Complaints Commissioner

Office of the Complaints Commissioner
3rd Floor
48–54 Moorgate
London EC2R 6EJ

Tel: 020 7562 5530
Fax: 020 7256 7559
E-mail: complaintscommissioner@fscc.gov.uk
www.fscc.gov.uk

20th September 2013

Dear Complainant,

Your complaint against the Financial Services Authority
Reference Number: GE-L01515

I write with reference to your letter of 27th June 2013 addressed to the Office of the Complaints Commissioner. Please accept my apologies for the delay in issuing you with my Final Decision.

Part 6 of the Financial Services Act (the 2012 Act) requires the regulators to maintain a complaints' scheme for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of their relevant functions. Section 84(1)(b) of the 2012 Act provides that an independent person is appointed as Complaints Commissioner charged with the task of investigating those complaints made about the way the regulators have themselves carried out their own investigation of a complaint that comes within that scheme. The appointment has to be approved by H.M. Treasury. I currently hold that role.

From 1st April 2013, as part of the changes implemented by the Government, the FSA was replaced by the FCA, the Prudential Regulation Authority (PRA) and the Bank of England as regulators of the UK's financial services industry. I would add that although the FSA has been replaced, transitional provisions have been put in place to enable the continued consideration of complaints against the FSA. As your complaint relates to the inactions of the FSA, in relation to its objectives and duties under the Financial Services and Markets Act 2000 (FSMA) your complaint has been considered by me under the new transitional complaints' scheme.

As set out in the consultation paper (CP12/30 Complaints against the regulators) and confirmed in the policy statement (PS13/7 Complaints against the regulators), any complaints which have not been concluded as of 1st April 2013 will continue to be investigated by the FCA Complaints Team with the cooperation of the PRA if needed and my office. In practice, this means that, although the governing legislation will have changed there will be no change to the manner in which, or the terms under which, your complaint is investigated.

Your complaint

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

- you are unhappy with the FSA's actions relating to its decision to place Stockbroker A (the firm) into the Special Administration Regime.

- specifically you say that the rules imposed by the FSA did not allow you to close the position you had opened in Stock Z on 3rd February 2012 (which had a settlement date of 2nd March 2012).
- you add that the FSA's actions resulted in you incurring a £10,000 loss (by having to settle the position). You have also suggested that, had you been able to close the position before the settlement date you would have been able to realise a £7,000 gain.
- you therefore feel that the FSA, in removing the firm's Part IV Permissions (and placing it under the Special Administration Regime), did not place your interests as a customer first and that it is this action which has directly led to the loss you say that you have incurred.

Coverage and scope of the transitional complaints scheme

The transitional complaints scheme provides as follows:

9.1 The transitional 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 under FSMA. The transitional 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.

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

9.3 The transitional complaints scheme does not apply to the Bank's functions under Part 5 of the Banking Act 2009 (overseeing inter-bank payment systems) as this was not previously subject to these complaints arrangements.

I should also make reference to the fact that my powers derived as they are, from statute contain certain and clear limitations in the important area of financial compensation. FSMA (as the relevant legislation in place at the time) stipulated in Schedule One that the FSA is exempt from "liability in damages". It stated:

(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.

I have referred to FSMA here as it was FSMA which was the relevant legislation when you first raised your complaint and when the actions about which you are unhappy occurred. This exemption has been rehearsed in sections 25(3) and 33(3) of Part 4 of Schedule 3 of the 2012 Act. I would add here for the sake of completeness that you have not alleged that the FSA (or the FCA) acted in bad faith nor have you adduced evidence of any act of bad faith on the part of the FSA which would have the effect of bringing 3(a) above into play.

The transitional complaints scheme nevertheless then goes on to provide in paragraph 6.6 that:

> *Where it is concluded that a complaint is well founded, the relevant regulator(s) will tell the complainant what they propose to do to remedy the matters complained of. This 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 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 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. There is no act taken by the FSA (or indeed by the FCA) which is incompatible with the Human Rights Act 1998 which directly caused you to lose your possessions. The loss you say you have incurred is your decision to invest with a stockbroker which subsequently admitted failing to segregated client funds from its own funds and utilising client money to meet its own operating costs and therefore placing the assets of all of its customers at risk.

My Position

As part of my investigation into your concerns I have obtained and reviewed the FCA's investigation file. In reviewing your complaint I have considered the comments you have made when corresponding both with the FCA's Complaints Team and my office.

From the correspondence I have seen it is clear that you opened a position with firm to purchase 10,000 shares in Stock Z (at a price of £1.29 per share) on 3rd February 2012 and that this position had a settlement date of 2nd March 2012. However, as part of the FSA's monitoring of the firm the FSA became aware that, due to losses, the firm had capital resource issues. As a result of further investigations, the firm admitted verbally to the FSA on 8th February 2012 *to utilising a considerable amount of client money* (my emphasis) to meet its own costs. The firm confirmed this in writing to the FSA on 9th February 2012. The FSA therefore had, correctly in my opinion, significant concerns over the considerable amount of money which remained in the firm's client account together with the assets it held on behalf of its customers.

Given these concerns and the information presented to it, the FSA, as the UK's financial services regulator, had a statutory duty to protect consumers generally. The FSA's general duties were set out in Section 2 of FSMA (as this was the relevant legislation which was in place at the time) and are described 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 FSMA required the FSA to discharge the regulatory objectives, an order of prioritisation in which the statutory objectives must be considered by the FSA was not set within FSMA. Instead FSMA provided the FSA with a discretion over how it prioritised its objectives and how it carried out its duties stipulating only, in Section 2(1), that it must act in a way which:

(a) was compatible with the regulatory objectives; and

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

The composite effect of these provisions is to create an inevitable tension between market confidence, 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.

Whilst I appreciate that you feel that the FSA failed to protect you as a consumer who had invested through (and held an open position with) the firm in question, I feel it may be useful if I explain why the FSA placed the firm under the Special Administration Regime. On 10th February 2012, the FSA issued the firm with a Supervisory Notice which prevented it from carrying out its business. This Supervisory Notice also froze the assets the firm held for both itself and those who had invested with it (although it allowed the firm to continue to close open positions for its customers).

As I have indicated above the FSA issued this Supervisory Notice and placed the firm under the Special Administration Regime as it became concerned that the firm had failed to protect and segregate the money it held on behalf of investors from its own money. Given that the FSA was also concerned that the firm *by using* (my emphasis) the money it was holding for investors to meet its own costs this in effect may have deprived some consumers of their investments.

I appreciate that you are unhappy with the FSA's actions, but as the FCA explained in its letter of 13th June 2013, that the FSA was aware that the firm had not protected (or segregated) clients assets from its own assets. Given this, the FSA appointed Administrator B, as the firm's administrator, and required it to undertake a full reconciliation of client assets and to ensure that the reconciliation and return of client money took priority over the interests of other creditors. The administrators also needed to confirm which client assets the firm may have used for its own purposes and then had to ensure that the affected consumers were placed in the correct positions (i.e. had their investments returned or placed in the position they would have been in had the firm not used the clients' assets for its own purposes).

Although the Supervisory Notice the FSA issued on 10th February 2012 prevented the firm from conducting regulated activity, this *did not* (my emphasis), as I have indicated above, apply to the firm's ability to close open positions on behalf of its customers. However, any proceeds the firm received as a result of the closure of a customer's open position would not have been immediately released to the customer as the firm's assets had to be frozen to allow this reconciliation. In my opinion, it would have been difficult for the administrators to complete the reconciliation (and ensure that consumers were not adversely affected) if the firm was allowed to continue to trade (on both its own and its investors accounts). It should also be noted that the Supervisory Notice also *required the firm* (my emphasis) to write to its customers and notify them of the FSA's actions.

I would also add that given the FSA's concerns and the issue of the Supervisory Notice, I understand that, on 17th February 2012, the London Stock Exchange decided to suspend the firm's membership. This resulted in the firm being unable to trade on either its own account or on behalf of those clients who had invested with it (including those who held open positions). It is ultimately the action of the London Stock Exchange which resulted in you being unable to close your open position in Stock Z.

I would stress here that the decision to suspend the firm's membership of the London Stock Exchange was a decision which was made by the London Stock Exchange, and although possibly linked to the issue of the FSA's Supervisory Notice, was not a decision which was directly influenced or was requested by the FSA. Given the firm's suspension from the London Stock Exchange, once the reconciliation of stocks had been completed, the administrator made arrangements to transfer the firm's assets (which included all open positions) to Stockbroker C, a different stockbroker, who had entered into a commercial arrangement with the firm to take over the management of its clients' investments. I would add here that the FSA *did not have any involvement* (my emphasis) in the appointment of or the transfer of the firm's assets to Stockbroker C.

In your letter to my office you have stated that you are seeking appropriate compensation from the FSA as a result of the losses you have incurred as a direct result of its actions. As I have set out above, the problems you have experienced are, in my opinion, the result of the firm's actions and what subsequently transpired and not as you suggest the result of the FSA taking action to ensure that consumers had not been adversely affected by the firm's failure to protect (and segregate) its clients' assets. With this in mind, if you feel that you have been adversely affected as a result of being unable to either 'trade' on your investments or obtain dividend payments from the firm in a timely manner then you should refer your concerns to the Financial Services Compensation Scheme (FSCS). The FSCS can be contacted at:

Financial Services Compensation Scheme
7th Floor, Lloyds Chamber
1 Portsoken Street
London
E1 8BN

Telephone: 0800 678 1100 or 020 7741 4100

Email: enquiries@fscs.org.uk

In taking action that the FSA did, and which it was required to do under FSMA, the FSA made arrangements to allow the firm, through Administrator B, to action consumer's instructions to close open position. I accept that, in your case, the short time scale involved before the settlement date of the options you purchased in Stock Z made it difficult for you to arrange the closure of your open positions before the settlement date. However, this is not the fault of the FSA as the situation ultimately resulted from the actions of the firm and/or its administrator who took over responsibility for the firm (after the issue by the FSA of the Supervisory Notice on 10th February 2012). Given this, I continue to believe that this is something which could fall under the jurisdiction of the FSCS or should be pursued with the administrators.

I appreciate that in your response to my Preliminary Decision you confirmed that you have been in contact with the FSCS and that, in December 2012, the FSCS rejected your complaint. Whilst I appreciate that the FSCS has made this decision, from the correspondence I have seen the basis upon which you approached the FSCS and upon which the FSCS reached this conclusion is unclear. Whilst, as the FSCS has explained in its letter, it is unable to compensate a consumer for the loss of potential gain, it may be able to compensate a consumer for a loss incurred *as the direct result* (my emphasis) of the firm's actions which resulted in the consumer's inability to close an open position which then resulted in consumer incurring a loss. Whilst I hold this view I should point out that this is ultimately something which falls under the FSCS's jurisdiction alone and is for the FSCS itself to rule upon. Nevertheless I do suggest you re-open this matter with the FSCS as soon as possible. I would also be grateful if you could inform me of the outcome.

I appreciate that my Final Decision will not be the one you had hoped to receive but I hope that you will understand why I have concurred with the FSA's decision that the FSA should not offer you any form of redress. Clearly the FSA had an obligation to protect consumers generally and it is simply not possible for the FSA to assess the impact its actions may have on each customer of a firm. When taking action any Regulator will be placed in an unenviable position of having to protect consumers generally rather than all consumers individually, this is particularly true when there is a requirement that action must be taken urgently. Although the relevant Regulator must take steps to reduce the impact its actions may have on consumers, it is the inevitable price of intervention in such matters that some consumers may be adversely affected.

As I have set out above, FSMA did not place an order of prioritisation in which its statutory objectives must be considered and provided the FSA with a discretion over how it prioritised its objectives and how it carried out its duties stipulating only that it must 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.

There is nothing I have seen which indicates that the FSA failed to act appropriately in this instance as the action it took was both "*compatible with the regulatory objectives*" and was what the FSA considered to be the "*most appropriate for the purpose of meeting those objectives*" as the firm had openly admitted to the FSA that it had utilised a considerable amount of client money to meet its own costs.

The FSMA places a duty upon the FSA to take action to protect consumers generally which in this case would extend to protecting client assets and preventing the firm from utilising these for its own benefit. The FSA did this. Once the FSA had placed the appropriate protection in place (removing the firm's permissions, freezing its assets and appointing administrators) the FSA's involvement ended. It was *the administrators* (my emphasis) who were given the responsibility of reconciling assets, and then transferring these to a different broker. As the firm was effectively in administration, it was the administrators who would also be responsible for auctioning your request to close an open position. As such, any responsibility for the delay in transferring the assets (to allow you to deal with Stockbroker C) or in carrying out your instructions to close your open position would appear to fall on the administrator and the arrangements it put in place *rather* (my emphasis) than the FSA.

Although I do have sympathy for the position you find yourself in, as you have clearly lost an amount of money as a result of the trade you entered into with the firm, ultimately, from the information presented to me by both you and the FSA, there is nothing to suggest that the FSA acted inappropriately in placing the firm into the Special Administration Regime as a result of its admission that it had used a considerable amount of client money to meet its own expenditure or that its actions *directly* (my emphasis) led to you being unable to close out your open position and to realise the gain as you have alleged.

Yours sincerely

Sir Anthony Holland
Complaints Commissioner