



Reference No: FS/2010/0012

FINANCIAL SERVICES – Part IV Permission – Refusal by Authority – Application for permission to conduct insurance broking activity – Lack of understanding of requirements of regulatory system – Lack of experience – Threshold Conditions 4 and 5 – Reference dismissed – FSMA 2000 s40

**THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
FINANCIAL SERVICES**

**MOHAMMED KARIM
T/A MK INSURANCE SERVICES**

Applicant

- and -

FINANCIAL SERVICES AUTHORITY

The Authority

**Tribunal: SIR STEPHEN OLIVER QC
CHRISTOPHER CHAPMAN
NICHOLAS DOUCH**

Sitting in public in London on 15 March 2011

The Applicant in person

Adrian Berrill-Cox of the Financial Services Authority

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DECISION

The Reference

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1. By reference notice of 8 June 2010 the Applicant (Mr Mohammed Karim) referred the Authority's Decision Notice of 29 April 2010 to the Tribunal. The reasons given for Mr Karim's reference are:

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"I have applied to work as an independent insurance broker under the name of M-K Insurance Services. I have experience in this branch. I have worked before and I am working at the moment as insurance broker. But the FSA refuse my application to work as an independent insurance company. They believe that I don't have experience. This is the reason that I want to refer the case to the Upper Tribunal."

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2. The decision taken by the Authority which Mr Karim refers to this Tribunal is to refuse his application under section 40 of the Financial Services and Markets Act 2000 ("the Act") for Part IV permission to carry on the regulated activities of (a) advising customers on non-investment insurance contracts, (b) arranging (bringing about) deals in non-investment insurance contracts, (c) making arrangements with a view to transactions in non-investment insurance contracts; (d) dealing as agent in non-investment insurance contracts, (e) assisting in the administration and performance of a non-investment insurance contracts and (f) agreeing to carry on regulated activity. Mr Karim, having come to understand the meaning of "dealing as agent" and "assisting in the administration of a non-investment insurance contract", has confirmed that he will not be undertaking these regulated activities and that they can therefore be removed from the application.

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The legislative background

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3. Section 41 of the Act provides:

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"The Threshold Conditions

(1) "The Threshold Conditions", in relation to a regulated activity, means the conditions as set out in Schedule 6.

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(2) In giving or varying permission, or imposing or varying any requirement under this part the Authority must ensure that the person concerned will satisfy, and continue to satisfy, these threshold conditions in relation to all of the regulated activities for which he has or will have permission.

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(3) ..."

4. The relevant Threshold Conditions for the purposes of this reference are Threshold Conditions 4 and 5. Threshold Condition 4 is set out in paragraph 4 of Schedule 6 to the Act and provides:

5 “(1) The resources of the person concerned must, in the opinion of the Authority, be adequate in relation to the regulated activities that he seeks to carry on, or carries on.

10 (2) In reaching that opinion, the Authority may –

(a) ...
(b) have regard to –

15 (i) ...
(ii) the means by which he manages and, if he is a member of a group, which other members of the group managed the incidence of risk in connection with his business”.

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5. Threshold Condition 5 is set out in paragraph 5 of Schedule 6 to the Act and provides that:

25 “The person concerned must satisfy the Authority that he is a fit and proper person having regard to all the circumstances including:

(a) his connection with any person;
(b) the nature of any regulated activity that he carries on or seeks to carry on; and
30 (c) the need to ensure that his affairs are conducted soundly and prudently.”

35 6. COND 1.3.1G in the Authority’s Handbook under Threshold Conditions acknowledges the general obligation under section 41 of the Act that the Authority must ensure the firm will satisfy, and continue to satisfy, the Threshold Conditions in relation to each regulated activity for which it has, or will have, permission. In doing so, the Authority will consider this in the context of the size, nature, scale and complexity of the business which the firm carries on or will carry on if the relevant application is granted. In relation to Threshold Conditions 4 and 5, the Authority will consider whether a firm is ready, willing and organised to comply, on a continuing basis, with the requirements and standards under the regulatory system which applied to the firm.

45 7. Threshold Condition 4 requires the Authority to ensure that a firm has adequate resources in relation to the specific regulated activity or regulated activities which it seeks to carry on (COND 2.4.2G). In this context, the Authority will

interpret the term adequate as meaning sufficient in terms of quantity, quality and availability, and “resources” as including all financial resources, non-financial resources and means of managing its resources; for example, capital, provision against liabilities, holding of or access to cash and other liquid assets, human resources and effective means by which to manage risks. The Authority will consider whether the firm is ready, willing and organised to comply with the systems and controls and the “prudential standards” part of the Handbook when assessing whether it has adequate resources.

8. When considering whether a firm will satisfy and continue to satisfy Threshold Condition 4, the Authority will have regard to all relevant matters, whether arising in the UK or elsewhere (COND 2.4.4G(1)). Relevant matters may include but are not limited to whether the firm has taken reasonable steps to identify and measure any risks of a regulatory concern that it may encounter in conducting its business and to have installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times.

9. In complying with the “systems and controls” procedure, a firm is required to plan its business appropriately so it is able to identify, measure and manage the likely risks of regulatory concern it will face.

10. COND 2.4.6G recognises that any newly formed firm can be susceptible to early difficulties. These difficulties could arise from a lack of relevant experience and judgment or from ill-constructed and insufficiently tested business strategies. Consequently the FSA will expect the firm which is applying for Part IV permission to take adequate steps to satisfy itself and, if relevant, the FSA that it has a well constructed business plan or strategy plan for its product or service which demonstrates that it is ready, willing and organised to comply with the relevant characteristics in the prudential standards part of the Handbook and the systems and controls part as applied to the regulated activity that it ceases to carry on. The application for permission should demonstrate that its business plan or strategy plan has been sufficiently tested and that the financial and other resources of the firm are commensurate with the likely risks it will face.

11. Turning now to Threshold Condition 5 (suitability), COND 2.5.2G requires the firm to satisfy the FSA that it is “fit and proper” to have Part IV permission having regard to all the circumstances including its connections with other persons, the range and nature of its proposed (or current) regulated activities and the overall need to be satisfied that its affairs are and will be conducted soundly and prudently. The FSA will also take into consideration anything that could influence a firm’s continuing ability to satisfy this threshold condition including the suitability of the individual or individuals concerned with the firm. Key to the Threshold Condition 5 requirements is the overall need for the FSA to be satisfied that the affairs of the firm will be conducted soundly and prudently.

12. COND 2.5.6G allows the Authority, in determining whether a firm will satisfy and continue to satisfy Threshold Condition 5 in respect of conducting its business

with integrity and in compliance with proper standards, to have regard to all relevant matters. These matters include whether the firm has been open and cooperative in all its dealings with the Authority and is ready, willing and organised to comply with the requirements and standards under the regulatory system. The firm must have taken
5 reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements under the regulatory system that apply to the firm and to the regulated activities for which it has, or will have, permission.

13. By COND 2.5.7G relevant matters to be taken into account include, where the
10 business is that of “insurance mediation activity”, that all persons directly involved in its insurance mediation activity demonstrate the knowledge and ability necessary for the performance of their duties.

Mr Karim’s Application for Part IV Permission

15 14. Section 6 of the application form dealing with compliance arrangements states the necessity of establishing compliance procedures before the applicant firm is authorised and that the firm must, as a minimum, have in place compliance procedures relating to, among other things, complaints handling, reporting
20 requirements, notification to the FSA and reliance on others. The items listed under compliance procedures together with matters separately listed should form the core of a “compliance manual”. In response Mr Karim confirmed that he would have documented compliance procedures in place and would have a compliance monitoring programme in place. He also confirmed that all senior management would be aware
25 of and understand the compliance procedures.

15. The application form also refers to “treating customers fairly” (“TCF”). In response to this Mr Karim confirms that he has the procedure in place to confirm with the management information required in respect of TCF. (The FSA has expressed the
30 view that Mr Karim has not been sufficiently specific in answering this question or demonstrating an understanding of TCF.)

The decision of the FSA

35 16. The FSA declined Mr Karim’s application for Part IV Permission. It was unsure, in the light of the information supplied by Mr Karim, whether he would satisfy and continue to satisfy the Threshold Conditions in relation to the regulatory activities for which he sought permission. Specifically the FSA was not sure that his
40 “resources” were adequate for those activities for purposes of Threshold 4. In that connection he appeared to have little of a business plan, little awareness of the obligations of the FSA as regulator to the market and little awareness of his own compliance obligations to the regulator and of his duties to his own customers.

17. Regarding Threshold 5 (suitability), the FSA was not satisfied that Mr Karim’s
45 affairs would be conducted soundly and prudently. The proposed activities included “insurance mediation”, i.e. acting as broker between customers and insurance providers, a business that required a back-up or locum to stand in if Mr Karim were

incapacitated; it also called for the need to treat customers fairly. Mr Karim had not, in the view of the FSA, satisfactorily demonstrated his skills and experiences in understanding, operating and managing the proposed activities. This was further evidenced by his response to the question as to locum arrangements which appeared to be “prospective” in that it indicated “if the business is going well” he would expand his office by renting a bigger office and employing somebody on a commission basis or from a job agency on a temporary basis as locum. This, in the view of the FSA, did not address the immediate requirement.

10 **Conclusions**

18. In common with the FSA we recognise that the only resource of substance available to Mr Karim is Mr Karim himself. To be satisfied as to Threshold Condition 4 the FSA, as regulator, must ensure that Mr Karim has the necessary ability to carry out and continue to carry out the regulatory activities in compliance with proper standards and demonstrate a continuing readiness and ability to comply with the relevant requirements of the regulatory system. In common with the FSA, we are not satisfied from the evidence that Mr Karim satisfies and will continue to satisfy Thresholds 4 and 5. His honesty and his integrity have never been in dispute. He has not, however, demonstrated relevant experience of broking and of the obligations arising in the course of a broking business which are assumed by the broker to his customers and to the insurance providers. Moreover, while he has passed sufficient professional exams to give him the knowledge of the regulatory system, he has not satisfied the FSA or us that he has demonstrated a practical grasp of the requirements of the system. He has not shown that he understands the most basic and relevant of those requirements.

19. The evidence available to us has included Mr Karim’s answers on his original application form, his written and oral responses to subsequent queries raised by the FSA and his explanations to us in the course of the present hearing. We will now examine the particular topics that the FSA have regarded as significant. None of those are, by themselves, determinative of Mr Karim’s suitability; the overall balance is the important thing.

20. Mr Karim does not appear to have been fully aware of the implications of the “capital resources” requirement. During the course of written representations to the FSA (of the RDC proceedings) he had stated that he had capital resources totalling £10,000; however, he has failed to provide any evidence in support of that figure. There appears to be an inconsistency between the figure of £10,000 and the sum stated in the statement of assets and liabilities provided by Mr Karim in an e-mail of 24 August 2009 (which document, the FSA have pointed out, exaggerated his net assets by over 50%). This feature is not determinative however. This is because we are not aware that Mr Karim’s proposed business activities, which will not involve handling clients’ funds or providing clients with credit, will require much in the way of capital backing.

21. Mr Karim appeared to the FSA to be unaware of the demands of the Threshold Conditions. He told us that his “trading manuals” had covered these and he complained that the FSA’s questions were satisfied by cliché-ed answers which were not appropriate to his business activities, being activities that were essentially very straightforward and very easy. We shared the FSA’s concerns in this respect. Mr Karim did not satisfy us that he had grasped the implications of conducting business as a broker at the scale that he anticipates. The particular transaction between him that the customer and with the insurance provider may be straightforward, but taken collectively they carry with them the relationships and obligations that are directly within the area of responsibility of the FSA. In that connection we observe that, as regards the reporting requirements, he was not aware of the RMAR (the principal reporting form for firms of his type). Mr Karim had stated that he kept his records on a computer system so he would be able to provide the information when required. His explanation regarding RMAR reporting was that he would have his records available for inspection by the FSA. That, we agree, indicates a lack of understanding on Mr Karim’s part as to the means by which the FSA conducts regulation.

22. On compliance monitoring Mr Karim had said, when asked about establishing a system – “I meant, if the FSA want to check my work at any time, I have everything ready for compliance checking”. We have already observed, as regards Threshold Condition 4, that the FSA has to be sure that, among other things, the firm seeking permission must have a system in place that enables the firm to identify and measure any risks of a regulatory concern that it might encounter in conducting its business and that it has installed appropriate systems and controls. The firm has to be proactive in reporting any concerns to the regulator; it cannot rely on the regulator to unearth problems. As we understand Mr Karim’s evidence, no constructive thought has been given by him to those aspects of compliance. We share the concerns of the FSA.

23. Then, as regards the requirement to treat customers fairly, we note that Mr Karim had explained to the FSA that he believed this to relate to offering the cheapest quote to his customer. That is plainly an inadequate response. His answers to the application form on this topic are, as we have already observed, too vague to give us any assurance in this respect.

24. We come now to an assessment of Mr Karim’s relevant experience. We see this as an important feature regarding Threshold Condition 5.

25. Mr Karim describes himself as having been an estate agent and prior to 2005 as having arranged home and contents insurance “on my own for my clients”. He worked with another person who qualified and became regulated in 2005 and after that Mr Karim sent his clients on to this person. This person is not however able to be a referee since he has not been a regulated broker. Mr Karim describes his insurance business as being that of a general insurance broker in the years before regulation for about three years, presumably between 2002 and 2005. However, in his CV supplied to the FSA, there has been no mention of any involvement in insurance broking. The FSA asked Mr Karim what exposure he had had to UK regulation, having regard to the fact that he had not advised clients since 2005. Mr Karim’s response had been

that millions of people arrange various types of insurance without involving brokers and do it on-line. He said however that the area in which he intended to become involved could not be arranged on-line. He went on to say that he was qualified as an insurance broker and had worked in this area since before 2005. In this respect he said:

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“I know all FSA compliance rules and working as an insurance broker is very easy for me and I will totally be in compliance with the FSA rules.

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I kept the up-to-date with IFS learning materials in the general insurance market to maintain competence.”

26. It seems to us that Mr Karim’s current lack of experience explains the disingenuous and unconvincing replies that he has given to enquirers as to his understanding of the regulatory requirements with which he would need to comply and of the importance and relevance of those requirements. But more to the point his inexperience is, we think, fatal to his present application. We note in this connection that Mr Karim is unable and unwilling to provide references. Possible referees are, he said, not prepared to involve themselves with the FSA in any way. This is a further flaw in Mr Karim’s application for permission. Finally in this connection, we mention that we, in common with the FSA, are concerned that Mr Karim has not appeared to recognise the need for adequate back-up facilities should he become incapacitated. These are essential and Mr Karim’s failure to place any real emphasis on, for example, the engagement of a locum is a symptom of how out of touch he is with the requirements to organise himself so as to comply with the prudential parts of the FSA’s Handbook and the systems and controls procedure.

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27. For all those reasons we think the FSA was right. The FSA, like us, cannot be sure on the available evidence that Mr Karim satisfies and will continue to satisfy the conditions in Threshold Conditions 4 and 5. We therefore dismiss the reference.

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28. Having said that we think that with experience and advice as to the practicalities of the regulatory system, so far as it relates to his line of business, Mr Karim may become better able to claim Part IV Permission. He is a person of integrity. But he has done himself no favours by pursuing his quest for permission entirely on his own and without the help of an employer, partner, referee or adviser.

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SIR STEPHEN OLIVER QC

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RELEASE DATE: