Complaints Commissioner

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Final report by the Complaints Commissioner

Complaint number FCA001533

The complaint

1. On 9 December 2021 you asked me to investigate a complaint about the FCA.

What the complaint is about

2. The FCA summarised your complaint as follows:

Part One

You made two investments into fixed rate property bonds with Firm W (an unregulated firm) via Firm X, a previously authorised firm. Firm X's authorisation ceased on 4 November 2018. You say that you invested £5,000 on 17 June 2017 and £10,000 on 10 September 2019, with an expectation for the bonds to pay interest at 10% every quarter. You say that you received some interest payments on the first investment totalling £1,000 net. Your view is that Firm X is responsible for the return of your £5,000 investment, however, Firm X has refused liability and so have the Trustees of W.

As such, you would like the FCA to compensate you for the loss of your investment because Firm X was an authorised firm at the time of your first investment.

Part Two

Firm X was not authorised at the time of your second investment, but the firm continued to provide you with financial promotional materials for W which indicated that Firm X was still authorised by the FCA. Your view is that the FCA should have ensured that Firm X remove all misleading financial materials in circulation and that W printed new financial promotions material removing Firm X's previously authorised status

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because Firm X was no longer authorised. You allege that the FCA's failure to do this exposed investors to financial harm. You say that the FCA failed to resolve this exposure through, "regulation, controls, and associated audits".

To resolve this allegation, you have requested compensation for your second investment.

You believe that the FCA did not carry out 'enough' due diligence on Firm X and has failed in its duty of care towards you.

What the regulator decided

3. The FCA did not uphold your complaint.

Why you are unhappy with the regulator's decision

4. You have said to me that 'I placed a lot of reliance on the "regulated" status of Firm X and its FCA logo and its recommendations of an investment as suitable and with security such as was being shown. The logo gave the assurance the FCA knew what the firm was doing and the implications of that on retail investors. That the FCA had carried out due diligence on Firm X, Firm W and X Group (the Trustees), as all are offering some financial service, regulated or not some research, knowledge sharing, or whatever to ensure the products were being marketed ethically, morally and legally and if regulated were within their rules, and even if not, people like me were safe to invest in the products and services of a UK market.' (Element One)

5. You feel the FCA should not have allowed Firm X to cancel its permissions before it had made sure W had withdrawn the Firm X approved financial promotion and/or it should have carried out checks itself to ensure this had happened. (Element Two)

6. You say 'The former director of W was a convicted felon. It is now well known in the creditor circles, police action fraud etc and for the FCA to not carry out some DD on the directors of a firm being promoted by a firm they have granted regulation too, or to check they have done it themselves implies the FCA care little what the regulated firm do, so long as they pay their dues to the FCA'. (Element Three)

My analysis

Element One

7. The background to this case is that you invested £5,000 on 17 June 2017 and £10,000 on 10 September 2019 in Firm W. The firm (according to information on the Gazette) went into administration in May 2020 and liquidators were appointed on 11 May 2021. Firm W has never been authorised/regulated by the FCA. Firm W was a UK based property developer incorporated in 2015.

8. When you first invested in 2017, you say relied on firm W financial promotions which were approved by Firm X in their role of a regulated firm providing s.21 FSMA approval.

9. In 2018, Firm X cancelled its permissions and ceased to be authorised by the FCA. You were not aware at the time this had happened.

10. You made a further investment in firm W in 2019. You did so directly with the firm and you say that the firm W was still using promotional material approved by Firm X. You say this gave you confidence to invest again in firm W.

11. You subsequently lost all your investments with Firm W.

12. You say that you ‘placed a lot of reliance on the "regulated" status of Firm X and its FCA logo and its recommendations of an investment as suitable and with security such as was being shown. The logo gave the assurance the FCA knew what the firm was doing and the implications of that on retail investors’.

13. Firm X approved the financial promotion (i.e. the information memorandum) of Firm W. You inferred from this that Firm X was effectively making a recommendation to the suitability and possibly low risk of the investment, and this gave you sufficient comfort to proceed with the investment.

14. However, I consider there were sufficient warnings to alert you to the fact that this was an unregulated investment, aimed at ‘sophisticated investors’ including the fact that the literature from Firm W stated that they were neither authorised nor regulated by the FCA, and that despite the approval of the information memorandum by Firm X, nothing in the document constituted investment, legal, accounting or tax advice. It is not the case, as you allege, that Firm X were recommending the investment as suitable to you via their approval of the

information memorandum, and there were sufficient warnings in place to make you alert as to the risk involved in the type of investment you were making.

15. Although I do not consider that Firm X's approval of W's financial promotion constitutes a recommendation or advice to invest in firm W's products; and although there were sufficient warnings in place to alert investors to this, it may be helpful if firms who provide s.21 FSMA approval were required to also provide clarification of what this approval actually means in practice. I invited the FCA to provide comments on this before I finalise my report, specifically what type of due diligence or checks are provided by firms providing s21 FSMA approval and if this could also be disclosed specifically in the approval process to prospective investors in order to avoid a possible 'halo' effect in this regard.

16. The FCA has responded that 's21 of FSMA does not set out the level or type of due diligence that a regulated firm needs to carry out prior to the approval of a financial promotion from an unregulated firm (into either the firm or the proposed investment). However, firms approving financial promotions are required under FCA rules to ensure that they comply with our financial promotion rules (COBS 4.10.2 R (1)). This includes ensuring that the financial promotions are be fair, clear and not misleading (COBS 4.2.1 R).

17. Although the approval of a financial promotion is allowed under s21 of FSMA, a regulated firm is still required to apply the rules in the FCA Handbook 2 as follows:

18. The financial promotion complies with our financial promotion rules (COBS 4.10.2 R (1)). This is also true of firms which approve their own financial promotions for communication by unauthorised persons (see PERG 8.9.3 G). All financial promotions must be fair, clear and not misleading (COBS 4.2.1 R).

19. If the product is advertised as being eligible for a particular tax treatment, does the product actually meet the requirements for this treatment? (For tax treatment, see also COBS 4.5.7 R; COBS 4.5A.8) COBS 4.2.5 G states that 'a financial promotion should not describe a feature of a product or service as 'guaranteed', 'protected' or 'secure', or use a similar term

20. A financial promotion for a product provider should not suggest or imply that the product provider's activities (e.g., issuing bonds) are regulated if they are not (COBS 4.2.4 G (4)).

21. A firm approving a financial promotion must confirm that the promotion complies with all applicable financial promotion rules (COBS 4.10.2 R (1)). In particular, a financial promotion that is likely to be received by a retail client must give a fair and prominent indication of relevant risks when referencing potential benefits (COBS 4.5.2 R (2); COBS 4.5A.3 UK).

22. Where a financial promotion contains certain types of comparison, the firm approving the promotion must ensure that such comparisons are meaningful and presented in a fair and balanced way (COBS 4.5.6 R); COBS 4.5A.7 UK)'.From the FCA's response I consider that most firms providing s.21 FSMA approval do not check the viability of the underlying product and focus primarily on ensuring the language used to market the product complies with legislation. I do not think this is something most investors would ordinarily know. The FCA published a consultation CP22/2: Strengthening our financial promotion rules for high risk investments, including crypto assets (fca.org.uk) which closed on 22 March 2022. In June 2021, the Treasury confirmed the Government intends to legislate to introduce a new regulatory gateway for firms approving promotions for unauthorised persons (s21 gateway) when parliamentary time allows. The paper explains in detail how this will look like and it seems that there are planned improvements which ultimately benefit investors.

23. Whilst I think this is a positive step forward, I am concerned that there is no timescale specified for the change in legislation , and in the meantime a substantial proportion of investors may continue to rely inadvertently on regulated firms providing s.21 FSMA as a form of endorsement. Whilst this would not be the fault of the FCA, in my view a good regulator should seek to ensure clarity and transparency for investors especially when it is alerted that a potential misconception by investors exist, as is the case here. I recommend the FCA determines an appropriate action to address this issue and report back to me in one months' time.

24. However, it is also the case that the FCA does not regulate unregulated products or firms. Therefore, there is no expectation that it should be required to monitor Firm W or its trustees in the way that you refer.

Element Two

25. You feel that the FCA should have required firm X to ensure W was not using its promotional material before it cancelled its permissions, or alternatively, the FCA should have checked this.

26. The FCA's response to you on this element of your complaint is 'At the time you made the investment in September 2019, the involvement of firm X had ceased. Once firm X had withdrawn their approval of the financial promotions from W, it was the responsibility of W to update their promotions accordingly. W were not a regulated firm and firm X were not involved at the time of the investment. Whilst it is unfortunate that you invested a second time, I have not upheld this part of your complaint.

27. Firm X had written to W to withdraw its approval and notified this to the FCA prior to cancelling its permissions. Neither the firm, nor the FCA, checked to see whether W had complied with Firm's X request that it withdraw its promotional material approved by Firm X. You say Firm W continued to use it almost a year after it was requested not to. As the FCA does not regulate firm W, it is not incumbent on it to provide these checks. In general, if an unauthorised firm is falsely claiming to have had its financial promotions approved or the firm that approved them was not authorised at the time of the approval then the promotions would be in breach of section 21 FSMA, and the FCA could potentially refer for investigation (and prosecution). The issue here seems to be that the FCA would have to be alerted in some way that such a breach was occurring (which did not happen in this case), rather than proactively monitoring unauthorised firms for such breaches, as it is not required to regulate unregulated products or firms.

Element Three

28. You are making the case that Firm X and the FCA ought to have known that the director of unauthorised firm W had been convicted for financial crime in 2008 under a different name. Your complaint to the FCA was that it had not

undertaken due diligence in overseeing firm X, because Firm x approved financial promotions for what later transpired was a firm run by a director with a criminal conviction. The FCA responded that the director was 'convicted in 2008 which is sometime after the authorisation of the firm and the start of the regulation of firm X by the FSA. Therefore, I do not believe that any connection of firm X to the director prior to 2008 would have been any cause of concern'. I do not find the FCA's response unreasonable.

Amerdeep Somal
Complaints Commissioner
31 March 2022