

Financial Services and Markets

FSA Enforcement Cases – suitability and change of control

Henry Neil Limited – failure to comply with suitability requirements

On 9 September 2009, the FSA fined the small IFA Henry Neil Limited ("HNL") £14,000 for giving unsuitable investment recommendations to its clients, breaching Principle 9 (Customers: relationship of trust) and a number of associated conduct of business rules. The FSA found a number of failings to comply with suitability requirements: the most serious of these failings related to recommendations to a number of customers to surrender a segment of a particular existing offshore investment bond and to reinvest the proceeds of sale in a new bond. HNL did not explicitly link the surrender and reinvestment recommendations, or explain the consequences of the transaction overall.

Taking HNL's failings as summarised in the Final Notice, the following clear warnings have been sent to all investment advisers and investment managers subject to the suitability requirements in COBS 9:

- You must conduct a proper individual assessment of each customer's attitude to risk, considering his particular needs and circumstances – having exactly the same risk rating for all customers (as HNL did for all 35 of the files reviewed by FSA) suggests that the "fact find" element of the suitability assessment (in terms of assessing a client's knowledge, experience, financial situation and investment objectives) has not been completed properly;
- You must undertake adequate or independent product research – this must involve consideration of alternative products and, assuming they are not considered suitable, you should provide an explanation as to why not in the suitability report;
- You must ensure that the suitability report is concise and intelligible for the client and the risk warnings are not hidden or diluted – above all, the suitability report must be individually tailored to the relevant client and must show the basis upon which the firm has concluded that the recommended investment matches the client's attitude to risk and investment objectives. Having long and complicated suitability reports packed with generic, duplicative information suggests an unthinking approach;
- You must show that the risk rating for a recommended product matches the particular customer's attitude to risk;
- Your suitability reports must detail all of the charges and costs associated with the recommendation – they must also indicate whether or not the recommended investment will be financially beneficial and whether or not it will mitigate any potential tax liability;
- Overall, the suitability assessment must be carried out on a client-by-client basis – you cannot afford to allow the process to become homogenised and generic.

Please [CLICK HERE](#) for the Final Notice.

Vijay Kumar Sharma – failure to pre-notify change of control is a crime

The FSA secured its first criminal conviction against someone for failing to notify it about a change in control at a regulated firm prior to the change taking place. The Financial Services and Markets Act 2000 prohibits any acquisition or increase in control over a regulated firm except where the FSA is notified in advance and either the FSA consents or the FSA's assessment period elapses. "Control" includes holdings of 10% (or, for some firms, 20%) of the shares or voting power in a regulated firm or its parent.

Mr Sharma was the sole director of mortgage broker Exetra (UK) Limited. He acquired a controlling interest in the firm but failed to give the FSA prior notice of that fact. He was fined £3,000 by the City of Westminster Magistrates Court for failing to make this notification. He was also fined a further £3,000 for making false and misleading statements to the FSA contrary to section 398 of the Financial Services and Markets Act 2000.

While it appears from the FSA press notice that the FSA considered that Mr Sharma's failure to notify the FSA of the change of control was deliberate, rather than accidental, the case sends a number of very clear messages to all would-be controllers about the importance of complying with the change of control requirements:

- Failure to comply with the statutory requirements is a **criminal** offence. Following changes to the law, the offence can now be tried on indictment, as well as summarily – consequently, criminal fines in future are likely to be a great deal higher than the one imposed on Mr Sharma;

- The FSA is clearly minded to pursue criminal sanctions for failure to make the required notifications – do not be lulled into thinking that it will reserve this approach only for particularly egregious cases;
- The Witness Statement from Graeme Ashley-Fenn, Director of Permissions, Decisions & Reporting Division at the FSA, which is attached to the FSA press release, refers to the fact that, of the 512 notifications of change of control which the FSA received in the first five months on 2009, 163 of these were "after the event" – i.e. the change of control had already taken place. It is important to note the following:

As regards the statutory requirements applicable to controllers/would-be controllers:

- Any person who decides to acquire or increase control over an authorised firm must notify the FSA **before the change** – i.e. no "after the event" notification is permitted for the controller/would-be controller in any circumstances; *and*
- No such change of control can proceed unless either FSA consent has been obtained or the FSA assessment period has elapsed.

As regards the FSA rule requirements applicable to authorised firms:

- A firm must notify the FSA as soon as it becomes aware that a person has decided to acquire or increase/decrease control over it; or
- Where the change of control takes place without the knowledge of the firm, the firm must notify the FSA within 14 days of becoming aware of the change of control.
- Any controller or prospective controller must therefore ensure that it makes **prior** notifications as required by the legislation and does not proceed with the acquisition of, or increase in, control unless FSA approval has been obtained or the FSA assessment period has elapsed – failure to comply with these requirements is a criminal offence.

Please [CLICK HERE](#) for the Press Notice.

If you would like further information or advice on these matters, please contact Margaret Chamberlain, Jane Tuckley or Tim Lewis in the Financial Services and Markets Department or your usual contact at Travers Smith.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T +44 (0)20 7295 3000
F +44 (0)20 7295 3500

www.traverssmith.com



Margaret Chamberlain
margaret.chamberlain@traverssmith.com
+44 (0)20 7295 3233



Jane Tuckley
jane.tuckley@traverssmith.com
+44 (0)20 7295 3238



Tim Lewis
tim.lewis@traverssmith.com
+44 (0)20 7295 3321