

Financial Services and Markets

FSA wins appeal in Fox Hayes case on approving financial promotions

On 17 February 2009, the Financial Services Authority ("FSA") won its appeal in relation to two Financial Services and Markets Tribunal ("FSMT") decisions regarding Fox Hayes, a solicitors firm. This case will be of interest to all firms that approve financial promotions for others, particularly where the third party promoter is based overseas.

Background

Between 2003 and 2004, Fox Hayes approved 34 financial promotions for five overseas companies. These promotions offered recipients a free research report, and also asked them to confirm that they would like to be contacted about further services. The emphasis of the communications was on the former (the free research report), whereas their primary purpose was the latter (to obtain the recipient's consent to be contacted in relation to other investment opportunities). Investors who gave consent were then contacted by the overseas companies, who tried to persuade them to invest in high risk, illiquid overseas securities. In the long term, almost all of these securities lost most of their value.

The Court of Appeal's findings

The Court found that Fox Hayes had breached FSA rules requiring firms that approve financial promotions:

- to take reasonable steps to ensure those promotions are clear, fair and not misleading (COB 3.8.4R(1)); and
- not to approve promotions for an overseas person unless they have no reason to doubt that the overseas person will deal with UK customers in an honest and reliable way (COB 3.12.6R(2)).

The Court also increased the penalty imposed by the FSMT against Fox Hayes from £146,000 to £954,770, to include a £454,770 secret commission made by Fox Hayes' former senior partner.

Commentary

Fox Hayes was held to have breached FSA financial promotion rules in force during 2003 to 2004. Since broadly equivalent requirements apply today, the Court's comments on Fox Hayes' specific failings are highly relevant to firms' current systems and controls for approving third party promotions.

In particular, Longmore LJ held that Fox Hayes:

- had failed to take reasonable steps to ensure the promotions it approved were clear, fair and not misleading, as it knew that the true purpose behind those promotions (i.e. to contact investors to sell them high risk shares) was disguised; and
- had reason to doubt that the overseas companies would deal with UK customers in an honest and reliable way because:
 - Fox Hayes knew the promotions' true purpose was disguised, and that they were not therefore clear, fair and not misleading; and
 - the fact that Fox Hayes' former senior partner had received substantial secret commissions in connection with the promotions was deemed to be within the knowledge of the firm as a whole.

Key points for firms

The case is a boost for the FSA in its fight against overseas boiler rooms and other share scams and, more generally, in pursuing its strategy of credible deterrence. Margaret Cole, FSA director of enforcement, indicated that firms should expect the FSA to take action not only if they actively assist boiler room operators, but also if they "turn a blind eye to the legitimacy of their clients in exchange for fees or commission".

However, the lessons of the case go beyond the world of boiler rooms and share scams. Firms that approve financial promotions for others may wish to consider the following key messages:

- firms must consider carefully in each case whether and on what grounds they can confirm that third party promotions comply with applicable FSA rules;
- firms should be prepared to look beyond what the ostensible purpose of a third party promotion might be, to identify its true purpose - what is missing, or obscured, may be as significant as what is written; the purpose of the promotion must be clear on its face;
- firms should think about their knowledge and understanding of the third party's business in determining whether:
 - a promotion is clear, fair and not misleading; and
 - there is any reason to doubt an overseas third party's honesty and reliability;
- information within the knowledge of all staff is relevant to the firm's compliance with the FSA's requirements, even if that information is not widely known within the firm – firms should take account of this in their systems and controls (e.g. by training staff and implementing clear policies and procedures in relation to approving third party promotions).

The full judgment is available online at: <http://www.bailii.org/ew/cases/EWCA/Civ/2009/76.html>.

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