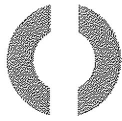 Complaints Commissioner

Office of the Complaints Commissioner
8th Floor, City Tower
40 Basinghall Street
London EC2V 5DE

Tel: 020 7562 5530
Fax: 020 7562 5549
E-mail: complaintscommissioner@fscc.gov.uk
www.fscc.gov.uk

30 June 2011

Dear Complainant,

Complaint against the Financial Services Authority (FSA)
Reference Number: GE-L01038

I write with reference to your correspondence with my office in relation to your further complaint against the Financial Services Authority (FSA). I note that you have made no response to my Preliminary Decision. This now represents my Final Decision.

At this stage, I think it would be worth explaining my role and powers. I am charged, under Paragraph 7 of Schedule 1 of the Financial Services and Markets Act 2000 (the Act), with the task of investigating those complaints made about the way the FSA has itself carried out its own investigation of a complaint that falls within the complaints scheme. The investigations I undertake are conducted under the rules of the Complaints Scheme (Complaints against the FSA - known as COAF). I have no power to enforce any decision or action upon the FSA. My power is limited to setting out my position on a complaint based on its merits and then, if I deem it necessary, I can make recommendations to the FSA. Such recommendations are not binding on the FSA and the FSA is at liberty not to accept them. It rarely declines to do so however. Full details of Complaint Scheme can be found on the internet at the following website; http://fsahandbook.info/FSA/html/handbook/COAF.

(i) Your Complaint

1. In essence you are unhappy with the actions or inactions of the FSA in relation to its Enforcement investigation into Firm A, Mr X and Firm B.

2. Following the issue of an Interdict and Arrestment Order (the Interdict) on 2 September 2008, you allege that the FSA failed to take the appropriate action to ensure that *open* (my emphasis) positions Firm A held with FX Firm. (a US Foreign Exchange (FX) Trading FX Platform) were closed. You allege that the FSA's failure to do this led to the position becoming subject to adverse market movements which culminated in those who had made loans to Firm A incurring a loss of around $17 Million. You feel that, as this loss was caused by the FSA's failure to close the position on 2 September 2008 (when the Interdict was issued) you are looking for the FSA to reimburse those affected accordingly.

You first complained to the FSA in September 2008. At that point the FSA informed you that it was not able to investigate your complaint as it was engaged in Enforcement proceedings surrounding, among others, the cause of your complaint. The FSA relied on 1.4.4. of COAF and stated that it was deferring its investigation of your complaint.

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On 18 May 2010 you wrote to the FSA, by email, stating that you wanted your complaint handled by it now that the Enforcement matters had been concluded. Your complaint was expressed in the following way and I quote, by way of extract, from that letter:

> "My complaint still stands as to why the FSA allowed a deficit of £ *(sic)* 17million to be lost whilst they had total control over Firm A as at the 2nd of September? Now I for one want my money back and the FSA are *(sic)* to be held responsible."
>
> You also referred to the original complaint you made to the FSA on 30 June 2009 which stated:
>
> "I was sadly an investor of Firm A and the FSA had an injunction against the company on the 2nd sept 2008. I would like to highlight point 10.6 and 10.7 from the [Provisional Liquidators Report] report that Mr X continued trading even after the injunction was in place and lost a staggering 17,148,960. Now how the hell did you allow him to do this after which the injunction was in place and surely you should have authority to contact FX Firm and cancel all trades??? *(sic)*
>
> I personally will be holding the FSA and Mr X responsible for the loss of my funds, I demand an explanation and otherwise will be seeking legal advise *(sic)*.
>
> I will also be making this information public to the media should I not receive an appropriate answer along with my funds, at which stage the FSA can then answer to the media".

(ii) Compensation limitations

When considering your complaint I should also at this point make reference to the fact that my powers derived as they are, from statute contain certain limitations in the important area of financial compensation. I raise this issue at this stage as plainly the matter of compensation lies at the heart of your complaint. The Act stipulates in Schedule 1 that the FSA is exempt from "liability in damages". It states:

"(1) Neither the Authority nor any person who is, or is acting as, a member , officer or member of staff of the Authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the Authority's functions.

(2) (Irrelevant to this issue under investigation)

(3) Neither subparagraph (1) nor subparagraph (2) applies

(a) if the act or omission is shown to have been in bad faith; or

(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the [1998 c.42] Human Rights Act 1998."

COAF nevertheless then goes on to provide in paragraph 1.5.5 that:

> *"Remedying a well founded complaint may include offering the complainant an apology, taking steps to rectify an error or, if appropriate, the offer of a compensatory payment on an ex-gratia basis. If the FSA decides not to uphold a complaint, it will give its reasons for doing so to the complainant, and will inform the complainant of his right to ask the Complaints Commissioner to review the FSA's decision."*

If I find your complaint justified, it is to that paragraph that I must refer in order to decide any question of a "compensatory payment on an *ex-gratia* basis.

If you were to take the view that Schedule One referred to above was relevant in the context of the Human Rights Act 1998 (HRA) I should explain that Section 6(1) of the HRA that is referred to, provides as follows:

> *"It is unlawful for a public authority to act in a way which is incompatible with a Convention right".*

The only Convention rights that I consider may be relevant are contained in Article 1 of the First Protocol set out in the HRA.

Article 1 of the First Protocol provides:

> *"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*
>
> *The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties".*

(iii) Foreign Exchange Dealings

It is necessary for me at this stage to make a few brief remarks about margin FX dealings generally. It is not an activity that should ever be undertaken by the inexperienced. It is an exceptionally risky business requiring great skill, experience and understanding of how the markets work. The market is extremely volatile and even the smallest of movements can leave any trader with crippling losses. The odds are not in favour of the newcomer – in short it is not an activity for the faint-hearted or the untrained. Some have described that because margins are lower on a margin FX dealing that the high gearing makes the whole enterprise from a lay person's perspective like a casino.

All this is made so by the ability, as is the norm, to trade on a margin basis. With margin FX trading, the 'investor' only needs to place a limited amount of capital with the platform. The capital which the investor places with the platform only needs to meet the platform's initial margin requirement (often around 0.5% of the trades placed). The effect on the investor is that there can be considerable gains for, for example, a 0.5% stake but correspondingly, as happened in this case, an enormous loss can equally and quickly be the result.

If the investor includes a "stop loss" with the investment the investor is provided with an element of protection, albeit to a limited level, should the FX trade go against him. By setting a stop loss, the maximum loss which can be incurred is fixed and should losses reach the set level the position is closed out. As such, if a stop loss of 5% is selected, if the FX trade goes against the investor, the maximum loss is fixed, subject to slippage (or the reasonable time it takes to close the positions), at 5% of the initial margin requirement (or capital used in relation to the trades). This therefore offers a significant level of protection especially for the inexperienced investor.

A recent commentator said this in the context of margin FX dealing:

> *"It is not an area for the beginner. You need to have proper training and be able to look at and interpret charts.*
>
> *Many forex traders use charts to try to spot trends. If you don't want to rely on technical analysis you need to have a good grasp of global economics. Expectations of changes in interest rates, gross domestic product growth and other macroeconomic conditions move exchange rates. You need to understand how and why."*

In summary to understand fully this complaint it is necessary to appreciate that margin FX dealings encompass the capacity to incur enormous losses almost instantaneously and that the uninitiated or untrained can rarely avoid losing substantial sums of money as there is a poor control of such losses due to the lower margins. Such losses can happen extremely quickly.

I did not at any point in my investigation come to the view that Mr X, Firm A or Firm B came within this category of experience, understanding and knowledge at any stage of their operations. Indeed they were, not surprisingly as events showed, therefore singularly unsuccessful.

(iv) Chronology

I note that the FSA, in its decision letter, has provided some background to its dealings with Mr X, Firm A and Firm B's application to become authorised. However, by truncating the detailed chronology of events as the FSA's Stage 1 decision letter of the 8th November does, a less than full background picture is provided. I take the view that that is unfortunate in all the circumstances of this unhappy matter because I consider in the light of what I say later that the detail of the chronology is important in order to understand the precise background to what happened and the FSA's actions. The full chronology of events appear to me to be as follows:

7 June 2005 -	The FSA wrote to Firm A seeking information concerning Firm A's activities having noted that their website appeared to offer foreign exchange trading services.
13 June 2005 –	Mr X informed the FSA that Firm A had not acted in breach of any financial services legislation.
20 June 2005 –	Mr X informed the FSA that Firm A had engaged compliance consultants to advise on the FSA authorisation process and that Firm A had recently become an appointed representative of Network C.
5 October 2005 –	The FSA sought evidence of Firm A's appointment with Consultant C.
14 October 2005 –	Firm A informed the FSA that they had completed an application to be an appointed representative of Network C.
19 December 2005 -	Firm A contacted the FSA and informed it that Firm A was now an appointed representative of Network C. The FSA requested details of the steps taken in order for Firm A to become appointed.

20 December 2005 -	Firm A stated that in fact it had only submitted an application form to Network C.
April 2006 –	The FSA made enquiries with Network C and learnt that Firm A had been refused authorisation on two separate occasions in the preceding 12 months.
4 September 2006 –	The FSA wrote to Firm A seeking confirmation that Firm A was not engaging in regulated activities.
11 October 2006 –	Firm A wrote to the FSA enclosing copies of introducer agreements it had in place with Mortgage Company J and Mortgage Company K.
16 October 2006 –	The FSA informed Firm A that it was closing its file on the basis that Firm A was simply acting as an introducer.
February 2007 –	An investor (since 2006) with Firm A makes contact with the FSA because that investor felt the returns he was getting were "too good to be true" and the investor had concerns.
4 May 2007 –	The FSA visited Firm A's Edinburgh offices unannounced.
10 May 2007 –	Mr X attended a meeting at the FSA's offices. During the course of the meeting he was asked to produce certain documents. (My investigation obtained the detailed notes of that meeting which are relevant as to the state of knowledge of the FSA at the conclusion of that meeting).
16 and 23 May 2007 –	Mr X contacted the FSA indicating that the FSA would receive the requested information soon.
29 May 2007 –	Mr X sent the FSA a draft proposal.
11 June 2007 –	The FSA asked Mr X for further information regarding the draft proposal.
26 June 2007 –	The FSA contacted Mr X to find out when he would be in a position to provide the information requested on 11 June 2007.
12 October 2007 –	The FSA received an application for Part IV Permission for Firm B. However the FSA did not receive a personal application for Mr X to carry out a controlled function.
14 January 2008	You 'invest' £10,000 with Firm A
21 January 2008 –	The FSA wrote to Firm A raising concerns about Mr X's ability to manage an FSA authorised business.
23 January 2008 –	Mr X posted a message on Firm A's website stating that the FSA had completed its initial assessment of the application and that he was in the process of organising a time to visit the FSA offices as part of stage two of the exercise.
11 Feb, 17 March 2008 –	The FSA left messages for Mr X asking for a response to its letter of 21 January 2008.
12 February 2008 -	You 'invest a further £2,000

23 February 2008 -	You 'invest a further £3,000
25 February 2008 -	You 'invest a further £2,000.
7 April 2008 -	You 'invest a further £3,000
18 April 2008 –	The FSA wrote to Firm A, again to ask for a response to its letter dated 21 January 2008.
29 April 2008 (dated 6 March 2008)	The FSA received a letter from Firm A addressing the issues raised in its letter of 21 January 2008.
1 May 2008 -	You 'invest a further £1,000.
13 May 2008 -	You 'invest a further £3,000.
29 May 2008 -	You 'invest a further £1,000.
29 May 2008 –	A meeting took place between the FSA, Mr X and Compliance Consultant F (the compliance company assisting Firm B with the application).
2 June 2008 –	The FSA emailed Mr X to confirm action points from the 29 May meeting.
24 June 2008 –	Mr X contacted the FSA and informed it that he was withdrawing Firm B's application.
4 July 2008 –	The FSA acknowledged Mr X's request to withdraw the application and noted the intention to re-apply for authorisation in the future.
28 July 2008 –	The FSA appointed investigators to conduct an investigation into Firm A and Mr X.
1 August 2008 –	The FSA wrote to the Bank D listing information.
4, 6 and 12 August 2008 -	Bank D produced the requested information.
22 August 2008 –	The FSA interviewed a client of Firm A.
1 September 2008 –	The FSA obtained two search warrants in Scotland for the offices of Firm A and the residential address of Mr X.
2 September 2008 –	The FSA obtained an Interdict and Arrestment (a freezing and restraint) Order in Scotland (the Interdict). This froze the assets in two of Firm A's known UK bank accounts and restrained Mr X and Firm A from carrying out the regulated activity of accepting deposits in the Capital Injection Scheme without the requisite FSA authorisation. The FSA also wrote to Webhost L, the webhost for Firm A's website requiring it to preserve information relating to Firm A.
5 September 2008 –	The FSA wrote to IT Services Provider M the firm that held the recordings of calls made from Firm A's offices. The FSA also wrote to IT Services Provider N the company responsible for maintaining a backup of Firm A's computer systems.
5 September 2008 –	The FSA received a copy of an email which was sent by Mr X to his clients.

8 September 2008 –	The FSA faxed a statement to Firm A and asked that Firm A email it to all clients and post it on Firm A's website.
9 September 2008 –	The FSA called Mr X.
9 September 2008 –	Mr X sent an email to the FSA containing copies of previous correspondence with the FSA. Also Mr X carried out the corrective action required by the FSA in its fax of 8 September 2008.
18 September 2008	The FSA wrote to Bank D asking for further documents regarding Firm A.
18 September 2008 –	The FSA spoke with a customer of Firm A who called the Customer Contact Centre (CCC) and Independent Complaints Scheme.
23, 25 and 26 September - and 9 October 2008	The FSA contacted a number of Firm A clients in order to gather information regarding their investments.
24 September 2008 –	Bank D provided the material requested on 18 September 2008. The FSA also wrote to the IT Services Provider N to request further details.
26 September 2008 –	Firm A produced a spreadsheet containing a list of clients and account balances.
29 September 2008 –	A customer of Firm A informed the FSA that information had been received by emails through the Firm A website stating that there were funds in the US and they were safe.
30 September 2008 –	The FSA received a further email from a customer of Firm A attaching a further communication sent through the Firm A website.
2 October 2008 –	The figures supplied by Firm A on 26 September 2008 seemed inaccurate and so the FSA requested revised figures.
2 October 2008 –	The FSA received a further email from a customer of Firm A attaching a further communication sent through the Firm A website.
2 October 2008 –	The FSA attended the residence of a Firm A client in order to obtain a witness statement. However, the client decided that it was no longer in his best interests to give the statement.
2 October 2008 -	The FSA received an email from a Firm A client stating that that client was now unable to attend a meeting on 3 October to give a witness statement.
3 October 2008 –	A further spreadsheet of clients and account balances was provided.
3 October 2008 –	FSA wrote to IT Services Provider O to request copies of Mr X's emails sent and received from the Firm A email address.
6 October 2008 –	A further request was made by the FSA to Bank D for information.

6 October 2008 –	Mr X spoke with Accountant P about the Interdict.
8 October 2008 –	The FSA wrote to Network C requesting information.
9 October 2008 –	Bank D provided the information requested on 6 October 2008.
9 October 2008 –	The FSA took a witness statement from a Firm A client.
9 October 2008 –	FSA received a letter from Firm A through its solicitors stating that they had been advised to appoint administrators on the grounds of its insolvency.
14 October 2008 –	The FSA sent an email to IT Provider E requesting information regarding Firm A. IT Provider E responded on the same day.
16 October 2008 –	The FSA received an email from the US Commodity Futures Trading Commission (CFTC) containing information from FX Firm.
17 October 2008 –	The FSA received a further email from a customer of Firm A attaching a communication from Mr X.
21 October 2008 –	Administrator G was appointed as provisional liquidators.
22 October 2008 –	The FSA acting through its solicitors wrote to Firm A's solicitors requesting details on the investments made through Firm A.
23 October 2008 –	A public statement about Firm A was placed on the then FSA Consumer Website, Moneymadeclear. At the same time the FSA emailed customers of Firm A.
30 October 2008 –	The FSA met with a Firm A client to take a witness statement.
19 December 2008 –	Provisional Liquidators' Report from Administrator G was provided to customers of Firm A.
5 June 2009 –	An order was obtained in the High Court which appointed Administrator G as administrators and liquidators of Firm A.
8 June 2009 –	The FSA wrote to customers of Firm A to advise them of the appointment of Administrator G.
21 July 2009 –	Administrator G issued a proposal to creditors for achieving the objectives of an administration.
August 2009 –	Mr X put forward terms for a personal repayment proposal.
November 2009 –	Mrs X offered to pay money into a trust set up for the benefit of Firm A's investors.
26 November 2009 –	The High Court granted a permanent Interdict and Arrestment Order prohibiting Mr X and Firm A from taking part in unauthorised deposit taking activities whilst unauthorised.
17 December 2009 –	A progress update for creditors from Administrator G.
19 December 2008 -	Provisional Liquidators' Report produced by Administrator G.
21 July 2009 –	Administrator G (the appointed administrators and liquidators of Firm A) issue a proposal to creditors for achieving the objectives of the administration.

December 2009 and June 2010 –	Progress updates provided to Firm A's creditors by Administrator G.

*(v) **The Provisional Liquidators Report***

Before I consider the effect of the chronology it is appropriate to set out some relevant paragraphs from the Provisional Liquidators' Report dated 19 December 2008 referred to in the above chronology. The relevant paragraphs are 1.6, 1.7, 1.9, 7.7.1, 7.7.2, 10.1, 10.2, 10.3, 10.5, 10.6, 10.7, 10.8. I do so because these paragraphs set out the essential nature of what was going on as perpetrated by Mr X.

1.6 The deficiency to creditors is largely explained by losses on trading through FX Firm, estimated at £11,503,927, money and benefits to the Mr Xs estimated at £1,328,267 and business expenditure of £1,399,497.

1.7 We could not identify any trading by the Company which could reasonably be expected to produce the rate of returns that the Company promised and notionally allocated to investors.

1.9 Those investors who received repayments from the Company were repaid from the capital deposited by new investors.

And then:

7.7.1 The spreadsheet of 3 October 2008 shows that, between 16 October 2006 and 2 September 2008, the Company accepted funds from 815 separate investors. All but one of these are listed from 31 May 2007 onwards.

7.7.2 These investors signed loan agreements with the company, which provided for fixed interest of 9.25% plus a bonus payable at the discretion of the Company. According to the loan agreements, the capital sum was repayable on demand. The account holders were guaranteed the return of the capital sums plus the annual interest as can be seen from page 22 of FSA's exhibit CAP1.

And then:

10.1 The Company is therefore insolvent.

10.2 We have not identified any trading that could reasonably be expected to produce the rate of returns that the Company promised and notionally allocated to investors.

10.3 No materially profitable trading was undertaken. There were four significant periods of trading with FX Firm as follows:

10.5 On 17 May 2007, $1,777,590 was paid in from the Company's Bank D account. By 30 July 2007 $1,669,106 has been lost.

10.6 Between February and August 2008 five deposits, totalling $17,269,800, were made from the Company's Natwest accounts. Currency trading continued throughout the period, with no significant gains or losses. Between 23 September and 1 October 2008 $10,551,375 was lost by trading on the exchange rate between the Euro and the US dollar.

10.7 Between 12 August and 6 October 2008 $6,597,585 was lost by trading on the exchange rate between Sterling and the US dollar.

10.8 Those investors who received payments from the Company were repaid from the capital deposited by new investors.

Having set out some relevant extracts and background material to the activities of Mr X, I need now to address specific aspects of what occurred *seriatim*.

(vi) Delay

There are periods of delay in the chronology that initially I found disconcerting. The first relevant delay arose between April and September 2006. In April 2006 the FSA, despite the fact that it had been misled, appeared to delay contacting Firm A for 5 months to enquire whether Firm A was engaging in regulated activities. The second arose between February 2007 and May 2007 where the FSA was contacted by an investor alleging that the returns he was receiving were "too good to be true"!

These two periods of delay when coupled with the information disclosed at that time might be considered by an inquisitive regulator to be suspicious and worthy of some further investigation or enquiry. In May 2007 there may have occurred a possible failure of good judgement by those involved at that time not to have pursued further the matters disclosed at the two meetings.

The third period of delay arose between June 2007 and October 2007 and between February 2008 and April 2008 when clearly time might be of the essence as between Firm A and the FSA in its capacity as an authoriser of regulated activities.

The cumulative affect of these delays appears to me to indicate that the unregulated activities of Mr X and Firm A *might* (my emphasis) have been uncovered earlier thereby possibly (I can put it no higher than that) avoiding some of the losses that were eventually sustained. The FSA's Stage 1 decision letter dated 8 November 2010 by truncating the chronology minimises an appreciation of that possibility. I regret that the result is that a misleading impression is left in the mind of the reader of that letter. The FSA's Stage 1 Investigation might have been a lot fuller in my view. It will of course never be known what earlier enquiry in 2007 may have achieved but I return to these issues later in this Final Decision letter since there are some important *caveats* that need to be understood in that context.

(vii) Your Respective Position

The essential nature of your position contained in your email of 18 May 2010 is that you made loans to a company, which you appear to have understood, was not regulated by the FSA. In doings so you signed an agreement which allowed the company to "use the loan capital arising from the agreement (as it [saw] fit) in the course of its business" and understood that the company would invest your loan in FX transactions. In summary you:

(a) suspected that Firm A was unregulated;

(b) that the returns it was offering via the loan documentation were your prime motivation for lending the sums you placed with it by means of a loan;

(c) that the agreement entered into with Firm A involved a loan of capital to that company and finally therefore that;

(d) you were, in reality, each an unsecured lender to a limited company which was the borrower.

All the above activity appears to have been done to avoid supervision by the FSA. I should raise (although I will refer to it later) the issue of contributory negligence in the sense that, although the issue of negligence is not relevant in the context of the FSA's regulatory behaviour, it is relevant to those issues to which I must have regard in considering the actions of any investor dealing with Firm A. Making loans that are unsecured to a limited company known to be unregulated has relevance in any subsequent claim for compensation pursued elsewhere. It is helpful if at this point I quote from paragraph 9 of the "Interim Agreement" that you entered into:

> *"9. You the capital injector, agree that this agreement;*
>
> - *Constitutes an un-solicited loan agreement*
> - *Is not a financial promotion*
> - *Is not a regulated contract*
>
> *The lender further agrees, that Firm A can use the loan capital arising from this agreement (as it sees fit) in its course of business….."*

In your correspondence with both my office and the FSA you have not indicated or offered any explanation over why you entered into substantial loan agreements with Firm A. However, given that Firm A was a relatively new company (being incorporated on 23 March 2004) it is unclear how the returns it was offering were to be achieved. Clearly, the offered returns were excessive and were not likely to be achievable continually over the long term even if Mr X had predicted accurately all exchange rate movements over the relevant time which I find hard, if not impossible, to believe. This leads me to conclude that the scheme Mr X was running amounts to what can be best described as a *ponzi* scheme. This is supported by the comments at 10.2 of the Preliminary Liquidators Report dated 19 December 2009 where it states that it has "*not identified any trading that could reasonably be expected to produce the rates of returns that [Firm A] promised and notionally allocated to investors*"; and further at 10.8 where it is stated that: *"Those investors who received payments from the Company were repaid from the capital deposited by new investors"*.

From the chronology I have set out above, you will see the various steps that involved activity by the FSA during the period when you were both lending these sums of money to Firm A. I will return to the relevance of the essential nature of what you were about later in this Final Decision.

(viii) Dishonesty, Convictions and the Application for Authorisation

The matters in this heading are all best considered collectively. Whatever the FSA's knowledge may have been of Mr X's previous convictions for dishonesty (as well as when exactly it became aware of them), this does not mean, on its own, that it would automatically prevent Mr X receiving approval to conduct regulated activity. The FSA, during the approval process, would consider the information Mr X had given in relation to his convictions, which would include when the conviction(s) occurred, the background and actual nature of the offence(s) with which he was charged and, ultimately, of which he was convicted. (As a matter of record Mr X *never* (my emphasis) did freely disclose that he had any previous convictions.)

The FSA would then consider his conduct since the conviction(s) before deciding whether his application for approval should be approved or whether the convictions should produce a recommendation that the application be declined. A non disclosure of any previous convictions is a matter which the FSA takes into account.

During the approval process the FSA asks the applicant firm to complete an extensive application form which sets out significant information about it and the regulated activities it intends to conduct. The information the FSA asks the applicant firm to confirm includes (but is not limited to):

- the legal status of the firm;
- details of the individuals who will own and control the business (and whether these individuals have ever been convicted of criminal offences);
- the type of regulated activity the firm will conduct;
- the type of people the firm intends to provide services to;
- details of the firm's finances (including who will provide its start up and regulatory capital);
- details of the firm's infrastructure (both employee structures and IT); and
- a full business plan including estimated financial statements.

The FSA also requires an "Application to Perform Controlled Functions under the Approved Persons Regime" application form (which is commonly referred to as a Form A) from all of the individuals who will undertake a controlled function for the firm.

A controlled function can be summarised as a role within the firm which either has a significant influence on the direction of the firm (such as a director or compliance officer) or where the role involves the provision of financial advice to consumers. When completing a Form A, the individual application is asked to provide details which include (but is not limited to):

- personal details including full (and previous) names, national insurance and passport numbers (to enable a full PNC check to be conducted);
- background and experience; and
- full details of any criminal convictions (whether expired or not).

In this case, although the FSA received an application from Mr X on behalf of Firm B, (which as stated did not disclose on the part of any of its directors any previous convictions), it appears that the applications were withdrawn by Mr X before any decision could be made on whether the previous convictions yet to be uncovered should prevent his approval and whether Firm B met the FSA's requirements to enable it to become an authorised firm. It is also relevant to comment that the fact that Mr X concealed previous convictions in any application would ultimately have been taken into account by the FSA.

The FSA only considers applications for approval from individuals and/or firms which wish to conduct regulated activity as defined by the Act and the Financial Services and Markets Act 2000 (Regulated Activities) Order (the Order), which can be found at http://www.legislation.gov.uk/uksi/2001/544/contents/made. As such, the FSA is powerless to prevent any individuals or firms conducting activity which does not fall within the descriptions set out in these pieces of legislation. The FSA was alerted to the action of Mr X (through Firm A) in 2005. From the papers I have seen there is insufficient evidence to indicate that the enquiries the FSA then made led it to conclude that, at this time, Mr X was conducting regulated activity as described by the legislation I have referred to above quite apart from the important factor of whether there was sufficient evidence to obtain a Court order as would have been necessary. I return to that issue later.

In the FSA's Stage 1 decision letter of 8 November 2010 to you, it explained that it was again alerted to Mr X's activities in 2007. Following further enquiries, the FSA took a view that the business Mr X was conducting did amount to regulated activity (which neither he nor Firm A were authorised to conduct). Following discussions with the FSA, Mr X agreed to cease this type of business and engage with the FSA with the view to becoming authorised.

Although the FSA was aware that Mr X may have been in breach of the Act as he was working with it, the FSA did not conduct a PNC check. Had it done so it may have become aware of the convictions you have referred to in your complaint. The FSA has explained that, as a PNC check is an invasive tool, and it is only permitted to conduct a PNC check *if* (my emphasis) it has reason to believe that Mr X had been convicted of a criminal offence. In this instance, as I have indicated above, Mr X was working with the FSA towards becoming authorised and the FSA did not have any reason to believe (from either the disclosures Mr X had made or the intelligence it had obtained) to suspect that Mr X had been convicted of a criminal offence. As such, the FSA had no reason to request the completion of a PNC check at the time it was considering Mr X's actions, or when assessing his application to become authorised.

However, even if the FSA had conducted a PNC check in May 2007, the fact that Mr X had convictions does not, as I have explained above, automatically mean on its own that Mr X would not have received approval. The FSA considers each case on its own merits and in doing so considers a number of factors which include:

- when assessing previous convictions are when the offences occurred,
- the specific nature of the offences,
- the applicants 'behaviour' and 'conduct' since these convictions,
- whether the convictions were disclosed on the individual's Form A. The effect on any failure to disclose I have referred to earlier in this section as being a matter that is taken into account ultimately by the FSA.

On 12 October 2007 (after a period of delay which I have already referred to) the FSA received an application from Mr X for authorisation on behalf of his new firm, Firm B. Under the FSA's authorisation process the firm together with the individuals who are to conduct what are known as controlled functions have to apply for authorisation. In this case, the FSA received an application for authorisation from Firm B, and from an individual who was to be one of the directors of Firm B.

However, the FSA did not receive a Form A from Mr X himself and as such was unable to come to a view on his fitness and propriety and whether he should have received approval. Given that Mr X was to be Firm B's largest share holder (controlling 90% of the firm), its chief executive and also undertake a number of senior roles (all of which needed FSA approval), it is in my opinion strange that Mr X did not himself, submit a Form A with Firm B's application. However, this would not on its own prevent the FSA from considering Firm B's application.

From the information provided to me by the FSA it appears that, when considering Firm B's application, the FSA had a number of questions regarding its business plan and requested additional information to allow the application to be considered more fully. Unfortunately, from the papers I have seen it does not appear that Mr X was, at that time able to provide this information, and instead some considerable time later, on 24 June 2008, he opted to withdraw the application with the intention of resubmitting it a short-time later.

Although I believe that Mr X may have provided a different timeline and explanation for the events, from the information I have seen and which I have set out in considerable detail earlier there is nothing to indicate that the history of events the FSA has provided is not completely accurate. Mr X's version of events in frequently inaccurate, for example he states in one chronology that "we never solicited" yet in one complainant's case (not yours) the complainant was persuaded to 'invest' after receiving a cold call. Similarly, Mr X confirmed to the FSA (when it visited his offices on 4 May 2007) that his staff had previously made 'cold calls'. The FSA's notes of this meeting confirm:

> *"[Firm A] attracts customers mainly through word-of-mouth recommendations. The only other way that clients are attracted is through the [Firm A] website. [Mr X] informed the FSA that [Firm A] no longer makes cold-calls to attract customers. They have (sic) done this in the past but stopped this activity following the contact with [the FSA] in 2006*".

However, given Mr X's admitted background of dishonesty and his fraudulent *modus operandi* in running Firm A I have no hesitation in coming to accepting the FSA's chronology. The Stage 1 decision letter of the FSA dated 8 November 2010, however by truncating the chronology during the crucial period of months in 2007, could create a misleading impression in the mind of the reader.

(ix) Unauthorised Collective Investment Schemes

The papers I have seen also suggest that, prior to the FSA's visit in early 2007, Mr X was effectively running an unauthorised collective investment scheme (UCIS). Following the FSA's visit in May 2007 it appears that Mr X, ceased accepting customer's money with the view simply to investing this money in his UCIS, but instead offered loan agreements where he or Firm A accepted loans which were to be repaid with returns from FX transactions. How the loans were to be repaid or why they were made by investors does not detract from the fact that they were unsecured loans to a limited liability company.

Although consumers entered into the transactions on the basis of a loan or capital injection agreement, Mr X was using this introduced capital to support his margin FX trading transactions. Those who had made loans were to receive returns funded by these FX trading transactions however unlikely that such returns would arise out of that activity. Mr X was, in effect, conducting regulated activity by running a UCIS.

(x) What the FSA did and what did it not know

Due to concerns about the transactions Mr X was making, the FSA eventually sought to protect consumers (in line with its statutory obligations) by applying for the Interdict in the Scottish Courts. The FSA was granted the Interdict by the Scottish Courts and served it on 2 September 2008. At this point the FSA was aware that Mr X and Firm A held a number of bank accounts, all of which were held in the United Kingdom, and that only two of these were, effectively, active. From the considerable information the FSA has provided to me, at the time the Interdict was issued, the FSA was aware that Firm A had been engaged in deposit taking without authorisation and making financial promotions also without authorisation. At the time, the FSA *did not know for a fact* (my emphasis) that Mr X was conducting margin FX trading with the organisation known as FX Firm Inc. (FX Firm) located and regulated in the United States of America. This company was not regulated in the UK. Whilst FX Firm does have a group firm which conducts regulated activity within the UK (and which is authorised by the FSA) Mr X dealt with FX Firm in the United States of America *which was not under the FSA's jurisdiction* (my emphasis).

I would add here for the sake of completeness that, although the FSA regulates one of FX Firm's group companies, this does not give it an avenue whereby it can make enquiries with or obtain information from its parent without approaching the appropriate regulator or court in the United States of America. Similarly, the fact that a number of FX Firm's senior members of staff are also authorised by the FSA does not mean that they have to assist the FSA in relation to the activities of the UK subsidiary's (non-UK based) parent firm. Any request for information on the activities of the non-UK authorised parent firm would still need the assistance of the appropriate (in this case US) regulator. Further, it follows that the FSA was unaware of the open and unprotected positions Firm A held with FX Firm. There were clear indications that arose at the meetings in May 2007, that a company going by the name of FX Firm played some role in the activities of Firm A. The question is what role; and whether the FSA knew or could have reasonably been expected to know the detail of what that role was.

I now turn in detail to the factual matter of the FSA's knowledge. There are two aspects to that. One is, did the name of FX Firm surface and come to the knowledge of the FSA, and if so, when did that happen. The second aspect following that is did the FSA know that Mr X was using FX Firm, or some other organ, to conduct margin FX trading and what safeguards (if any, such as stop loss) were imposed on that trading activity.

To answer those two questions I need to consider the notes made by the two FSA representatives at the unannounced meeting at Mr X's serviced accommodation in Edinburgh on 4 May 2007 and the subsequent follow up meeting at the FSA's offices on 10 May 2007. Extracts from the note of that meeting include:

"*In relation to FOREX [Mr X] acts as an introducer to a US company called [FX Firm]... [FX Firm] do all the trading on behalf of the clients. [FX Firm] also provide the trading statements and results to the clients. The contract in FOREX business is between [FX Firm] and the client*"

And

"*[Mr X]* has *approximately 25 FOREX clients. [Mr X] told us that the client funds for the 25 customers are held by [FX Firm]. In the past, some customers have sent cheques to [Mr X] for these investments, but [Mr X] had stopped this practice because they (sic) realised that they (sic) were not supposed to hold client funds. The funds therefore wired/paid directly to [FX Firm].* "

And

"*Mr X eventually conceded that there are two types of FOREX clients – those that deal with Gain and those that deal directly/through [Mr X] (and [Mr X conducts] the deals on their behalf)*".

There is a great deal of further relevant information but the above is sufficient to identify that the name of FX Firm was known early on to the FSA and that FX Firm played a role in Mr X's activities. This is further confirmed by the notes of the follow up meeting at the FSA's offices on 10 May 2007. In particular Mr X states:

"*All customer monies go to [FX Firm]. A 'pot of money' is held is held on behalf of Firm A and the profit that is made on the Firm A money is distributed to the clients*".

And

"*[FX Firm] is not authorised in the UK*"

(It should be added to for the sake of completeness in this instance that, in 2005, when the FSA first became aware of Mr X that there were indications on Mr X's website of connections with FX Firm but not in a manner that appeared to involve a breach of the provisions of the Act). It is clear nevertheless that FX Firm, as an entity, was known to the FSA in the context of a possible breach of the Act in May 2007 but that it was a company controlled by the American Regulator.

The second question therefore is did the FSA know that Mr X and/or Firm A was using FX Firm to conduct FX trading on behalf of clients of Firm A. That is a far more complex matter to come to a clear conclusion about. Clearly, from the information the FSA possessed at the time, there were suspicions that Firm A were conducting margin FX dealings through FX Firm and possibly other firms. Similarly, when Firm B applied for authorisation, the application form, which the FSA received on 12 October 2007 asks at 4.1:

"*Will the applicant firm be using off-the-shelf IT systems?*

If you are using both off-the-shelf and bespoke IT systems, you must list the off-the-shelf systems in the boxes provided and provide a brief description of your bespoke systems."

In answer to this question, Mr X has indicated that he will be using off-the-shelf systems and has stated:

Business transaction recording system	This is presently is (*sic*) [FX Firm] although the firm may move elsewhere
Accounting system	Accounting system is Act, may moved (*sic*) to Sage line 50
Other IT systems, e.g. Word, Excel	Reuters 3000 Xtra, Bloomberg, Trendsetter

From this it is, clear in my opinion, that the FSA should have been aware, or at least alerted, to the fact that the Mr X (through Firm A) had an existing relationship with FX Firm, although this does not show that he was currently trading and even more importantly had any open positions. This view is relevant given the agreement he had made with the FSA in May 2007. This is also something I will return to later in this Final Decision.

How much detail and whether there were open or closed positions and when that was established I am not able to be certain about. The Provisional Liquidators' Report of 19 December 2008 now makes the position clear and I will refer in detail to that Report later by quoting extracts from it.

(xi) How the FSA deals with Unauthorised Business

Under this heading I need to refer to the issue of investigative skills brought to bear in this matter in the light of the chronology I have set out earlier in greater detail than is contained in the Stage 1 decision letter of the FSA dated 8 November 2010. Quite apart from the delay that I have identified, and the dissembling by Mr X himself as the sole director of Firm A, it could be considered, without knowing the full background to the FSA's investigatory resources and policies, that greater curiosity should have been aroused at least as to what exactly was going on at Firm A between 2006 and the end of 2007, bearing in mind the contact made by an investor in February 2007 with the returns that were mentioned, as well as what transpired at the meeting on 10 May 2007 between Mr X and the FSA. What was disclosed at the two meetings in May 2007 might appear to indicate the necessity for further investigation. However, against that initial view are the important factors I now identify as matters that the FSA has to consider having regard to its resources and the demands of the Courts.

The position of the FSA and what it can do in the area of unauthorised business needs to be set out in some detail in order to consider whether its actions were justifiable at the time and without the benefit of hindsight. The FSA receives between around 4,000 and 6,000 complaints about the possibility of unauthorised business activity each year. Of that number, around 1,200 may be actively looked at in more detail. The rest are what can best be described as boiler room scams and are dealt with differently and in a way not relevant to the issues I am considering in this Final Decision. The FSA has to use its resources proportionately in that it is funded by the Industry (not the Government) and thus indirectly by the consumer who purchases products from the regulated industry.

At the time of the events covered by this Final Decision there were 23 individuals in the Unauthorised Business Team (UBT) split into two teams one for vetting (11 staff) and one for investigations (12 staff). In 2009 the manager of the UBT asked for more resources and the size was effectively doubled following observations made by operational staff within the then UBT that the risks posed by unauthorised businesses were increasing. This increase arose out of the financial crisis and the perception that consumers might be more tempted to place their money with unauthorised business due to a combination of mistrust in financial services firms and the lower level of returns achievable through normal (authorised) financial services business. There are now four teams. The manner in which the UBT operates is relevant to the events in this Final Decision particularly as they remain permanent features of the FSA's limitations in the area of investigating allegations of unauthorised business activity.

The purpose of the vetting enquiry is to discover which of the approximately 1,200 enquiries relate to the most severe examples of unauthorised business posing the biggest risks to consumers. Those which represent the biggest risks are referred to the investigation teams to conduct an investigation. Because of its limited resources, the FSA has to take a proportionate and risk based approach to cases, depending on the circumstances. On average, each year, the department takes legal action against between 10 and 20 firms or individuals who are suspected of conducting large scale unauthorised business which pose the biggest threats to consumers' assets and interests.

The vetting team have a checklist before a possible unauthorised activity can be considered to justify further and more detailed investigation. There are four main criteria:-

(i) the number of complainants;

(ii) the amount of money involved;

(iii) the type of activity – thus for example, mortgage advice would rank lower than deposit taking;

(iv) the known character of the individual involved.

Information gathering thereafter is a slow and difficult process and *dictated by the boundaries that the Courts have set* (my emphasis), before a Court will grant a freezing order. Those boundaries involve production to a Court of verifiable evidence (usually difficult as fraudsters do not sign agreements) or at least four witnesses prepared to testify in open court. The production also of evidence of money being held in a "collection" bank account. Finally, that the alleged perpetrator has shown clear evidence of non co-operation with the FSA. This last aspect is particularly influential and important.

In this case, the fact that Mr X *had appeared to co-operate* (my emphasis) – see my earlier chronology – would have made it unlikely that the FSA would have been successful before 2008 in approaching a Court with a view to an intervention against Mr X. As to the issue of delay, the FSA response is that invariably responding organisations take more time than the FSA would wish in responding to the FSA's enquiries. Collecting sufficient evidence to satisfy the Court is therefore time consuming and cannot be done overnight quite apart from the demanding evidence insisted upon by a Court before granting the appropriate order.

In this instance, the FSA received an anonymous letter in July 2008 providing valuable evidence which, for the first time, would allow the FSA to take action against Mr X. I would add that prior to this date the FSA, although having suspicions about Mr X's activities (and actively undertaking investigating Mr X's activities) held, what it believed was insufficient evidence to justify a more intrusive investigation as, until that point, there was insufficient evidence to convince the courts, on an *ex parte* basis, that further legal action was needed and indeed warranted. It is important that that is borne in mind. I have no doubt that your own legal adviser will have told you how demanding the Courts are when considering *ex parte* applications.

(xii) The Interdict and Events Thereafter

Prior to the Interdict being granted, the FSA had identified funds of about £2.3 million in Firm A 's collection account (and that the account was receiving in the region of £500,000 per week in the form of 'loans'); therefore the FSA as a matter of priority took urgent action to freeze those accounts. That was at the forefront of the FSA's mind once it obtained the Interdict.

The FSA adds that it believed that any delay in freezing those funds, which may well have occurred if at that point it had sought to try to trace any of the funds which had already been moved *from* (my emphasis) that collection account, would be detrimental overall to those caught up in Mr X's illegal operations. That delay would have run the risk that the £2.3m would also have been dissipated. That may be a reasonable judgement for the FSA to make in all the circumstances in the light of what it knew factually at that time.

Further, it was reasonable for the FSA to conclude that, due to the amount of new 'loans' and new 'customers' who were joining the scheme, potentially more money would also have been lost if it did not take immediate and urgent action in the context of the collection account. In those circumstances, the FSA states that its absolute priority was to stop the activity and freeze the funds in the collection account. This appears to me in my Final Decision, to be a reasonable position for it to take given the circumstances at that time known to the FSA and over which it had control.

The FSA obtained the Interdict on 2 September 2008 and served this on Mr X the same day. It should be noted here that the Interdict purely froze the Mr X's personal assets and those of Firm A. I would add here that, as Mr X had a number of other businesses which he ran from the same offices as Firm A, the Interdict did not exclude him from his offices nor allow the FSA to remove *all* (my emphasis) his computers.

The search warrant and Interdict only allowed the FSA to take possession of documents and information (including computers) which *were relevant* (my emphasis) to the investigation and to take steps to allow it to preserve these documents/information. They also allowed the FSA to take copies of the relevant documents/information, and obtain information from people present at the premises in relation to the investigation.

I would add that, in respect of the computers, the Interdict only applied to computers which held information which *was directly relevant* (my emphasis) to the investigation and which were owned by Mr X and or Firms A and B. It did not allow the FSA to remove all of Mr X's computers, particularly those which were not used in relation to the activities of Forms A or B. For the avoidance of doubt, I would stress here that, as Mr X ran a number of business from his offices, the FSA could not take possession of all the computers in the office particularly those which were used in relation to his other businesses and were not used in relation to the activities of Firms A and B.

Likewise, the Interdict could not prevent Mr X's movements and, in particular, exclude him from the offices. As Mr X ran other businesses from these offices, the Interdict only prevented Mr X from conducting deposit taking activities, it did not prevent him from conducting his other business activities (which were not related to those of Firms A and B)or from accessing his offices.

Similarly, the Interdict did not restrict Mr X's activities and specifically prevent him from purchasing new computers (or using other computers) which I understand he may have done providing they were not used for deposit taking activity. Likewise, the Interdict did not allow the FSA to 'investigate' any new computers as they could not have held information relating to the activities of Firms A and B at the time the Interdict was served as they were not owned by Mr X at that time (unless there was strong evidence to indicate that the new computers were being used in relation to deposit taking activity).

Once the Interdict had been obtained, the FSA had two principal concerns; to protect the terms of the Interdict and to close Firm A down as quickly and effectively as possible in order to prevent further losses. The FSA began work on an application to the High Court to appoint provisional liquidators (Administrator G). The FSA considered Administrator G's appointment to be an urgent matter because:

(i) provisional liquidators have the power to take over the day to day running of the company and, in so doing, could definitively bring to an end any attempts by Mr X to use the company to engage in further unauthorised activities;

(ii) provisional liquidators also have wide powers to investigate a company's financial affairs, *to trace and, where possible, recover consumer funds, including funds based abroad* (my emphasis);

(iii) importantly, because provisional liquidators have the power to take control of the company, they (unlike the FSA) are able to carry out a full investigation of the company's financial affairs without being concerned about the possibility of any, as yet unidentified, consumer funds being dissipated.

In the course of its investigation, the FSA collated a considerable amount of banking information about Firm A's activities. From this it was apparent that Firm A's financial affairs were complex, with payments being made to numerous third parties on any given day. An examination of the large number of bank statements the FSA obtained show that FX Firm was only one of several beneficiaries to benefit from money transfers from that collection account. (However, I note that the Provisional Liquidators' Report dated 19 December 2008 indicates that only FX Firm was used for margin FX transactions). I also understand that due to the large number of transactions, as part of the FSA's investigation into Firm A's activities, the FSA appointed an external firm of forensic accountants to analyse Firm A 's bank account statements for the previous 12 months.

The FSA received this analysis on 10 October 2008 (which was the same day as the final position Firm A's open position with FX Firm was closed). That delayed receipt was particularly unfortunate for all concerned.

Could different actions have produced a different result? Although Mr X was served with the Interdict on 2 September 2008, it appears *that he did not disclose to the FSA the existence of the open FX positions he held with FX Firm to the FSA* (my emphasis). That is a matter of considerable regret particularly for his investors and poses the question of why on earth not if as he continued to insist, even at this stage, that he had at the front of his mind the interests of those investors?

Additionally, it appears from the information provided by the Provisional Liquidators' Report dated 19 December 2008, that yet further positions were opened on 23 September 2008. Given that the FX dealing is almost a 24 hour a day five days a week activity, and large losses can arise almost instantaneously, it is unclear why Mr X decided to enter further positions in the knowledge that he would not be able actively to monitor or to alter them during normal office hours when the FSA's investigators were present. This is an unusual, if not perilous, position to adopt with other people's money particularly when, as I understand it, Mr X had not put any 'stop losses' in place to safeguard his 'investors' interests (particularly as he was trading contrary to the Interdict and outside normal office hours).

Subsequently, between 1 and 3 October 2008 FX Firm closed these positions as there was insufficient capital left in the trading accounts by way of margin to cover a further adverse market movement. The remaining funds being transferred to Firm A's legal advisers on 8 October 2008.

It is now worthwhile quoting from the Provisional Liquidators' Report dated 19 December 2008 being paragraphs 8.8.3 and 8.8.5.

8.8.3 FX Firm have confirmed that there was no "Stop Loss Order" put in place to mitigate against such material losses. If such an order had been in place there would have been an automatic trigger included within the account to close the account, hence limiting trading losses. For example, if there had been a 2% Stop Loss Order in place the losses would have been automatically restricted to 2% of the capital at risk. The individual carrying out the trades, could have placed such a Stop Loss Order, but did not do so.

8.8.5 We understand that [Mr X] was the only individual who traded through [FX Firm] on behalf of the Company. [Mr X's] private office at the St Andrew Square premises contained a bank of screens for monitoring movements in the markets. There was no similar facility anywhere else on the premises. We note that [Mr X] kept his office locked. In addition, many trades took place outside normal working hours.

I would add here that, from the information I have seen, it does not appear that although the Interdict was served on 2 September 2010, the FSA was made aware of the FX Firm holdings (or more importantly the fact that they were open positions) *at that time* (my emphasis), indeed the FSA only appears to have become aware of the existence of the open positions when Mr X's lawyers wrote to it on 9 October 2008. That again does demand an explanation from Mr X that has not been forthcoming. Had this notification been earlier, the position might have been entirely different.

Although the FSA served the Interdict on 2 September 2008, the FSA could only freeze or take action to freeze the accounts *it was aware of* (my emphasis) and those which fell within the jurisdiction of the Court issuing the Order. In this instance, as I have indicated above, it does not appear that the FSA was aware of the open positions Firm A held with FX Firm. It would not be possible for the FSA to freeze (or attempt to freeze) assets of which it was unaware. Similarly, as FX Firm is located in the United States of America (and therefore falls under the jurisdiction of the US Regulators and courts), freezing assets outside the jurisdiction of the British Courts is an added complication.

If the FSA had been fully aware of the assets Firm A held with FX Firm it would have had to apply to the US Courts for a similar order authorising the closing of the positions. The Interdict the FSA obtained was an interim order obtained *ex partie* and it would have been difficult for the FSA to enforce such an *interim order* (my emphasis) in the US (especially one obtained on an *ex parte* basis as is usually the case with freezing orders), as the US courts do not consider there has been a sufficient consideration of the merits of the underlying dispute in the case of an interim order. It is therefore likely that the US courts would not have been willing to enforce the relevant order, by granting an immediate similar US order thereby protecting the funds at that point.

This is all a matter of conjecture in the ultimate analysis as I have no means in this Final Decision of establishing what would have been the position. Finally, even if the FSA had been aware of the open FX Firm positions and had applied to the US courts for a similar order there is nothing to indicate that the overall outcome for those who had 'invested with' or 'loaned' money to Firm A would have been any different.

I would add those further positions that were entered into by Mr X, as he was the only person who had access to the FX Firm account, after the Interdict was granted and served *without* (my emphasis) the knowledge of the FSA, is particularly regrettable. Had these additional positions not been entered into it is also possible that the overall position for those who had 'invested with' or 'loaned' money to Firm A may have been different. Regretfully it is now a matter of speculation.

Having considered the matters you have raised generally with my office, I do not dispute the fact that, positions held with FX Firm when the Order was issued resulted in an adverse result for those who 'invested with' or more accurately lent money to Firm A which was unsecured.

(xiii) The Legal effect of these events

Having done the best that I can to establish the essential factual background to what are a number of complex events over a considerable period of time, I can now turn to the legal effect of those events. An investigation of the kind that I undertake has, inevitably, its limitations given the absence of sworn testimony elicited by examination in chief and tested by cross examination. The first aspect is of the essential nature of your relationship with Firm A, how the FSA's actions impacted upon it and the effect overall in legal terms.

As a lender to a limited liability company you would normally rank as an unsecured creditor. From that starting point there then needs to be considered how and whether the FSA's actions impacted upon you in such a way as to bring into play the possibility of an application of Article 1 of the First Protocol of the Human Rights convention as set out in the HRA and which I identified at the beginning of my Final Decision.

I have already set out that the FSA is not liable for negligence or poor judgement (or incompetence, gross or otherwise) when carrying out its functions unless there is evidence of bad faith. For completeness purposes I record here that I have not found any evidence of bad faith on the part of the FSA.

The question remains however as to whether from an English Common Law perspective the FSA's actions in 2008 or its intervention directly caused or led to your loss of the unsecured loan you had made to Firm A. That is to say that by its actions the FSA was the direct cause of the loss that you sustained by making an unsecured loan to Firm A. The chain of causation in legal terms is not an easy issue to establish. It involves considering detailed evidence as to whether the FSA's actions or its inactions directly led to your loss. Matters that can arise include the issue of forseeability, remoteness of loss suffered or what is known as *novus actus interveniens* which in lay terms means an intervening act such as for example a particular position on a "stop loss" arrangement taken by Firm A or a failure to put one in place at all either of which was unknown to the FSA and which had a consequence in terms that could not easily be foreseen or prevented. Thus it was the operation, it might be suggested, of the way that the margin FX arrangement was put in place rather than anything that the FSA did or failed to do that led to the loss unless it could be established that a particular factor was foreseeable if not known by the FSA. In turn the entire scenario might be considered only a remote possibility.

All these legal issues involve a detailed analysis of the factual evidence and what conclusions can be drawn there from. Ascertaining all the relevant factual evidence in a case such as this is not a realistic prospect in an investigation of the kind that I am able to undertake, made worse by an absence of adversarial argument on the relevant legal issues.

In this context I also need to remind you of the other relevant issue that I have canvassed earlier in this letter. That is that of contributory negligence, although equally it could be said that the delays that took place cumulatively and the problem of investigatory urgency could also be considered in this area and would attract a careful and detailed analysis after a forensic examination of all the evidence.

There is then the further complication of placing what I have set out above in the context not of English Common Law parameters as I have identified them but in the context of a claim under Article 1 of the First Protocol as set out in the HRA. That involves a reference to Article 41 of the Convention which states:

> *" ... that there has been a violation of the Convention or the protocols thereto, and if the internal law of the High Contracting Party concerned allows only a partial reparation to be made, the Court shall, if necessary, afford just satisfaction to the injured party."*

The background to that legal aspect is that it is one that is rooted in a civil code European style jurisdiction which sits uneasily alongside the English Common Law parameters of liability and ascertainment of damage that I have identified.

There is not a surfeit of authority for me to consider as to the operation and applicability of these various provisions within the HRA in the context of the Act. There are considerable conflicting authorities and how they would impinge upon this issue. I do not have the benefit either of legal argument urged upon me as to what is the correct legal approach. This is an area where there are different authorities as to what issues of law and monetary compensation exactly should be considered within the context of the HRA. It is the case, as far as I know, that the particular circumstances of your case and their interaction with the provisions that I have set out has not previously arisen or been considered by any judicial authority either here or at the Court of Human Rights at Strasbourg.

Conclusion and Rationale

This investigation has plainly taken longer than I would have wished primarily because a lot of what I needed to know was not uncovered by the FSA in its own investigation and therefore what was reported to you in its findings in its Stage 1 decision letter of 8 November. It is also unfortunate that much of the information I requested from the FSA was not presented in as timely manner as I would have hoped and indeed has, to an extent been provided in what can best be described as on a 'piece meal' basis. This is regrettable. However, the position ultimately however is this.

First, you freely entered into an unsecured loan to a limited company which was a subterfuge to overcome Mr X's failure for his activities to be authorised by the FSA.

Second, margin FX markets are notoriously volatile, complex and not for the uninformed investor. In essence they can give rise almost instantaneously to enormous losses.

Third, what was known to the FSA at any particular time, and the demands of any legal process in the context of that knowledge at any time, dictated what the FSA could do and when it could do it. While I may have the occasional reservation about some delay at various times I have equally to have had regard to the issue of the FSA's resources, proportionality in that context, as well as the overarching demands of any legal process that needs to be put in place through the Courts.

Fourth, the issue of the inevitable involvement of a foreign legal jurisdiction and the limitations that that imposed upon the FSA at the time of these events is particularly relevant.

Fifth, the fact that the margin FX dealings *in their open state* (my emphasis) were not disclosed to the FSA, and indeed were continuing while its investigations following the obtaining of the Interdict were ongoing and it was thereby in no position to prevent the dissipation of the monies in the United States of America.

Sixth, I would further add that the FSA appears to have acted within its powers and proportionately and despite not being able to take formal action when it became aware of the activities being conducted by Mr X through Firm A, did do a great deal but in many cases where fraud is involved it is not always in time to prevent investors suffering substantial losses which we all regret. In this case Mr X was concealing a quite dishonest series of acts to the detriment of those who lacked the experience and knowledge to see through his subterfuges.

Accordingly for these principle reasons as well as what I have identified peripherally throughout it is my Final Decision that I cannot uphold your complaint concerning the regulatory actions or inactions of the FSA.

I should add this. If I had upheld your complaint I could not, in any event, come to any final conclusion on the issue of monetary compensation since this scheme is not able nor equipped to deal with the complex legal issues that arise. It would clearly be an issue that can only be pursued, if at all, in the High Court where evidence can be tested by cross examination because of the adversarial process involved and where all the legal issues can also be argued out.

Those issues will include, in English Common Law terms whether the chain of causation is clear, the lack of forseeability of subsequent events by the FSA in the context of your entering into a loan agreement with Firm A and the fact that Mr X entered into further positions without the safety of "stop loss" arrangements, outside office hours (when he was unable to react to adverse market movements) and in breach of the terms of the Interdict. All that is apart from the essential and crucial fact that you were an unsecured lender to a company with limited liability.

The Court would then place all those issues in the context of Article 1 of the First Protocol as set out in the HRA, and whether you have a valid claim for damages taking into account those issues of your contributory acts, the issue of causation as well as the amount of any pecuniary loss you may have suffered within the context of Article 1. I should add finally that in the context of Article 1 and the issue of pecuniary awards within the provisions of the HRA it is also the case that the principles behind such awards are far from clear (Article 41 as I have set out above is the relevant Article). Such damages are often awarded on what is described as an equitable basis and not on a par with English Common Law principles. No doubt you will take detailed legal advice on all these complex issues if you decide to proceed further.

I regret that my Final Decision will be a disappointment to you but I hope that I have set out in sufficient detail the reasons why I have arrived at the view it contains.

Yours sincerely,

Sir Anthony Holland
Complaints Commissioner