Complaints Commissioner

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24th September 2013

Dear Complainant,

Your complaint against the Financial Services Authority
Reference: GE-L01565

I write with reference to your email of 16th August 2013 addressed to the Office of the Complaints Commissioner. Please accept my apologies for the delay in issuing you with my Decision Letter. This delay has been caused by me requesting further information from the Financial Conduct Authority (FCA), one of the regulators which has replaced the Financial Services Authority (FSA).

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 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 relations 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 email to my office I understand that your complaint concerns the fact that:

- you are unhappy with the outcome of the FCA's investigation into your complaint.
- specifically you feel that the FCA's investigation concentrated upon the events surrounding the failure of Investment Manager A and its associated funds as a whole rather than the specific failure of Investment Manager A's Finance Fund.
- despite the fact that FCA addressed your concerns on a wider basis that you felt was necessary you still feel that the FSA failed to supervise and monitor adequately Investment Manager A's Authorised Corporate Director (ACD), Firm M.
- you add that, whilst the FSA introduced a redress scheme for the investors of Investment Manager A, you feel that "*the funds were totally mis managed (sic) and the FSA should not be letting Firm M off the hook. The funds were basically used to prop up old bad investments. This was not what the marketing literature said it was going to be for*".
- you add that as "*I am looking for the loss incurred to be compensated by Firm M and not my Financial Adviser. Firm M should have been better monitored by the FSA as to what it was actually doing with the funds and what their literature promised. I therefore believe that the FSA should ultimately be made responsible for making up my loss*".

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 investigation into your complaint commenced and when the events 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. 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 regulated firm (Firm M), in relation to the investment choices it allowed to take place, through the actions of Fund manager A, *rather* (my emphasis) than as a direct result of the actions of the FSA itself.

My Position

From your letter to my office I can appreciate why you are unhappy with the events which occurred and the loss you now face as a result of the failure of the suspension of all of Investment Manager A's funds as a whole and specifically the Finance Fund in which you invested.

Having now had the opportunity to review FCA's complaint investigation file I note that, although the FCA provided you with a great deal of information surrounding the FSA's actions, it felt that ultimately this was not something which it was able to consider under the rules of the Transitional Complaints Scheme. I believe that the FCA has relied upon paragraph 3.5 of the rules of the Transitional Complaints Scheme, as it felt that your concerns amounted to dissatisfaction with the manner in which the FSA had supervised Firm M and the manner in which the consumer redress scheme, of which Firm M is a party, had been designed. Having viewed the papers presented to me, as you have not provided any evidence to suggest that the Regulator has acted unreasonably, unprofessionally or alleged any other misconduct on its part, I concur with the FCA's view that it can correctly rely upon the provision contained within paragraph 3.5 of the rules of the Transitional Complaints Scheme. For completeness, paragraph 3.5 of the rules of the Transitional Complaints Scheme states:

3.5 Circumstances where the regulators will not investigate

The regulators will not investigate a complaint under the Scheme which they reasonably consider amounts to no more than dissatisfaction with the regulators' general policies or with the exercise of, or failure to exercise, a discretion where no unreasonable, unprofessional or other misconduct is alleged.

Although the FCA relied, correctly upon paragraph 3.5 of the rules of the Transitional Complaints Scheme not to investigate fully your complaints I note that the FCA provided you with additional information in relation to circumstances surrounding the suspension of the investment funds (and associated sub-funds) provided by Investment Manager A. However, although the FCA did this, I appreciate that you felt that the FCA addressed the circumstances surrounding the Investment manager A's funds as a whole rather than the Finance Fund in which you invested and that this may have an impact upon how your complaint was considered.

With this in mind, I feel it may be useful if I provide you with details, by way of background, to the creation of the Investment Manager A funds and Firm M's subsequent involvement as the funds ACD. Given the 'interaction' between all of Investment Manager A's funds, I have provided details for both Investment Manager A's Diversified and Investment Funds. The Finance Fund in which you say you invested was a "sub-fund" of Investment Manager A's Investment Fund

Investment Manager A's Diversified Fund was created in 2002 by Investment Manager X. The fund was authorised by the FSA with Investment Manager X acting as ACD. Investment Manager X continued as ACD until September 2007 when Investment Manager A acquired the rights to act as investment manager to a portion of Investment Manager X's business. This acquisition led to the rebranding of the fund as Investment Manager A's Diversified Fund. It was also this acquisition which led to Investment Manager A delegating Firm M as ACD on this fund. At the time of its suspension, Investment Manager A's Diversified Fund had four sub-funds (the Global Growth, the Balanced Fund, the Income Fund and the Finance Fund).

Prior to acquiring the rights to act as investment manager for a number of Investment Manager X's funds, on 29th June 2006 Investment Manager A launched its own fund, the Investment Fund. At the time of the launch Investment Manager A appointed Firm M as ACD for the fund. However, although Firm M was appointed as ACD at the fund's launch, Firm M subsequently delegated the role of investment manager back to Investment Manager A. At the time of its suspension, Investment Manager A's Investment Fund had two sub-funds (the Investment Portfolio and the Specialist Portfolio).

As indicated above at the time of the suspension of Investment Manager A's two funds Firm M was the ACD for both of the Funds. The ACD is a corporate body and authorised person given powers and duties by the Regulator to operate an Open Ended Investment Company (OEIC). The directors of an OEIC must take all practicable steps to ensure that the OEIC has a qualified ACD on the board. The ACD's responsibilities include dealing with the day to day operation of the OEIC, managing the OEIC's investments, buying and selling the OEIC's shares on demand, and pricing the OEIC's shares based on the value of the OEIC's assets.

These responsibilities (particularly responsibility for managing the OEIC's investments) may be delegated, but overall responsibility for performance of the obligations remains with the ACD. An OEIC is also obliged to have a depositary, which is a firm independent of the OEIC and its directors that holds the legal ownership of the OEIC's assets and is responsible for their safe custody. It also has responsibility for taking reasonable care for ensuring that the ACD complies with its regulatory obligations.

The Regulator's Rules for authorised firms acting as authorised fund managers, a term that includes the ACD function, are set out in COLL, which came into force on 12th February 2007. In this case, as a result of its investigation into Firm M's actions as ACD it was clear that Firm M did not adhere to the Regulator's rules in respect of a number of its principles. The Regulator's findings are set out in the Final Notice which it issued on 13th November 2012.

Whilst the Regulator's findings are set out within the Final Notice, these can be summarised as breaches of Principles 2 (skill, care and diligence) and 3 (management and control) of the Regulator's Principles for Businesses (the "Principles") and Rules contained in the parts of the FSA Handbook relating to Collective Investment Schemes ("COLL") which occurred between June 2006 and March 2009. In essence, the FSA found that Firm M failed to adequately identify and mitigate potential conflicts of interest between Investment Manager A as delegated investment manager of the funds and the funds themselves, and failed monitor the performance and compliance of Investment Manager A, including a failure to monitor what processes were in place to ensure that Investment Manager A complied with the prudent spread of risk obligation.

From the Final Notice the FSA issued to Firm M, the Regulator accepts that, Firm M did monitor the quantitative investment and borrowing power restrictions (which would include that the investments were in transferable securities or other such similar investments). However, Firm M did not have sufficient controls to assess whether the funds were invested in assets which would provide a prudent spread of risk as required by the Regulator's rules. The Regulator also sets out that, the Regulator would expect the ACD, where it has delegated the investment management function, to have sufficient controls in place to allow it to understand the investment manager's risk management and investment-decision making processes, and to assess how a consideration of the prudent spread of risk obligation was factored into those decision-making processes. In this case, the Regulator sets out that it did not believe that Firm M's process met this requirement.

I appreciate that you appear to feel that the Regulator, having found that Firm M had failed to meet its required standards in overseeing the actions of the delegated investment manager, should have been instructed to reimburse all investors for all of the losses they have incurred. As I have indicated above, the taking of action against a firm (and the level of any sanction applied as a result of that action) is a matter for the Regulator's judgement following consideration of all of the evidence available to it (some of which it may not be possible to place in the public domain due to the confidentiality restrictions imposed upon the Regulator by FSMA and the 2012 Act.).

When commenting on this, my starting point must be FSMA itself (as this was the legislation which was in place when the Regulator took action against Firm M and when you made your initial complaint to the Regulator). Section 2 of the FSMA 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 a 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, through the exercise of the Regulator's regulatory powers (and a judgement concerning how it acts) and the protection of consumers. In effect the Regulator had 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 and I have borne in mind when examining in detail all the many records the Regulators have now presented to me when I examined your complaint in all its detail.

Next I turn to the issue of disclosure of what action the Regulator took. A complainant may pose the question "*why did the Regulator not take action to safeguard fully my interests as a consumer?*" In answering that question however Parliament has imposed real restrictions upon both the Regulator and myself by the imposition of section 348 of FSMA as to how that question can be answered in the case of a complainant. I would add that these restrictions have been repeated in section 18 of Part 2 of Schedule 12 of the 2012 Act and apply to all of the new Regulators.

In summary, Parliament by virtue of Section 348 of FSMA (and section 18 of Part 2 of Schedule 12 of the 2012 Act) imposes upon the Regulators (both past and present) a ruling of confidentiality in the context of disclosing its response or position when acting in the discharge of its functions as the relevant regulator. This means that, other than in limited circumstances, the Regulator is unable to disclose any information about what action it did or did not take against a firm or individual (and the reasons for that decision).

While I do not believe that the exceptions apply, and I cannot comment further, I do myself have the power to delve more deeply into such matters, in my role as Complaints Commissioner, to enable me to be satisfied as to the propriety of what the Regulator has done (and may be continuing to do). I am however, although I can do this, limited, in most cases, as to the further disclosure of the details that I am informed about. I am therefore unable, directly, to answer the questions you have posed.

However, what I can say is that, from the information the Regulator has freely provided to me, it does appear that it has carried out appropriately its duties under FSMA. The Regulator's action in this regard resulted in the creation of a compensation fund which aims to provide consumers with redress equal to approximately 70% of the value of their holding at the time of the fund's suspension.

Although I cannot comment in depth on what action and why it arrived at the decision it did, I can confirm that the information provided to me indicates that the Regulator considered in considerable detail all of the information presented to it. Following its own enquiries I believe that the FSA undertook what I consider to be reasonable course of action and arrived at a judgement which does not, to me, appear to be irrational.

Whilst I am limited in respect of what additional detailed information I can provide to you, I feel that I should set out that I am particularly drawn to this view as a result of the information which the Regulator has given to me which indicates that it believes that Firm M was not solely responsible for consumer losses as there were failings by a number of other parties (in relation to the sale of and administration of Investment Manager A's products), some of which are not authorised by the UK Regulators. I appreciate that you will be disappointed that I cannot provide you with specific further information, over and above that what is set out in Firm M's Final Notice, in relation to the Regulator's decision making process, but I hope you will understand why that is the case.

I can appreciate why you are unhappy that the redress scheme introduced by the FSA does not meet fully all of the losses consumers will face as a result of their Investment Manager A's investments. However, the Regulator has taken the view that, although Firm M's oversight of the matters it delegated to Investment Manager A was insufficient, it was not solely responsible for consumer losses.

Where an investor relied on unsuitable advice from an independent financial adviser (IFA) in making an investment in any of the Investment Manager A's funds, the investor is entitled to recover from the firm the full amount of loss arising from that advice. If IFAs are found to be at fault, they may be responsible for investor losses, but if they are not at fault, they will not be held responsible. The Regulator has informed me that, in its opinion, there was considerable mis-selling of Investment Manager A's products by the industry, which is clearly not the fault of the parties involved in the redress scheme. I would add the fact that the Regulator has held Firm M responsible for certain breaches of COLL and its Principles for Businesses rules, for which an adviser is not responsible, does not alter that position.

I would also add at this point that you have commented that "*the marketing literature [for the Finance Fund] stated categorically that the risk was long term and low to medium and the funds would be invested in asset backed companies*". Whilst the Regulator viewed the fund as a higher risk, the risk rating of the fund was not set by the Regulator, or even Firm M. The risk/classification of a fund is independently considered by the Investment Management Association (IMA) who, in this case, rated the Finance Fund as 'cautiously managed'. Given this rating by the IMA, it would not appear to me to be unreasonable for Firm M to market the fund in accordance with the IMA's risk rating.

I would also add that an adviser, when making a recommendation to a consumer, should not solely rely upon the firm's marketing literature but must also look at the a number of other factors which would including reviewing the underlying assets of the fund as set out within a fund fact sheet as this sets out where investments are made (including the highest holdings and the asset/sector breakdown of the underlying investment).

Whilst you invested shortly before the suspension of Investment Manager A's funds it must be remembered that the Finance Fund was a sub-fund of Investment Manager A's Diversified Fund. This means that, whilst each sub-fund has its own investment aims and are held, to a degree, separately from other sub-funds within the main fund, the assets were actually owned by the Diversified Fund. Given this it is not, in my opinion, possible for investors to be treated separately based upon their 'investment aims' and 'investment date' as the assets are ultimately pooled together within the main fund (which in this case was Investment Manager A's Diversified Fund).

I appreciate that you feel that, in view of what you believe to be failures in the Regulator's supervision and monitoring of Firm M it "*should ultimately responsible for making up my loss*". Whilst I can appreciate why you hold this view, investing in any type of asset backed investments (including cautious managers or even unitised with profit funds) does not offer any guarantee of security (particularly where the amount invested is above the amount where the Financial Services Compensation Scheme guarantees to provide 100% protection).

In this case the Regulator has identified that there have been failings on the part of a regulated company but has also identified that the losses incurred are not the sole result of the regulated firm's actions. The failings which resulted in your overall loss result from the actions of a number of firms which operated in different jurisdictions. Given this the Regulator created a redress scheme which it believes is appropriate in all of the circumstances. I would add that I have not been presented with any evidence to show that this is not the case (particularly given the different parties and jurisdictions involved in this unfortunate event).

Conclusion

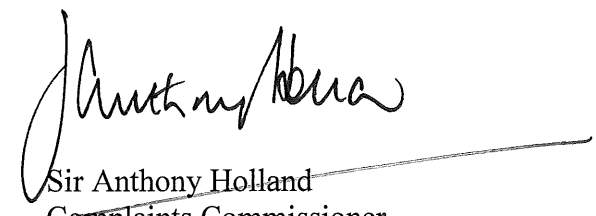
As I have explained, whilst the Regulator did not undertake a full investigation into your complaint it did consider the issues and provided you with a considerable amount of information to assist your understanding of the overall position in relation to its investigation into Firm M, the suspension of Investment Manager A's funds and actions of IFAs. Given the provisions of the 2012 Act and the rules of the Transitional Complaints Scheme, I believe that this was a reasonable position for the FCA to adopt.

I would however add for the sake of completeness that the Regulator also appears to have arrived at a judgement in respect of Firm M which, in my opinion, does not appear irrational. I appreciate that you would like me to provide further details of why I have reached this conclusion but, as I have indicated above, the provisions of Section 348 of the Act prevent me from doing this.

As I have explained above the FSA had to balance sensitivity and careful judgement with the statutory requirements of all of its regulatory objectives. Here it has undertaken the appropriate enquiries of Firm M and made what appears to be a reasonable and rational judgement based upon all of the information available to it. Clearly there were failing on the part of Firm M and the Regulator has highlighted these in the Final Notice which was issued on 13th November 2012. Whilst it is unfortunate that, the redress scheme that the Regulator created (with the voluntary agreement of Firm M and the involved other parties) has not compensated fully consumers, but, as the Final Notice has explained, the losses consumers incurred were not wholly attributable to Firm M.

Whilst I concur with the FCA's decision that this is not something which can be investigated under the rules of the Transitional Complaints Scheme I hope that my comments have provided you with further clarification and understanding of the events which transpired in this unhappy matter.

Yours sincerely,



Sir Anthony Holland
Complaints Commissioner