Complaints Commissioner

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2nd April 2012

Dear Complainant,

Complaint against the Financial Services Authority
Our Reference: GE-L01394

I write further to your letter of 8th February 2012 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

From your recent letter, I believe that your specific complaint relates to the following issues:

> You say that you received a cold call from a firm (which turned out to be a 'boiler room' operation) purporting to be an FSA authorised firm, Firm A. As a result of this call, on 1st November 2010, you invested £5,000 with the firm which you have now discovered that you have lost.
>
> You say that, before investing with the firm you contacted the FSA and were not made aware that the firm which contacted you purporting to be Firm A was likely to be a 'boiler room operation'.
>
> As a result, you allege that as, in your opinion, the FSA was negligent it is liable for the losses you say you have incurred.

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 nor have you suggested that the FSA has been guilty of bad faith on its part.

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.

My Position

As part of my investigation into your complaint I requested a full copy of the FSA's investigation file. I have now had the opportunity to review this file and can appreciate why you are unhappy with the situation. Before I comment further on your specific concerns I feel it may be useful if I provide some background on the genuine firm (which was not the one which contacted your client), Firm A, which is authorised by the FSA.

In this instance the genuinely authorised firm (which was not the one which contacted you), Firm A, was created in France, under French Law. As such it was regulated by the Autorité Des Marchés Financiers (which is French financial services regulator). Under the EU Investment Services Directive (ISD)[1], a firm's home regulator authorises a firm.

Once a firm has received authorisation from its home state regulator, providing that certain criteria are met, it can request what is called an 'EEA inward services passport' from its home state regulator will allow it to undertake regulated activity (or operate) in another EEA member state (such as the United Kingdom).

Once a firm has been granted with an 'EEA inward services passport' by its home state (in this case the French) regulator and the home state regulator has passed the required documentation to the host state regulator (in this case the FSA), the host state regulator is compelled to authorise the firm and to allow it to operate under its jurisdiction. In this case, once the Autorité Des Marchés Financiers had passed Firm A's details to the FSA, the FSA was compelled to authorise it to conduct regulated activity in the UK. In doing so the FSA provided Firm A with the authorisation number of X and authorised the firm with effect from 28th October 2003.

I would add here for the sake of completeness that when the FSA receives details of a firm which wished to operate within the United Kingdom on an 'EEA inward services passport', the FSA is *unable* (my emphasis) to request additional information before it allows an overseas firm to conduct business in the United Kingdom. Under the protocol which exists (and which forms part of EU law) regulators are *unable* (my emphasis) to 'gold plate' or increase their individual requirements above those set out under the protocol. I would also add that, under the 'EEA inward services passport' protocol the FSA is reliant upon the home state regulator (in this case the Autorité Des Marchés Financiers) to provide it with updates on the firm and notify it when if the firm creases trading. In this case, although the firm ceased trading in 2004, the Autorité Des Marchés Financiers failed to notify the FSA of this until November 2010.

[1] Markets in Financial Instruments Directive (MiFID) replaced the ISD. MiFID came into force on 1st November 2007.

I appreciate that your bank statements indicate that you 'invested' with Firm A on 1st November 2010 and you say that you confirmed the authorisation status of Firm A with the FSA prior to 'investing' with the firm. However, it is clear that, as part of the FSA's investigation into your complaint, it undertook a review of its call records and identified that it received three telephone calls from you.

Although I do not dispute your recollections, when undertaking a review into a complaint, have to base my findings upon the documentary evidence available to me. In this case, although you say that you called the FSA prior to investing, the FSA's records indicate that it received three calls from you and that these all took place after you had invested with the boiler room operation which was purporting to be Firm A. The FSA's records show that the calls you made to it took place on 2nd November 2010, 12th January 2011 and on 5th August 2011 and that only the calls which took place on 2nd November 2010 and 12th January 2011 related to the 'investment' you had made with Firm A.

I would add for the sake of completeness that the notes the FSA holds of the calls you made to it on 2nd November 2010 and 12th January 2011 clearly indicate that the FSA made you aware that the contact you received from those purporting to be from Firm A was likely to be a boiler room and you should not therefore 'invest' with it. The FSA's notes are recorded in the following terms:

> 2nd November 2010 at 10.17
>
> "*[Consumer] contacted by Firm A, potential boiler room cloning company. advised on all warnings details given from reg (sic), COLP [City of London Police] contact given reporting form completed*".
>
> 12th January 2011 at 12.28
>
> "*Client invested with company Firm A. Client unhappy that FSA advised that this was a regulated firm - explained that [previous operator] had given warning to say that it was a possible clone. Client unhappy that Bank B had allowed a fraudulent company to open an account - advised that this would need to be reported to the police, advised it would be noted on our system that client is unhappy that Bank B had allowed a fraudulent account. Explained scope of FSA, client advised that he is also dealing with FOS and FSCS with regards to his investment with this company. Explained risks of clone firms. Client unhappy that FSA is unable to sent (sic) out a complaint form for a bank - advised of [Complaints Team]*"

Whilst these notes are, I accept, brief, they do set out the reason why you called and details of what I believe to be the instructions given to you by the FSA in respect of the 'boiler room operation' (in relation to the payment of money). They also detail what the operator advised you.

It is clear from your letter that you feel that the FSA has not considered all of the calls you made to it, and that you feel the call you say you made prior to 1st November 2010 may mean the situation is viewed differently. Unfortunately, these are the only calls that the FSA has been able to locate and therefore consider.

Before I comment further, I would say that relying *solely* (my emphasis) on 'cold-call' sales tactics is *always* (my emphasis) a dangerous and risky practice. Frankly it should never be done. This is particularly true when the firm concerned is, or purports to be, based overseas and/or where it involves money being transferred to a bank account which is either overseas or is in a different name or territory to the firm from which the 'cold call' originated.

That in itself would be suspicious as well as unusual. I make this point as it is clear from the bank statement you provided that, despite the 'investment' being made through a firm purporting to be Firm A it appears that the money was transferred to an account in the name of "*C + NC Clients*". Given that you say that you say you have "*long business experience*", it is unclear to me why, given that the account name appears to be unconnected to the firm with which you were dealing, you chose to invest in what turned out to be a 'boiler room operation'.

I appreciate that you also provided copies of internal FSA correspondence which indicates that the FSA were aware of the existence of a 'boiler room operation which was purporting to be Firm A, prior to you 'investing'. In responding to your complaint I feel it may be beneficial if I set out the FSA's requirements *before* (my emphasis) it can alert members of the public to the existence of a 'boiler room operation'. Before the FSA can post an alert, it must satisfy itself that a firm in question either is a 'boiler room' or is acting in breach of the Act before it can posts any warnings on its website (as this may be to the detriment of a legitimate firm).

Under the Act, the FSA has four statutory objectives which are:

- market confidence – maintaining confidence in the UK financial system;
- financial stability - contributing to the protection and enhancement of stability of the UK financial system
- consumer protection - securing the appropriate degree of protection for consumers; and
- the reduction of financial crime - reducing the extent to which it is possible for a regulated business to be used for a purpose connected with financial crime.

Whilst the Act states these it does not provide any guidance with regard to the priority these should be given. As such the FSA is given a wide discretion on how it carries out its statutory responsibilities providing that they are consistent with the manner in which it carries out its general duties under the Act. I also feel that it may be useful if I refer you to Section 2 of the Act which sets out the FSA's general duties in the following manner:

(1) In discharging its general functions the Authority must, so far as is reasonably possible, act in a way—

(a) which is compatible with the regulatory objectives; and

(b) which the Authority considers most appropriate for the purpose of meeting those objectives.

(2) The regulatory objectives are -

(a) market confidence;

(b) public awareness;

(c) the protection of consumers; and

(d) the reduction of financial crime.

(3) In discharging its general functions the Authority must have regard to—

(a) the need to use its resources in the most efficient and economic way;

(b) the responsibilities of those who manage the affairs of authorised persons;

(c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

(d) The desirability of facilitating innovation in connection with regulated activities;

(e) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;

(f) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;

(g) the desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

(4) The Authority's general functions are—

(a) its function of making rules under this Act (considered as a whole);

(b) its function of preparing and issuing codes under this Act (considered as a whole);

(c) its functions in relation to the giving of general guidance (considered as a whole); and

(d) its function of determining the general policy and principles by reference to which it performs particular functions.

(5) "General guidance" has the meaning given in section 158(5).

From this you will see that, although the Act requires the FSA to discharge its regulatory objectives, it gives it discretion over how it does this providing that its act in a way which:

(a) is compatible with the regulatory objectives; and

(b) the Authority considers most appropriate for the purpose of meeting those objectives.

The composite effect of these provisions is to create an inevitable tension between market confidence and the reduction of financial crime, through the exercise of the FSA's regulatory powers and the protection of consumers. In effect the FSA has to balance sensitivity and careful judgement with the statutory requirements of all of its regulatory objectives. Issues like the ones raised in your complaint therefore will inevitably involve a consideration of difficult and differing courses of action for any regulator when seeking to deal both with prudential regulation and consumer protection. That is the generic background to the issues raised by your complaint.

Whilst it clear that the FSA first became aware of what it strongly believed to be a 'boiler room operation' purporting to be Firm A prior to 1st November 2010 as the firm was operating in the UK on an 'EEA inward services passport' the FSA had to make enquiries with the French regulator to establish if the firm was acting outside of its 'permissions' or whether its details had been 'cloned' by a 'boiler room operation'. Although the FSA contacted the French Regulator in October 2010 (as soon as it had been alerted to the action of the 'boiler room operation') it was not until 4th November 2010 that the FSA received confirmation that the genuine firm, Firm A, had ceased trading and the contact consumers had received originated from a 'boiler room operation' purporting to be Firm A.

I would add that from the information presented to me, it appears that the FSA took action to alert consumers as soon as it received confirmation that the firm had genuine firm had ceased trading in 2004 and that its details had been 'cloned' by a 'boiler room operation'. As such I feel that the FSA has acted appropriately and in a timely manner in alerting consumers.

Although I do sympathise with your position, I have to base my decision on the information I have available to me. In my opinion, having considered the information provided by both you and the FSA, I do not believe that you have provided sufficient, if any, evidence to show that the actions of the FSA *directly* (my emphasis) led to the loss you say you have incurred. This last aspect is important since the issue of what caused the loss is always relevant. Effectively what caused your loss was relying, for what plainly is for you an important investment, entirely on telephone calls from someone with whom you had had no previous contact and who was totally unknown to you and who had unfortunately also 'cloned' the identity of a genuine and legitimately authorised firm (albeit one which the FSA was unaware had closed some years before).

Conclusion

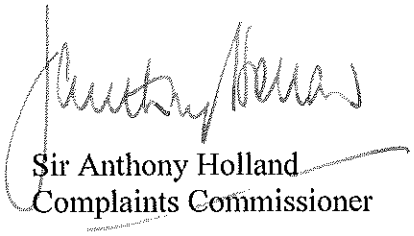
When considering whether I should conduct further investigations into your complaint, I have to consider the investigation and decisions taken by the FSA, the arguments and further evidence submitted by the complainant, together with the possible outcome or recommendations I could make. I must also take into account the legal position.

I appreciate that you maintain that the information the FSA provided to you was incorrect and that it was this incorrect information which directly led to your loss. However, as I have set out above, whilst it is clear you say that you contacted the FSA before investing, the information available to both the FSA and me, suggests that this is not the case. However, I would be happy to undertake a further review of the FSA's call logging system but, to enable me to do this, I will require you to confirm the date you contacted the FSA as, as I am sure you will appreciate, it is simply not possible for me to undertake any detailed examination of the FSA records of all calls received prior to the 1st November 2010 given that the FSA's own examination, although locating three calls, did not highlight a call being made before (my emphasis) 2nd November 2010. I would also add that, given that you invested on 1st November 2010 it is unclear why, and you have not offered any explanation yourself, you chose to contact the FSA on 2nd November 2010 to clarify the standing of the firm you believed to be Firm A.

I can and do understand that you have lost what is clearly not an inconsiderable amount of money, but this does not at the present time appear to have been the direct result of the FSA's actions. Indeed, from the information available to me, when receiving the 'cold calls' there is nothing to show that the individual with whom you are dealing was approved by the FSA and that they are simply provided you with the 'cloned' details of a genuinely authorised firm, albeit one which was operating in the UK on an 'EEA inward services passport'.

I am sorry that I am therefore not able to help further in this matter.

Yours sincerely



Sir Anthony Holland
Complaints Commissioner