Complaints Commissioner

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Dear Complainant,

Your complaint against the UK's Financial Services Regulators
Reference: GE-L01553

I write with reference to your letter of 5th June 2013 addressed to the Financial Conduct Authority (FCA) and the FCA's letter to you of 3rd July 2013 in connection with the above. As the FCA has explained due to the introduction of new legislation the complaint which you made to the FCA can now be considered by my office and, given that you asked for an independent review of the FCA's investigation, the FCA has passed the papers to me.

I need to explain my role and powers. 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 correspondence with the FCA, I understand your initial complaint relates to the following issues:

- You say that you, like 13,000 other consumers, were looking to transfer money into foreign currencies and were utilising the services of Firm A, a Small Payment Institution (SPI). You add that, although you transferred around £20,000 to Firm A as a result of its collapse the foreign currency you had requested (Euros) was not delivered to you and you are now unable to recover the £20,000 you have lost.

- You feel that FSA, as the regulator in place at the time of Firm A's failure, did not take the appropriate action when assessing Firm A's application. Specifically, you feel that the FSA did not complete adequate due diligence on the directors of Firm A, specifically Person B (Mr B), and, if it had, it would have discovered that one of Firm A's directors had a criminal conviction. In your view this criminal conviction should have resulted in the FSA rejecting Firm A's application.

- As a result of the information you allege the FSA provided to you, you say you proceeded to engage the services of Firm A. Unfortunately, before the transfer was completed, Firm A went into administration and as a result you say you have lost £20,000.

- You are also looking for the FCA to provide you with redress of £20,050 which reflects the money you lost as a direct result of Firm A's failure. Additionally, you also feel that the other 13,000 other consumers who have been financially disadvantaged as a result of Firm A's failure should also receive full compensation from the FCA.

As you remained unhappy with the outcome of the FCA's initial investigation into your complaint, you challenged the outcome of its investigation and asked for an independent review of its investigation to be undertaken. In making this request you set out that:

- You have challenged that FCA's interpretation of the impact The Rehabilitation of Offenders Act 1974 has on Mr B's convictions. Specifically you feel that these would not be classed as 'spent' convictions due to the overarching impact of FSMA and suggest that the FSA was negligent in approving Firm A.

- You add that the FSA did not act upon the warnings it received about the nature of Firm A's business model and operations

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 the FSA considered your complaint. This exemption has been rehearsed in sections 25(3) and 33(3) of Part 4 of Schedule 3 of the 2012 Act. You have not 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 conclusions 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 a subsequent regulator) which is incompatible with the Human Rights Act 1998 or which has caused you to lose any possessions. The losses you incurred were as a result of the actions of a FSA registered firm rather than the FSA (now the FCA) itself.

My Position

I have now had the opportunity to review the FSA's investigation file and your submissions to my office. I note that the FCA, when investigating your complaint, notified you that the role of the transitional complaints scheme (at that time) was to consider allegations concerning the actions or inactions of the Regulator when undertaking its functions as set out within FSMA.

Unfortunately, given that you were complaining about the Regulator's actions in respect of SPIs, the rules of transitional complaints scheme (at that time) specifically prevented your concerns from being considered. The Regulator's responsibilities for SPI were not part of the Regulator's functions as set out within FSMA but were responsibilities passed to the Regulator as result of the introduction of the EU's Payment Services Directive (2007/64/EC) which was implemented within the UK through the Payment Services Regulations 2009. Given the rules in place at the time, I concur with the Regulator's view that your concerns were not ones which could be considered under the rules of the transitional complaints scheme.

Notwithstanding this, I note that the Regulator provided you with a detailed explanation which it believed provided you with background to its actions in respect of Firm A. It is this additional information which you have now challenged and which I have been asked to consider under the revised transitional complaints scheme which was introduced on 1st April 2013.

From the papers presented to me it is clear that you were looking to convert around £20,000 of money into Euros. Although you transferred £20,050 to Firm A, I understand that Firm A did not provide you (either in physical form or by way of an electronic transfer to a bank account) with the Euros you had requested/ordered.

In your initial complaint to the FCA, you highlighted that "*none of this would have happened if you had done your due diligence on the Director [Mr B] who applied for registration with the FSA*". From this it appears that you clearly appreciate that there is a difference between "registration" with the regulator and "authorisation" by the regulator.

I appreciate that, when challenging the FCA's original decision, you have provided details of the "*Changes to registration procedures for money transmitters*". Whilst this document is useful *it only applies* (my emphasis) to applications from firms which have applied for registration since 1st October 2012. Firms which were registered prior to this date received registration under a different process which *did not require* (my emphasis) them having to meet the new registration criteria. I would however add, for the sake of completeness, that all firms which currently hold a registration status with the FCA will also have to meet these criterions by 30th September 2013. I understand that the registration status of any firm which cannot meet this requirement may then be reviewed.

It may be useful at this point if I provide briefly some background information relating to why firms like Firm A are now either registered with, or authorised by, the FSA because the distinction is so important. Following the implementation of the EU's Payment Services Directive (2007/64/EC) in 2007 by way of the Payment Services Regulations 2009, all firms offering money transfer services had to be either registered with or authorised by the FSA. The criteria for this was established by the EU Directive which set out that all firms who conducted up to €3M per month of qualifying payment transactions in a rolling average simply needed to be registered with the relevant regulator. Whereas all firms which conducted more than €3M per month of qualifying payment transactions in a rolling average this amount had to be authorised by the relevant regulator.

Under the Directive (and the Regulations), any firm which conducts transactions totalling more than €3M and therefore needs authorisation (rather than registration) will be subject to the normal authorisation and approval process. This approval process extends to consideration of applications from both the firm and the firm's individual directors (who would then be subject to the Regulator's usual 'fit and proper' tests).

However, any firm conducting small amounts of business (i.e. less than €3M per month) only needed to be registered with the FSA and was not required to go through the full authorisation and approval process (which did not extend to conducting 'fit and proper' tests on the firm's directors). Additionally, firms which were only registered with the Regulator were not subject to the Regulator's usual monitoring and supervision. Instead these firms were only required to submit periodic reports to the Regulator about that firm's activities.

Although the difference between registered with and authorised by the FSA may seem small to a consumer and even appears to be a distinction without a difference, it does have significant safety implications. Ultimately, as I have set out above, the FSA was not required by law to undertake significant checks into the background of the individuals running firms which are simply registered with it. The FSA was only required to undertake high level checks that none of the individuals responsible for management or operation of the business convicted of crimes relating to money laundering, terrorist financing or other financial crimes, that it is based in the UK; and that the firm was registered with HM Revenue and Customs (HMRC).

When registering a firm, such as Firm A, as the firm was already registered with HMRC, the FSA (as the Regulator) only required an application form to be submitted on behalf of the firm, itself, it *did not* (my emphasis) require an individual application form from the individuals responsible for the management of the firm. Given that Firm A was an SPI and the registration of an SPI firm *was not* (my emphasis) a FSMA activity, the Regulator was unable to undertake further background checks to confirm that the information provided by the applicant (i.e. the firm) was accurate.

I would however add that, had a criminal conviction on the part of a management or operation of the business been disclosed, the FSA would only have been able to seek further information about this conviction to allow it to determine whether the conviction fell into any of the relevant categories (i.e. money laundering, terrorist financing or other financial crimes). This is particularly relevant as, given that Mr B *was not* (my emphasis) seeking individual approval as part of this application (and accordingly was not therefore subject to a "fit and proper" test), the FSA would not have been able to seek to obtain further specific information either directly from him or other sources in connection with this application.

Additionally, I feel that I must add that, had Mr B's conviction been disclosed on Firm A's application form (which for the avoidance of doubt it was not), whilst this it would clearly have resulted in further more detailed consideration of the application, this on its own would not automatically mean that an application would be rejected. Where the offence/conviction was an isolated occurrence, it occurred some considerable time before the application was submitted and was for what could possibly be described as a relatively minor offence the then Regulator, had a discretion to make a judgement on whether to approve the application.

My role under the transitional complaints scheme is to undertake an independent review of the manner in which the current UK financial services regulators have undertaken their own investigation of a complaint, and under the transitional complaints scheme, to consider how the FSA did this. My role is not to review or second guess the regulatory judgements which do not form part of the complaints process. However, it is clear to me that your complaint in the context of whether a firm with which Mr B was a Director should have been registered with the FSA in this context does not come within any of the grounds set out in 9.1 (a)-(e) set out on page three earlier.

I have also noted your concerns regarding the manner in which Firm A managed its bank accounts but this is also something the Regulators could not address, regardless of the 'intelligence' it received. I must address a fundamental issue that arises at the onset of your problem and that relates to your expectations of what the Regulator can or cannot do.

If a firm is authorised the Regulator does have a considerable input into the way that firm conducts its affairs and there is a clear regulatory input. However, if it is not authorised, as in the case of Firm A, then the Regulator's input is limited to monitoring how a firm conducts its payment services activities (for example, that it transfers funds in a timely manner and that it discloses its charges clearly to customers). The Regulator has no power to check other aspects such as a firm's conduct or solvency. The mere fact that it is "registered" with the Regulator as a result of European legislative input does not bring with it any regulatory benefit nor the kind of safety reassurances that you were seeking.

There are also differences in relation to the safeguards which are in place regarding the safety of customer's money. As indicated above, there are no requirements for registered firms to put in place any arrangements to safeguard customers' money. Whereas, in the case of a firm authorised firm, arrangements must be put in place to safeguard customers' money whilst the firm is holding it (if overnight or longer). This applies if the amount of the transaction is more than £50.00, in which case they must safeguard the full amount and not just the amount of money over £50.00. The safeguarding arrangements must be kept separately (for example in a different account) to their own funds, so that if the firm ran into financial difficulties customers' money would still be safe.

Although authorised firms have to put in place safeguarding arrangements these arrangements there is a further complication. These arrangements *only apply to money it has received for making a payment transaction* (my emphasis). Money a firm receives for other business activities, including that received by it for a future purchase of foreign currency (whether or not this will then be transferred) would *not* (my emphasis) be covered by these safeguarding rules even if the firm was authorised. I would add here, for the avoidance of doubt, that, as Firm A was only registered with the FSA, these requirements would not apply in any event.

As I have explained above, the Regulator was only able to comment upon a firm's conduct in relation to activities which fall within its monitoring jurisdiction (in this case the Regulations). Specifically, in relation to Firm A, the FSA is only able to comment upon its conduct in relation to activities connected with the transfer of money and *not* (my emphasis) activities related to the holding of money for a future foreign exchange transaction. I make this point here as, although you have stated that you transferred money to Firm A, you have not indicated whether the money was transferred for immediate or future exchange and remittance

Firm A was registered with the FSA in relation to its money transfer activities (as required by the Regulations). As foreign exchange transactions are not regulated activities (under either FSMA, the Act or the Regulations) the FSA is unable to monitor or indeed comment upon the firm's activities in relation to this. I appreciate that as a result of the collapse of Firm A you have lost a significant amount of money which you had sent electronically to Firm A in respect of a currency exchange and transfer. Although I have considered your complaint and have considerable sympathy for the position you find yourself in, there is nothing to indicate that the Regulator failed in its statutory duty given the requirements placed upon it.

I am therefore unable to help you in this matter. I hope I have explained why.

Yours sincerely,

Sir Anthony Holland
Complaints Commissioner