an appropriate degree of protection for consumers, and due to its concerns that the Firms are failing to satisfy the effective supervision, appropriate resources and suitability Threshold Conditions.

120. The Authority has decided to rescind the requirements imposed by the First Notice other than the Continuing Requirements, with effect from the date of this notice, because it is satisfied that the Firms have complied with them in full and, therefore, they serve no further purpose. The Authority believes that the Continuing Requirements are an appropriate and proportionate means to protect against the risks posed to consumers who are customers of the Firms.

PROCEDURAL MATTERS

121. The decision which gave rise to the obligation to give this Second Supervisory Notice was made by the Regulatory Decisions Committee.

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122. This Second Supervisory Notice is given to the Firms under section 55Y(7)and (8) and in accordance with section 55Y(5) and (9) of the Act.

The Tribunal

123. The Firms have the right to refer the matter to which this Second Supervisory Notice relates to the Upper Tribunal. The Tax and Chancery Chamber is the part of the Upper Tribunal which, amongst other things, hears references arising from decisions of the Authority. Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, the Firms have 28 days from the date on which this Second Supervisory Notice is given to them to refer the matter to the Upper Tribunal.

124. A reference to the Tribunal can be made by way of a signed reference notice (Form FTC3) and filed with a copy of this Second Supervisory Notice. The Tribunal's contact details are: The Upper Tribunal, Tax and Chancery Chamber, Fifth Floor, Rolls Building, Fetter Lane, London, EC4A 1NL(telephone: 020 7612 9730; email: uttc@hmcts.gsi.gov.uk).

125. For further information on the Upper Tribunal (including the power to vary time periods) you should refer to the HM Courts and Tribunal Service website which will provide guidance and the relevant form to complete. The relevant page on HM Courts and Tribunal Service website can be accessed via the following link:

http://www.justice.gov.uk/forms/hmcts/tax-and-chancery-upper-tribunal

126. A copy of Form FTC3 must also be sent to the Authority at the same time as filing a reference with the Upper Tribunal. A copy of the reference notice should be sent to Kathryn Baildon-Smith at the Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Publicity

127. The Firms should note that section 391 of the Act requires the Authority, when the Second Supervisory Notice takes effect (and this Second Supervisory Notice takes immediate effect), to publish such information about the matter as it considers appropriate.

128. For more information concerning this matter generally, the Firm should contact Russell Moore at the Authority (direct line: 020 7006 4618).

Bob Ferguson

Chair of the Regulatory Transactions Committee

ANNEX

RELEVANT STATUTORY PROVISIONS

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1. The Authority's operational objectives established in section 1(B) of the Act include the consumer protection objective. Section 1C(1) of the Act states that the consumer protection objective is: securing an appropriate degree of protection for consumers.

2. Pursuant to section 55L of the Act, where a person has applied for a Part 4A permission or the variation of a Part 4A permission, the Authority may impose on that person such requirements, taking effect on or after the giving or variation of the permission, as the Authority considers appropriate.

3. Pursuant to and in accordance with sections 55L(2) and 55L(3) of the Act the Authority may impose a new requirement, or vary a requirement imposed under section 55L(3), in relation to an authorised person with a Part 4A permission ("A") if it appears to the Authority that – (a) A is failing, or is likely to fail, to satisfy the threshold conditions for which the Authority is responsible, […] or (c) it is desirable to exercise the power in order to advance one or more of the Authority's operational objectives.

4. Pursuant to section 55L(2)(c) the Authority may impose a new requirement in relation to an authorised person with a Part 4A permission under section 55L(3)(a), *inter alia*, if it appears to the Authority that it is "desirable" to exercise the power in order to advance one or more of the Authority's operational objectives. While this section makes clear that desirability is a matter for the Authority to determine, such a determination must be reached on reasonable grounds.

5. The Authority's operational objectives are set out at section 1B(3) and include the consumer protection objective and the integrity objective and the competition objective. Section 1B(4) states that the Authority must, so far as is compatible with acting in a way which advances the consumer protection objective or the integrity objective, discharge its general functions in a way which promotes effective competition in the interests of consumers.

6. The material operational objective on the facts of this case is the consumer protection objective.

7. Section 1C(1) defines the consumer protection objective as "securing an appropriate degree of protection for consumers" and section 1C(2) lists the criteria to which the Authority must have regard in considering what degree of protection for consumers may be appropriate.

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8. The effective supervision Threshold Condition provides that a person carrying on or seeking to carry on regulated activities which do not consist of or include a PRA-regulated activity, must be capable of being effectively supervised by the Authority. Those circumstances include, amongst other factors, the nature of the regulated activities that the firm carries on (2C(1)(a)) and the complexity of any products that the firm provides (2C(1)(b)). In this context the Committee is referred to COND 2.3.3G(1) (see the Annex to the Draft Notice at paragraph 16) which identifies the provision of adequate information to enable a determination of the firm is complying with requirements and standards under the regulatory system.

9. The appropriate resources Threshold Condition provides, in relation to a person ("A") carrying on or seeking to carry on regulated activities which do not consist of or include a PRA-regulated activity, that:

> "The resources of A must be appropriate in relation to the regulated activities that A carries on or seeks to carry on."

10. The matters which are relevant in determining whether A has appropriate non-financial resources include –

> (a) The skills and experience of those who manage A's affairs; […]

11. Appropriate resources: paragraph 2D(1) states that the resources of the firm must be appropriate in relation to the regulated activities that it carries on or seeks to carry on. Paragraph 2D(4) states that the matters which are relevant in determining whether a firm has appropriate non-financial resources include- (a) the skills and experience of those who manage the firm's affairs; […].

12. The suitability Threshold Condition provides, in relation to a person ("A") carrying on or seeking to carry on regulated activities which do not consist of or include a PRA-regulated activity, that:

> "A must be a fit and proper person having regard to all the circumstances including- […]
>
> (c) the need to ensure that A's affairs are conducted in an appropriate manner having regard in particular to the interests of consumers and the integrity of the UK financial system;
>
> (d) whether A has complied and is complying with requirements imposed by the [Authority] in the exercise of its functions, or requests made by the [Authority], relating to the provision of information to the [Authority] and, where A has so complied or is so complying, the

manner of that compliance;

(e) whether those who manage A's affairs have adequate skills and experience and have acted and may be expected to act with probity;

(f) whether A's business is being, or is to be, managed in such a way as to ensure that its affairs will be conducted in a sound and prudent manner" […]

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13. Section 55N(1) of the Act states that a requirement may be imposed to require the person concerned to take, or refrain from taking, specified action.

RELEVANT REGULATORY PROVISIONS

14. The Authority's policy in relation to its enforcement powers is set out in the Enforcement Guide (EG), certain provisions of which are summarised below.

15. EG 8.1.1 reflects the provisions of section 55L of the Act that the Authority may impose requirements on an authorised person where: (1) the person is failing or is likely to fail to satisfy the threshold conditions for which the Authority is responsible; […] or (3) it is desirable to exercise the power in order to advance one or more of its operational objectives.

16. EG 8.2.1 states that when the Authority considers how it should deal with a concern about a firm, the Authority will have regard to its statutory objectives and the range of regulatory tools that are available to it. It will also have regard to: (1) 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 (2) the principle that a restriction imposed on a firm should be proportionate to the objectives the Authority is seeking to achieve.

17. EG 8.2.3 states that in the course of its supervision and monitoring of a firm or as part of an enforcement action, the Authority may make it clear that it expects the firm to take certain steps to meet regulatory requirements. In the vast majority of cases the Authority will seek to agree with a firm those steps the firm must take to address the Authority's concerns. However, where the Authority considers it appropriate to do so, it will exercise its formal powers under section […] 55L of the Act […] to impose a requirement to ensure such requirements are met. This may include where: (1) the Authority has serious concerns about a firm, or about the way its business is being or has been conducted; […].

18. EG 8.3.1 states that the Authority may impose […] a requirement so that it takes effect immediately or on a specified date if it reasonably considers it necessary for the […] requirement to take effect immediately (or on the date specified), having

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regard to the ground on which it is exercising its own-initiative powers.

19. EG 8.3.2 states that the Authority 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.

20. EG 8.3.3 states that it is not possible to provide an exhaustive list of the situations that will give rise to such serious concerns, but they are likely to include one or more of four listed characteristics, these include:

> information indicating significant loss, risk of loss or other adverse effects for consumers, where action is necessary to protect their interests; and
>
> 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.

21. EG 8.3.4 states that the Authority will consider the full circumstances of each case when it decides whether an imposition of a requirement is appropriate and sets out a non-exhaustive list of factors the Authority may consider, these include:

> (1) The extent of any loss, or risk of loss, or other adverse effect on consumers. The more serious the loss or potential loss or other adverse effect, the more likely it is that the Authority's urgent exercise of own-initiative powers will be appropriate, to protect the consumers' interests.
>
> (4) The seriousness of any suspected breach of the requirements of the legislation or the rules and the steps that need to be taken to correct that breach.
>
> (8) The firm's conduct. The Authority will take into account: (a) whether the firm identified the issue (and if so whether this was by chance or as a result of the firm's normal controls and monitoring); (b) whether the firm brought the issue promptly to the Authority's attention; (c) the firm's past history, management ethos and compliance culture; (d) steps that the firm has taken or is taking to address the issue.

22. EG 8.4.3 states that under its section 55L power […], the Authority may, at any time and of its own initiative, impose on an authorised person such requirements as it considers appropriate.

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23. Potentially counter-balancing factors set out at EG 8.3.4(9) include the impact that use of the Authority's own-initiative powers will have on the firm's business and on its customers. The Authority 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 variation on the firm's reputation and on market confidence. The Authority 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 statutory objectives.

Guidance concerning the relevant Threshold Conditions

24. COND 2.3.3G sets out factors which the Authority will take into consideration, amongst other things, in assessing the effective supervision Threshold Condition.

25. COND 2.3.3G(1) states that these include whether it is likely that the Authority will receive adequate information from the firm, and those persons with whom the firm has close links, to enable it to determine whether the firm is complying with the requirements and standards under the regulatory system for which the Authority is responsible and to identify and assess the impact on its statutory objectives; this will include consideration of whether the firm is ready, willing and organised to comply with Principle 11 (Relations with regulators and the rules in SUP on the provision of information to the Authority.

26. COND 2.4.1A reflects the provisions of the appropriate resources Threshold Condition set out in paragraph 2D of Schedule 6 to the Act.

27. COND 2.4.2G(2A) states that paragraph 1A(2) of Schedule 6 to the Act provides that "non-financial resources" of a firm for the purposes of the threshold conditions include any systems, controls, plans or policies that the firm maintains and the human resources that the firm has available.

28. COND 2.5.1A reflects the provisions of the suitability Threshold Condition set out in paragraph 2E to Schedule 6 of the Act.

29. COND 2.5.4G(2) sets out examples of the kind of general considerations to which the Authority may have regard when assessing whether a firm will satisfy, and continue to satisfy, the suitability Threshold Condition. These include whether the firm: (a) conducts, or will conduct, its business with integrity and in compliance with proper standards; (b) has, or will have, a competent and prudent management; and (c) can demonstrate that it conducts, or will conduct, its affairs with the exercise of due skill, care and diligence.

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Guidance concerning Appointed Representatives

30. Chapter 12 of SUP (SUP 12) applies to a firm which is considering appointing, has decided to appoint or has appointed an appointed representative. SUP 12.1.2G states that SUP 12 gives guidance to a firm, which is considering appointing an appointed representative, on how the provisions of section 39 of the Act (Exemption of appointed representatives) work. For example, it gives guidance on the conditions that must be satisfied for a person to be appointed as an appointed representative. It also gives guidance to a firm on the implications, for the firm itself, of appointing an appointed representative.

31. SUP 12.2.1G states that: (1) Under section 19 of the Act (The general prohibition), no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is an authorised person, or he is an exempt person in relation to that activity. (2) A person will be an exempt person if he satisfies the conditions in section 39(1) of the Act, guidance on which is given in SUP 12.2.2 G. A person who is exempt as a result of satisfying these conditions is referred to in the Act as an appointed representative.

32. SUP 12.2.2G states that: (1) A person (other than a firm with only a limited permission) must satisfy the conditions in section 39(1) of the Act to become an appointed representative. These are that: (a) the person must not be an authorised person, that is, he must not have permission under the Act to carry on any regulated activity in his own right (section 39(1) of the Act); (b) the person must have entered into a contract with an authorised person, referred to in the Act as the 'principal', which: (i) permits or requires him to carry on business of a description prescribed in the Appointed Representatives Regulations (section 39(1)(a)(i) of the Act) (see SUP 12.2.7 G); and (ii) complies with any requirements that may be prescribed in the Appointed Representatives Regulations (section 39(1)(a)(ii) of the Act) (see SUP 12.5.2 G (1)); and (c) the principal must have accepted responsibility, in writing, for the authorised activities of the person in carrying on the whole, or part, of the business specified in the contract.

Guidance on activities which are regulated under the Act

33. PERG 8.30.1G states that with the exception of periodicals, broadcasts and other news or information services, the medium used to give advice should make no difference to whether or not it is caught by article 53(1) of the Financial Services and Markets Act (Regulated Activities Order) 2001 (SI 2001/544) ("Article 53(1)") ("Advising on investments").

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34. PERG 8.30.3G states that taking electronic commerce as an example, the use of electronic decision trees does not present any novel problems. The provider of the service will be giving advice for the purpose of Article 53(1) only if the service results in something more than a generic recommendation, as with a paper version.

35. PERG 8.30.2G states that advice can be provided in many ways including [amongst other methods listed]: "… (6) through the provision of an interactive software system".

36. PERG 8.30.5G states that:

> "Some software services involve the generation of specific buy, sell or hold signals relating to particular investments. These signals are liable, as a general rule, to be advice for the purposes of article 53(1) (as well as financial promotions) given by the person responsible for the provision of the software. The exception to this is where the user of the software is required to use enough control over the setting of parameters and inputting of information for the signals to be regarded as having been generated by him rather than by the software itself.