Complaints Commissioner

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10th October 2011

Dear Complainant,

Complaint against the Financial Services Authority (FSA)
Reference Number: GE-L01312

I write with reference to your emails of 22nd and 26th July 2011 in connection with your complaint against the Financial Services Authority (FSA).

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.

Your Complaint

- In 2007 I understand you invested a considerable sum of money with Firm A. You are unhappy as, following the FSA's decision to seek a 'winding up' order against the firm in 2008 you have lost most of the money you invested with Firm A.
- You feel that, although the FSA was aware of the actions of Firm A in 2005, it failed to take any action against the firm. You add that had it done so when it first became aware of Firm A's actions you would not have been able to invest with it and, as a result, would not therefore have lost the considerable amount of money that you have.
- As a resolution to your complaint, you are looking for the FSA to reimburse you with the £36,650 that you say that you have lost as a result of the FSA's inactions.

Coverage and Scope of the Scheme

COAF provides as follows:

(1) The complaints scheme provides a procedure for enquiring into and, if necessary, addressing allegations of misconduct by the FSA arising from the way in which it has carried out or failed to carry out its functions. The complaints scheme covers complaints about the way in which the FSA has acted or omitted to act, including complaints alleging:

(a) mistakes and lack of care;

(b) unreasonable delay;

(c) unprofessional behaviour;

(d) bias; and

(e) lack of integrity.

(2) [deleted]

(3) To be eligible to make a complaint under the complaints scheme, a person (see COAF 1.2.1G) must be seeking a remedy (which for this purpose may include an apology, see COAF 1.5.5G) in respect of some inconvenience, distress or loss which the person has suffered as a result of being directly affected by the FSA's actions or inaction.

I should also make reference to the fact that my powers derived as they are, from statute contain certain limitations in the important area of financial compensation. The Act stipulates in Schedule One 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". I formally record at this point given the above statutory provisions that I have found no evidence of bad faith.

If you were to take the view that Schedule One referred to above was relevant in the context of the Human Rights Act 1998 I should explain that Section 6(1) of that Act 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 Human Rights Act of 1998.

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".*

It is my view, given my views in this matter, that Article 1 of the First Protocol has no application in your case.

Chronology

I note that the FSA, in its decision letter of 6th May 2011 has not provided you with any information, by way of background, on the actions it took before it took action to 'close Firm A'. It is, in my opinion, unfortunate that the FSA's complaint handler chose not to do this as it leaves the reader of the decision with an incorrect view that the FSA "did nothing". I believe that it may have been useful if the complaint handler had included the chronology as it would have clearly indicated to you that the FSA did undertake a considerable amount of work and did not, as you claim, fail to take any action to prevent Firm A soliciting further funds from consumers. It may also have provided you with an understanding of the requirements placed upon the FSA by the Courts *before* (my emphasis) it is able to 'take action' against a firm.

5th February 2003	Firm A was incorporated
Mid 2005	The British Property Federation made representations to HM Treasury about firms offering "off plan" property developments through property clubs to unsophisticated investors.
3rd October 2005	Firm A obtains a legal opinion on its position from counsel. This opinion indicates that Firm A did not need to seek authorisation from the FSA.
Late 2005	The FSA consults on revisions to its "Perimeter Guidance" in relation to property clubs. Following consideration of the responses it received, the FSA amends the revised "Perimeter Guidance" to also take account of what have become known as land-banking schemes (such as those offered by Firm A).

6th March 2006	The revised "Perimeter Guidance" (which was contained in section 11 of the FSA's PERG handbook) comes into force.
15th March 2006	A new firm, Partnership B, is incorporated.
29th March 2006	Firm A comes to the attention of the FSA following a pro-active call from a law firm (Law Firm C). The law firm informs the FSA that Firm A has instructed it as the revised "Perimeter Guidance" has alerted Firm A to the fact that the 'investments' it offered prior to 16th March 2006 (the "first scheme") may have fallen into the category of a collective investment scheme (CIS). As such it wants the law firm to provide it with legal advice.
Late March/Early April 2006	Law Firm C disagrees with the legal opinion which Firm A obtained by Firm A on 3rd October 2005 and seeks a second opinion from different counsel (a QC). The QC's opinion indicates that activities Firm A were undertaking prior to 16th March 2006 did require it to obtain authorisation from the FSA. Firm A introduces a revised 'investment' which it says was designed in accordance with the advice given by the QC so that it was not a CIS.
5th April 2006	A meeting is arranged between the FSA, Firm A and Firm A's lawyers to discuss the matter.
19th April 2006	Law Firm C forwards Firm A's proposals to the FSA. The proposals amongst others include the intention to create a new corporate entity (Partnership B) which will apply for authorisation and to write to investors of the "first scheme" to notify them of their rights under section 26 of the Act (the Section 26 letter).
4th May 2006	Firm A obtains a second opinion from the QC.
11th May 2006	The FSA responds to a draft Section 26 letter.
12th May 2006	Firm A responds to the FSA's comments on the proposed letter.
31st May 2006	The FSA responds to Firm A's email of 12th May 2006.
8th June to 12th July 2006	There is a further exchange of correspondence between the FSA and Firm A.
30th June 2006	Partnership B applies for authorisation to conduct regulated activity.
July/August 2006	The FSA asks for further information in relation to Partnership B's application. There is an exchange of correspondence between the FSA and Firm A in relation to the Section 26 letter.

8th August 2006	Partnership B responds to the FSA's questions.
August 2006	The FSA poses further questions about Partnership B's application.
15th August 2006	There is a further exchange of correspondence in relation to the Section 26 letter.
August to December 2006	The FSA's assessment and consideration of Partnership B's application continues.
November 2006	A consumer contacts the FSA and informs it that Firm A is again promoting 'investments' (the "second scheme").
4th December 2006	There is an exchange of correspondence between the FSA and Firm A in connection with the promotion of the "second scheme".
14th December 2006	The FSA sets out its initial views on Partnership B's application.
15th December 2006	Firm A (on behalf of Partnership B) responds to the FSA.
January 2007	Firm A's auditors resign.
5th January 2007	Firm A/Partnership B send a further response to the FSA in relation to the application.
10th January 2007	The FSA responds to Partnership B's letter
23rd January 2007	Partnership B responds to the FSA's letter.
31st January 2007	Partnership B's lawyers write to the FSA's in house Chief Counsel.
3rd February 2007	A member of the FSA's Enforcement division receives an unsolicited email from a marketing agency working on behalf of Firm A promoting the "second scheme".
6th February 2007	The FSA formally commences an investigation into Firm A under section 168(3) of the Act.
14th February 2007	The FSA writes to Partnership B in connection with its application and sets out the FSA's concerns. The FSA also informs Partnership B that it is minded to recommend that Partnership B's application for authorisation is rejected at the Consideration Meeting of the FSA which is set for 27th February 2007. The FSA grants Partnership B an extension to allow it to respond to the FSA's concerns.
16th February 2007	The FSA contacts the firm (Firm D) which undertook marketing on behalf of Firm A.
19th February 2007	Partnership B responds to the FSA.

21st February 2007	The FSA attended a seminar held by Firm A.
26th February 2007	Partnership B informs the FSA that it is intending to withdraw its application.
March to May 2007	The FSA's investigation was ongoing.
6th March 2007	The FSA received a letter from Firm A setting out its proposals following the withdrawal of Partnership B's application.
4th April 2007	A consumer wrote to the FSA enclosing a copy of Firm A's brochure and asked about its marking activities (specifically in respect of the "second scheme").
4th May 2007	The FSA is notified that Firm A's auditors had resigned in January 2007.
15th May 2007	A consumer emails the FSA and complains about Firm A's sales tactics in respect of the "second scheme".
23rd May 2007	The FSA responded to Firm A's letter of 6th March 2007 and requested a response by 1st June 2007.
1st June 2007	Law Firm E, Firm A's new lawyers, contacts the FSA and requests an extension.
5th June 2007	The FSA receives a letter from Law Firm E stating it would respond by 11th June 2007 and confirmed that Firm A was prepared to accept a number of the undertakings required by the FSA.
13th June 2007	Firm A obtains a further opinion from the QC on its activities.
15th June 2007	The FSA receives Law Firm E's response.
5th July 2007	The FSA responds to Law Firm E.
20th July 2007	Law Firm E responds to the FSA's letter of 5th July 2007 and suggested a meeting with the FSA.
9th October 2007	The FSA holds a meeting with Firm A and Law Firm E.
12th October 2007	A lawyer from Law Firm E telephones the FSA to provide an update.
15th October 2007	A lawyer from Law Firm E telephones the FSA to provide a further update and confirmed that Firm A intended to cease trading during the week commencing 22nd October 2007.
18th October 2007	The FSA responds to Law Firm E and requested that Firm A complies in full with its instructions no later than 31st October 2007.
31st October 2007	Law Firm E telephones the FSA and informally requests a short extension to the response period.

1st November 2007	Law Firm E emails the FSA and formally requests a short extension as Firm A wanted to consider the advice it had received from both Law Firm E and the QC.
2nd November 2007	A hearing, in connection with the case the Investigation Branch of the Insolvency Service brought against Firm A's sole director (Mr X), is held.
12th November 2007	The FSA writes to Law Firm E setting out its position and confirming that it now reserves the right to seek action through the Courts without further notice.
13th November 2007	Law Firm E again contacts the FSA and provides an update.
23rd November 2007	The FSA receives a letter from Law Firm E providing an update together with a draft copy of the Section 26 letter Firm A is intending to send to its 'clients'. It also receives proposals from Firm A for altering the "second scheme" to ensure it fell outside of the CIS requirements. Firm A contacts Firm F (a firm already authorised by the FSA) in relation to the problems it is having with meetings the FSA's requirements.
23rd to 30th November 2007	The FSA considers the draft Section 26 letter and Firm A's proposals for alteration to the "second scheme".
30th November 2007	The FSA responds to Law Firm E's letter and Firm A's proposals.
December 2007	The FSA contacts Firm A's new auditor.
14th December 2007	Mr X is disqualified from holding the position of a director for a period of four years.
20th December 2007	Firm F contacts the FSA, by email, in relation to the discussions it has had with Firm A. This email indentifies further concerns about Firm A's practices.
4th January 2008	Following his appeal, the Court grant Mr X permission to remain a director of Firm A
January 2008	The FSA discovers that Mr X has been disqualified from being a director (with the exception of Firm A) for a period of four years.
17th January 2008	Law Firm E contacts the FSA and provides it with an update.
8th to 11th February 2008	The FSA conducts specific enquiries into the manner in which Firm A is marketing its "second scheme" to consumers.
11th February to 10th March 2008	The FSA considers the information provided to it by Firm A together with Firm A's conduct during its investigation.

10th March 2008	The FSA holds a meeting with the partner of Firm A's previous auditor to establish why it resigned.
31st March 2008	The FSA petitions the High Court for a winding up order and for the appointment of a Provisional Liquidator to facilitate this.

Your Position

The essential nature of your position is contained in your email of 22nd July 2011 is that when you invested with Firm A you were aware that:

(a) the firm was not regulated and authorised by the FSA;

(b) the 'investment' being offered was not one which was regulated by the FSA;

(c) you were, in reality, an 'investor' in what is therefore an unauthorised CIS. The overall result of this is that you did not have recourse to the safeguards that exist when dealing with authorised firms (such as recourse to the Financial Ombudsman Service and, in the event of the failure of the firm, to the Financial Services Compensation Scheme).

(d) You are ultimately unhappy that, as a result of the FSA's decision to petition to the High Court for a winding up and liquidation order, you have lost what is not an insubstantial amount of money.

Unauthorised Collective Investment Schemes and how the FSA deals with these

The papers I have indicate, as you suggest, that the FSA was aware of Firm A in early 2006. I can also appreciate your view that, as the FSA did not appear to have taken any action to protect consumers between 2006 and 2008, it should reimburse you for your losses in an unregulated and unauthorised firm. However, I hope you will see from chronology I have set out above (which was produced following consideration of the papers I have seen) indicates that this is not the case. It is clear that, during the period 2006 to 2008, the FSA did engage with Firm A in an attempt to ensure that consumers (particularly those who had 'invested' with it prior to 16th March 2006) were protected by either the authorisation of the firm or by clearly being made aware of the protection available to them under section 26 of the Act.

Whilst a consumer may well expect that once the FSA becomes aware of an 'investment' which may be an unregulated CIS, it is immediately able to 'close' the firm. Unfortunately, the reality is that this is not the case. Ultimately, although the FSA may wish to 'close' a firm, *to do so it needs the support and agreement of the Courts* (my emphasis). However, the Courts are only willing to support such a request, correctly in my opinion, if the FSA (as the petitioner and Regulator) is able to show that the firm concerned has breached the Regulated Activity Order which is set out in the Act.

Unfortunately, to provide the Court with sufficient evidence, the FSA *must* (my emphasis) engage with the firm, conduct an investigation and collate sufficient evidence to support its petition. In my opinion, it is clear that the FSA, as part of its engagement with Firm A was attempting to do this. Although it is clear that Firm A and the FSA were engaged in discussions for a long period of time in relation to this matter. This unfortunately, this is not something which could be avoided.

Although it was clear to the FSA, and indeed it appears to Law Firm C, that the 'investment' Firm A was offering was a CIS and was a matter of some debate particularly in view of the legal opinion Firm A had obtained from counsel in October 2005. A consumer could argue, not unexpectedly, given the FSA's views on the matter it should, at that point, have taken immediate action against the firm. As is indicated above, to 'close down' a firm the FSA has to apply to the High Court and as such, the FSA is, to a large extent, reliant upon the evidential requirements of the Courts before such an order will be granted. I would, add for the sake of completeness, that the fact that Firm A had obtained a legal opinion (which conflicted with the FSA's view as to the nature of its activities) prior to contact being made by with the FSA means that the FSA could not *at that time* (my emphasis) show that Firm A was acting in breach of the Act when it first became aware of Firm A.

In this case, as is highlighted by the chronology, the firm (through Law Firm C) contacted the FSA itself when it became aware that the changes the FSA had made to the Perimeter Guidance *may have meant* (my emphasis) that it was conducting an unauthorised regulated activity. In this instance, the position was not straight forward as the firm itself held a legal view which indicated that the 'investment' it was offering (the "first scheme") was not a CIS. Although this was disputed both by the FSA and Law Firm C, until the situation could be considered further and the firm had had the opportunity to consider the FSA's views (and obtain and the second legal opinion from the QC) the FSA could not take any action.

Likewise, once the FSA had done this, given that the firm was actively engaging with the FSA in trying to resolve the situation (regarding the "first scheme") and to ensure that the 'investment' it was currently offering (the "second scheme") was acceptable to the FSA, the FSA could again not take immediate action against the firm. The reason for this was not because the FSA did not wish to protect adequately consumers but simply that, as indicated above, the extensive requirements *imposed by the Courts* (my emphasis) that must be met.

When dealing with what amounts to unauthorised business, the Courts have clear and extensive evidential requirements and usually must also see clear evidence of the firm's continued non co-operation with the FSA. This latter aspect is particularly influential and important when the FSA applies to the Courts.

In this case, the fact that Firm A *had appeared to co-operate* (my emphasis) by contacting the FSA itself and engaging with it, – 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 either the Company or its director. 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.

Whilst it is clear that ultimately the firm was unable (or potentially unwilling) to comply with the FSA's requirements, the fact that it had engaged with the FSA and appeared to be taking steps to meet the FSA's requirements was likely to be sufficient to satisfy the Court that it was cooperating with the FSA. As I have set above, the FSA cannot take any action to 'close' a firm or prevent it from accepting further 'investments' *without the support of the Court* (my emphasis). Similarly, it is also clear from the papers the FSA has presented to me that, although it was clearly becoming frustrated with the lack of progress the firm was making to fulfil the FSA's requirements, ultimately it still felt that it was unlikely (given the cooperation it appeared to have received from the firm) that the Courts would grant its petition until March 2008 (by which time it was clear that the FSA felt that it held sufficient evidence to show non-cooperation with its requirements).

Conclusion

I appreciate that you are unhappy with the outcome of the FSA's investigation into your complaint. It is clear that the FSA's decision letter could, and probably should, have set out in more details what actions the FSA took during the period 2006 to 2008 and the reason why there appeared to be a considerable delay between the FSA becoming aware of the situation and the FSA actually taking action.

Clearly from the chronology, which I have produced from information which the FSA freely provided to me, the FSA engaged in considerable correspondence with the firm with a view to ensuring that consumers were protected adequately. It is also clear that, as a result of these discussions, the firm appeared to have acted upon the legal advice it received to address the FSA's concerns/requirements with "first scheme" and ensure that its revised 'investment' (the "second scheme") meant that it was not a CIS under the Act (and as a result the firm did not need to be authorised by the FSA).

I have noted your comments in your reply to my Preliminary Decision that, in relation to the delay in 'meeting' with Firm A's previous auditor. In this case the FSA was engaging with Firm A and considering a number of issues surrounding Firm A's conduct. Whilst the FSA was interested in the reasons behind the departure of Firm A's previous auditor, given the 'co-operation' and engagement Firm A was having with the FSA, the FSA did not feel that it was necessary until late 2007 to make specific and further enquiries of the auditor. From the information provided to me, in all of the circumstances, this does not appear to be an unreasonable judgement for the FSA to have made.

I can equally understand why you hold the view that the FSA appears to have not taken immediate action and "*allowed itself to be led on this by [Firm A] with the full knowledge of risk to investors, granting time extensions...during and by which time the company auditors had resigned*". I can also appreciate why you feel that this "*constitutes an unreasonable delay under the circumstances and that the [FSA's] implied soft handling of the affair amounts to a lack of care, given the full and obvious knowledge of the ongoing risk to investors and the likely outcome in their respect*".

Whilst I can understand your comments, as I have explained above, it is not acceptable for the FSA to simply launch what could be destructive injunction proceedings against the firm with a view to restraining its business activities and freezing its assets without first allowing the firm the opportunity to explain itself and amend practises to comply with the FSA's requirements. I would add here that, for the avoidance of doubt, *the Courts* (my emphasis) are unlikely to support such an application without first seeing evidence that the FSA has tried to engage with the firm and that the firm has either refused to engage with the FSA or has failed to fulfil its undertakings it has made to the FSA. In this case as I have explained it appears that the FSA believed that, in view of the co-operation (although limited) it had received, the Courts were unlikely to grant it with an injunction against Firm A.

It is unfortunate that the firm appears to have subsequently reneged on the understanding it provided to the FSA, and in doing so appears to have acted against the legal advice it was given (by both Law Firms C and E and the QC). However, as I have set out above, the fact that the firm did this is not the fault of the FSA. I would also add that, although I accept that there was a significant period of time between the FSA becoming aware of the activities of Firm A and the FSA ultimately closing Firm A, the fact is that it was unable to take immediate action. As I have set out above, this was as the direct result of the evidential requirements of the courts and *not* (my emphasis) as a result of delays on the part of the FSA.

I would also add that I have noted your comments that, by closing Firm A, the FSA effectively closed the only way in which you could realise the capital which you invested with Firm A. I appreciate that you are likely to have lost a not insignificant amount of money as a result of the closure of Firm A, but this is not something which the FSA could avoid.

Clearly, as I have set out above, the FSA had tried to work with Firm A in an effort to ensure that those who 'invested' with it prior to 16th March 2006 received the appropriate level of protection and that those who 'invested' with it after 16th March 2006 did so in a way which was not in breach of the Act. Given that Firm A appears to have failed to follow the guidance it received from both its lawyers, a QC and the FSA, ultimately, the FSA had, in my opinion, no alternative other than to seek the closure of the firm. I would add here for the avoidance of doubt that once the Provisional Liquidators were appointed, the management and disposal of Firm A's portfolio of land (which ultimately would include your 'investments') was a matter for the Provisional Liquidators and *not* (my emphasis) the FSA.

I appreciate that you will remain unhappy with my decision but hope that my letter has set out why I have reached this conclusion and also clarified the procedures and evidential requirements the FSA must adhere to.

Yours sincerely,

Sir Anthony Holland
Complaints Commissioner