FSA: REGULATORY ACTION AGAINST INDIVIDUALS – withdrawal of approval – prohibition order – fit and proper – obligations under Pensions Review – importance of compliance – disposal of assets without making proper provision for review – lack of integrity – proportionality of action – test to be applied

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

(1) ERNEST THOMAS RAYNER

(2) JOHN ROBERT TOWNSEND

Applicants

- and -

THE FINANCIAL SERVICES AUTHORITY

Respondent

Tribunal: WILLIAM BLAIR QC (Chairman)
MAURICE BATES
KEITH PALMER

Sitting in London on 14, 15, 16, 19 and 20 July 2004

Mr Peter Dodge, instructed by Vincent Sykes, for the Applicants

Mr David Mayhew, instructed by the Respondent, for the Respondent

DECISION

1. The Applicants are both financial advisers. The present matter arises out of the sale of their business on 20 October 2000. In summary, the Financial Services Authority ("FSA") contends that the sale was in deliberate disregard of their obligations under the Pension Review, the burden of proof being on the FSA. The Applicants on the other hand contend that the sale was a proper one, and that they had no reason to suppose that it would be likely to lead to a failure to comply with the Review.

2. Two decisions of the Regulatory Decisions Committee of the FSA both dated 17 October 2003 have been referred to the Tribunal. By the first, a prohibition order was made against Mr Ernest Rayner, by which he was prohibited from performing any controlled function relating to any regulated activity carried on by any authorised person. A financial penalty of £128,000 was also imposed on him. By the second, a prohibition order and financial penalty in identical terms were imposed on Mr John Townsend, and in addition his approval to perform the investment adviser function with a firm called Croesus Financial Services Ltd was withdrawn.

3. The Applicants contend in their References (both of which are dated 12 November 2003) that these decisions were inappropriate and disproportionate. In effect, they maintain that they should be able to resume their business as investment advisers. The position as regards the financial penalties is no longer relevant. Since the Decision Notices, the FSA has subsequently concluded that the operation of the two-year time limit in section 66(4) of the Financial Services and Markets Act 2000 prevented it from imposing penalties under that section. This is not an issue which has been re-opened before the Tribunal, though the Applicants have understandably said that the imposition of the penalties caused them considerable anxiety and distress.

4. Very similar issues arise in the case of each Applicant, and their References have been heard together, pursuant to the Tribunal's directions of 15 March 2004 under rule 9 of the Financial Services and Markets Tribunal Rules 2001.

The Pension Review

5. We must begin by giving a short description of the Pension Review. In 1988, a new type of pension was created. It was called the "personal pension", and such products were put on the market by most if not all major insurance companies. Individuals could choose to "opt out" of their employers' "occupational" pension schemes, and were given the right to transfer the cash equivalent of the pension benefits they had built up in the schemes into personal pensions. The evidence before the Tribunal is that more than 550,000 personal pensions were sold in the first two months. In the next five years, more than five and a half million were sold.

6. By 1992, it had become clear that a large number of people may have lost out, and may have been mis-sold personal pensions. They would have been better off joining, or remaining within, their occupational schemes. There were complaints about the manner in which the personal pensions had been sold to them. In December 1993, according to the evidence before us, KPMG reported that the applicable code of business requirements had been followed in less than one in ten of the pension transfer cases they had looked at.

7. In 1994, the Securities and Investments Board ("SIB"), which was then the "umbrella" financial services regulator in the United Kingdom, launched the Pensions Review, and initiated a programme of compulsory investigation for all product providers and intermediaries. This process took considerably longer than had been initially anticipated. It involved a very large number of firms including most life assurance companies, banks, and financial advisers. Because there were so many people potentially affected, firms had to look at the people most at risk first. These were those who had already retired, were close to retirement or who had died. They were called 'priority cases'. Priority cases were to be dealt with in Phase 1 of the Pensions Review. Following subsequent consultation, the FSA and the Personal Investment Authority ("PIA") issued a joint statement in 1998 setting out the policy for the review of the lower priority cases, which were called Phase 2 cases. The Applicants and their company had responsibilities under both Phase 1 and Phase 2. Through the course of the review, guidance was issued on a regular basis to the firms concerned.

8. According to the evidence of Mr Heather of the FSA, both phases of the pension review are now more or less done, although he also said that some three hundred firms failed to meet the deadlines set, and a substantial number still have not done so. 1.6 million people have had their pensions reviewed, and 1.1 million have been compensated. The scale of the task is shown by the fact that by the time all cases are finished, the industry will have paid out more than £11.5 billion in compensation, in addition, it will also have cost the industry some £2 billion to do the review work.

The Applicants

9. Most of the history of the Applicants and their business are not in dispute, though some of the key facts certainly are. Our findings of fact are as follows. Mr Townsend went into the insurance industry in 1979. Some years later, he set up on his own, and in 1983 he went into partnership with a Mr Michael Bugg. In 1986, he met Mr Rayner, who after training, was invited into the partnership. In 1989, Townsend & Bugg Financial Services was incorporated as Townsend & Bugg Financial Services Ltd, a company which in 1996 changed its name to Townsend Rayner Associates Ltd following what we were told by Mr Townsend was an amicable parting of the ways with Mr Bugg. This company has been referred to during the hearing as "TRAL".

10. Townsend Rayner Associates Ltd carried on business as Independent Financial Advisers ("IFAs") in the Kettering area, and according to the letterhead, the company sold investments, pensions and life assurance. Under the Financial Services Act 1986, which was then the applicable legislation, Townsend Rayner Associates Ltd required authorisation to carry on such business, which it obtained by way its membership of the PIA, one of the self regulatory organisations operating beneath the SIB. Mr Townsend and Mr Rayner were the directors of the company, and as directors and advisers, they were required to be (and were) registered with the PIA as Registered Individuals. (The equivalent term under the Financial Services and Markets Act 2000 is "Approved Person".)

Townsend Rayner Associates Ltd and the Pension Review

11. Mr Dodge, counsel for the Applicants, contends that these References are not about the competence of the Applicants in conducting the Pension Review. In that regard, their case was that whilst with hindsight they may have "bitten off more than

they could chew", they did their honest best. They believe that they devoted greater resources to the Review than many of their peer group.

12. The Tribunal agrees that the subject of the References is not the Applicants' competence or otherwise in conducting the Pensions Review. The FSA's case is one of lack of integrity in connection with the sale of the business, not lack of competence in carrying out the review. Nevertheless, it is clear that the manner in which the Applicants dealt with the Pension Review constitutes an essential part of the factual background, and we shall have to consider it in some detail.

13. The Applicants' evidence is that they began to undertake Phase 1 of the Pension Review in 1995. Their witness statements (standing as evidence in chief) explain the very considerable amount of work involved. In 1996, the company wrote to the PIA accepting liability for clients of Townsend & Bugg Financial Services (the partnership) for the purposes of the pension review. On 22 December 1998, Mr Rayner returned a form to the FSA indicating that Phase 1 had been completed. We note that as the result of the internal assessments carried out, none of the clients either of the partnership or the company had been offered redress.

14. On 21 January 1999, the FSA's Desk Based Monitoring wrote rejecting the assertion that the Review had been completed. (By now, the FSA was acting on behalf of the PIA. It only later assumed its statutory responsibilities under the Financial Services and Markets Act 2000 at the so-called "N2" being the day when the 2000 Act came into force on 1 December 2001).

15. There is one other background matter to mention which happened at this time. In January 1999, the excess under the Professional Indemnity Policy which covered Townsend Rayner Associates Ltd for claims relating to the Pension Review was increased from £2,500 to £10,000. The practical effect was significantly to increase the company's exposure in respect of any such claims reported after January 1999.

16. On 10 June 1999, the Pension Advisers Support System (PASS Review Ltd, known as "PASS") conducted what was called a "Healthcheck Identification Population Visit" at the company's premises. PASS is a body that was set up to help IFAs, though as Mr Townsend reminded the Tribunal, the visit was at the company's expense. Among other things, the PASS report dated 11 June 1999 recommended revisiting the Phase 1 cases. This would seem on the face of it to indicate a very critical assessment, but we were told by Miss Harris who gave evidence for the FSA, that it was not untypical of the recommendations being made by PASS to IFAs generally at the time.

17. In any case, the Applicants say that, of all the Phase 1 letters written to clients between 1995 and 1999, only sixteen responses were received. They say that they decided that no real loss was suffered by any of these clients, and that by late 1999 the company had discharged its requirements diligently and honestly. Meanwhile, in May 1999, Mr Rayner had completed and returned to the FSA a "project plan timescale" in respect of Phase 2.

18. However, we have to add a qualification to the account at this point, which bears on future events. It is plain from the Applicants' evidence, both written and oral, that by the late 1990s, they regarded the review process as "pretty depressing",

and in particular, they felt that it operated in an onerous way on small IFAs like themselves. They were sufficiently exercised to take the matter up with their local MP, who wrote to the Treasury on the subject. Their attitude can be summed up in a phrase both Applicants used, namely that "it became increasingly clear that the Review was going to be far more onerous than we had first thought".

The regulatory visits to the company

19. On 15 November 1999, the FSA's Pensions Review Monitoring Department ("PRMD") wrote to Townsend Rayner Associates Ltd requesting information to assess whether a monitoring visit should take place in the first six months of 2000. As Mr Mayhew, who represented the FSA put it, this was the beginning of the Applicants' problems with the regulators on the pension review front. On 26 November 1999, Mr Rayner responded to the effect that Santhouse Whittington Actuarial Services Ltd was checking a sample of Phase 1 cases with a view to calculating any loss assessment. Santhouse Whittington is a firm of actuaries. The firm had been recommended to the Applicants by Mr Jonathan Fry, who as we shall explain was involved in the purchase of the Applicants' business. It was part of the IFG Group plc, as was The Slater Group plc which ultimately bought the business. In fact, Mr Rayner's response was not quite accurate, because no cases had been sent to Santhouse Whittington at this time.

20. On 15 December 1999, PRMD selected six cases to review in detail from the list of cases supplied by the company. These included the cases of Mrs Dunn, and Mr Trzaskalski, and it was these two cases which were then referred by the company to Santhouse Whittington. Mrs Dunn was a non-joiner of the Teachers' Staff Superannuation Scheme, who in 1989 had taken a Scottish Widows pension instead. In June 1997, Townsend Rayner Associates Ltd had told her that no redress was due to her. However Santhouse Whittington's calculations came up with a different answer, and on 5 June 2000 the firm sent Mr Rayner their calculation of Mrs Dunn's loss, estimated at £12,433. We should add that it recalculated the figures at Mr Townsend's request, and on 16 August 2000 sent a revised calculation of loss estimated at £11,974. The calculation the FSA put before us for the hearing showed a figure of £9444.79.

21. On 6 June 2000, Townsend Rayner Associates Ltd had the first of three visits by the regulators to its premises. On this occasion, the visitors consisted of PRMD's loss assessment and redress calculation team. The team was headed by Mr Akbar. His evidence is that, "A loss assessment calculation compares the value of the occupational pension scheme (OPS) benefits given up with those under the personal pension (PP) policy. Where the OPS benefits are determined to be more valuable than those under the PP, a loss has occurred which must be extinguished by way of financial redress or reinstatement". In oral evidence, he told the Tribunal that the standard of the firm's loss assessments was "exceptionally poor". In the report he sent Mr Rayner on 30 August 2000, he wrote:

> "The monitoring visit identified serious concerns. This was evidenced by the very disappointing findings from our sample cases. You have already been advised in our letter dated 9 August 2000 that we have referred this report to our Enforcement Division to determine whether disciplinary proceedings are appropriate."

22. This was the first time possible disciplinary proceedings had been mentioned to the Applicants, and it was followed up by a letter from the PIA dated 7 September 2000 saying that the Enforcement Division's initial review indicated that disciplinary action might be necessary. On 28 September 2000, both Applicants replied expressing their extreme disappointment, and saying that they had endeavoured to carry out the Pension Review to the highest standards.

23. Meanwhile, on 16 August 2000, Santhouse Whittington sent Mr Townsend their loss assessment calculation on Mr Trzaskalski. This was a man who had opted out of the British Steel Pension Scheme in favour of a policy with Clerical Medical. On 23 December 1997, Mr Townsend had written to him saying that, "I am pleased to say there is no loss". However, Santhouse Whittington's calculation of his loss was £36,786. The calculation the FSA put before us for the hearing showed a figure of £16,188. But the true cost could well be higher, because where reinstatement in the occupational scheme is an option, it is the option of choice both for the investor and for the regulator. The cost of reinstatement will often be more than the actual loss assessment. Mr Akbar's report of 30 August 2000 noted that the company "is currently disputing the reinstatement cost … of £89,118 with British Steel". The Tribunal is not in a position to say whether this figure is correct or not. In fact, as we shall explain later, none of these figures is as clear as might appear at first sight.

24. Between 11 and 13 October 2000, the company had a further regulatory visit in connection with the Pension Review, this time from a team responsible for monitoring population identification by firms. (Population identification means the identification of those with a potential right of redress.) According to an internal FSA file note dated 19 September 2000, "the firm has been referred due to issues that have come to light during the recent Loss and Redress visit". What the visit entailed is shown by a letter from Sarah Harris of the FSA to Mr Townsend dated 25 September 2000. She said that the focus would be to verify the work undertaken in respect of both the priority phase 1 and the phase 2 reviews and to monitor progress. In particular, the team was going to look at the means by which the total population of cases to be reviewed had been determined, the approach taken to mail investors, the cases which had been excluded from the review, and the adequacy of compliance and cause of loss assessments. The adequacy of the application of various tests would be assessed, and the team would look at the adequacy of the work undertaken to implement redress.

25. It was only a few days later that the business was sold, though the impending transaction was not mentioned to the visiting FSA team. But before describing the sale, we complete our analysis of the October visit. Ms Harris wrote to Mr Rayner on 28 November 2000 saying that there were major weaknesses in the manner in which you have conducted the review of past business to date". She says that, "due to the serious nature of the findings from our visit, a referral has been made to our Enforcement Division". On the other hand, in her evidence she says that the "types of issues that I saw raised … were fairly standard ones". She told us that Mr Townsend and Mr Rayner were both cooperative. In contrast with the impression which Mr Akbar clearly formed on his visit, she did not appear to us to find the state of the company's efforts on the review particularly deplorable.

26. From the totality of the evidence however, and in particular from that relating to the company's record on loss assessment, we do draw a number of conclusions. We are satisfied that Townsend Rayner Associates Ltd did not conduct its responsibilities under the pension review at all well. Even allowing for the burden which it undoubtedly imposed on a small operation, the efforts made to do a proper job seem to us to be clearly insufficient. In giving evidence, Mr Townsend was candid enough to admit that they hadn't "made a very good job" of the review, and that "he wasn't proud of it", and that is how the Tribunal sees the situation as well. But as already indicated, what matters more for present purposes is how they dealt with the sale of the business.

The sale of the business

27. Although this does not appear in the facts as set out in the Decision Notice, it is clear to us that the Applicants were considering the sale of the business long before the agreements were signed on 20 October 2000. Mr Townsend first met Mr Jonathan Fry in 1998 at a seminar. His company, IFG Financial Services Ltd was looking for acquisitions. In December 1998, he wrote to Mr Rayner setting out purchase options, of which there were essentially two. One was an up front payment of three times renewal commission, in other words commission paid on the renewal of existing business, plus 50% of new commission. The other was a payment based on profit. But at the time, the Applicants say that they did not want to sell.

28. Nevertheless, there was a further meeting between them on 26 January 1999 which also involved Mr Harvey Spriggs, who had been Mr Townsend's accountant for many years. An important point as regards the timing of the sale was that both Mr Rayner and Mr Townsend seem to have qualified for retirement relief for tax purposes in July 2000. To tie in the sequence of events to that which we have already set out in relation to the Pension Review, on 21 January 1999 the FSA had written that to Mr Rayner to the effect that their Pensions Review had not been completed. In June 1999, the company had the visit from PASS we have described above.

29. On 7 September 1999, Mr Spriggs wrote to the Applicants about business restructuring, saying that any future offer from IFG for the business "would be based solely on the goodwill and client base leaving the company's property in your ownership". At the time, following a reorganisation of their capital in May 1998, Townsend Rayner Associates Ltd was jointly owned by the Applicants and their wives. With the sale in mind, and the growth of the Applicants' mortgage broking business (which fell outside the regulatory legislation), Mr Spriggs was now recommending a holding company structure.

30. These arrangements were put in place by the setting up of a new company, Townsend Rayner Group Ltd, which acquired the shares in Townsend Rayner Associates Ltd, and another new company, Townsend Rayner Mortgage Brokers Limited, whose shares were also held by the Group company. The shares in the Group company were held by the Applicants. Minutes of a directors' meeting which was apparently held on 1 January 2000, record as follows:

> "It was resolved that the Goodwill and Database of Townsend Rayner Associates Limited which had largely been created by the Directors John Townsend and Ernest Rayner should be formally transferred from

> the new subsidiary to Townsend Rayner Group Limited for the consideration of £1.

This passage describes a curious form of transaction. It is unclear what was intended to be included within the term "Goodwill and Database", but whatever it was, it belonged to Townsend Rayner Associates Ltd whether it had "largely been created by the Directors", or not. Nor is it clear what is meant by the phrase "formally transferred". Whatever was meant by it, the consideration paid for the transfer was a nominal £1, which we find hard to accept as fair value.

31. The minutes go on to say that "it was also resolved that the premises at 2 Church Walk, Kettering, Northants, should be purchased by Townsend Rayner Group Limited from the subsidiary for the sum of £89,076 being the latest professional valuation of the premises." We shall come back to that point. Minutes dated 3 January 200 show a meeting of the directors of Townsend Rayner Associates Ltd on that day, where resolutions are recorded mirroring those of the Group company.

32. PIA approval to the change in the ownership of Townsend Rayner Associates Ltd had been obtained in November. Mr Townsend summarised the practical effect of the new arrangements as follows: "From this point, Ernie and I received remuneration from TRGL [Townsend Rayner Group Ltd] only. It seemed to make good sense to keep the two businesses separate. It meant that we could distinguish between the income earned from the mortgage broking business and that earned from TRAL [Townsend Rayner Associates Ltd]".

33. In the course of 2000, the Applicants had further meetings with Mr Fry. On 6 June 2000 (which was the same day as the visit of Mr Akbar's loss assessment team), Mr Fry (writing as Managing Director of IFG Life and Pensions Ltd) confirmed the "proposed offer to acquire all the renewal bank, assets, goodwill, work in progress and debtor of Townsend Rayner Associates Ltd". He confirmed that they would make "an initial payment of £400,000, being four times current renewal". The difference between "initial commission" and "renewal commission" is explained in an Expert Report submitted by an accountant, Mr Patrick Storey, for the FSA. Renewal commission is paid so long as the client continues to pay the premiums, and the IFA concerned remains the agent of the client. Given the duration of the policies concerned such as pension policies, the renewal commission stream may extend over a substantial period of time.

34. There were a number of other terms of the offer, including the giving of an annual renewal warranty of £100,000, but we note in particular that the offer was for the business, not for the shares in the company. This, according to Mr Fry, was his "preferred route". So far as their own position was concerned, Mr Townsend and Mr Rayner the letter says that they would be offered a self-employed commission only contract at a rate of 50% of commission received. The parties met on 8 August 2000, and the notes of the meeting record that "the apportionment of purchase consideration is to be proposed by the vendor – such apportionment to take due account of prospective stamp duty liability".

35. It was on the following day, 9 August 2000, that Mr Akbar gave the first indication that shortcomings in the company's conduct of the Pensions Review would result in a referral to the FSA's Enforcement Division. We have seen a draft of the sale

contract dated 22 September 2000, from which we infer that there was some negotiating going on, though we were not told much about the detail. In terms of timing, we note that the visit from Sarah Harris's team monitoring population identification took place between 11 and 13 October 2000.

The Asset Purchase Agreement ("APA")

36. The sale of the business was accomplished by an Asset Purchase Agreement ("APA") which was dated 20 October 2000. There were five parties, namely Townsend Rayner Group Ltd and Townsend Rayner Associates Ltd, which together were described as "the Vendor", Mr Townsend, Mr Rayner, and The Slater Group plc, the latter company being described as "the Purchaser". The APA recites that "the Business is now and has for some time been carried on by the Vendor as beneficial owner". This was inaccurate. The business (defined as the business of financial and investment advice and services excluding the mortgage related advice) had been carried on solely by Townsend Rayner Associates Ltd, which was the only entity authorised to conduct investment business. In any case, the APA records that the "Vendor has agreed to sell and transfer and the Purchaser has agreed to purchase the Business (together with the Assets) as a going concern …". The Consideration is stated as £400,000 as apportioned in clause 2.1.

37. There is a list of "Assets" in clause 2.1. The list consists of goodwill, fixtures and fittings, the computer system, business intellectual property, business information, rights against third parties relating to the assets, and the business contracts and renewal commissions. Small amounts of the consideration of £400,000 were attributed to fixtures and fittings (£20,000) and the computer system (£10,000) but the bulk of the consideration was attributed to goodwill (£370,000). Nothing was attributed to any of the other items listed, and in particular, nothing was attributed to business contracts and renewal commissions. The APA does not apportion the consideration between the two vendor companies.

38. It is significant to compare the final version of clause 2.1 with the clause as it was in the draft dated 22 September 2000. In the draft, goodwill and business contracts and renewal commissions appear together, with £370,000 attributed to them as a whole. In the final version, business contracts and renewal commissions appear separately, and the sum of £370,000 is attributed solely to goodwill. Goodwill was defined as "the goodwill custom and connection of the Vendor in relation to the Business together with the exclusive right for the Purchaser … to carry on the Business under the name including the words 'Townsend Rayner' and to represent themselves as carrying on the Business in succession to the Vendor". From the evidence of Mr Spriggs, the amendment was made at his suggestion, though no detailed rationale was provided.

39. In other provisions of the APA, the Vendor warranted to the Purchaser that for the next three years, renewal commissions would not be less than £100,000 annually, and that if they fell below that figure Mr Townsend and Mr Rayner would provide compensation to the Purchaser, with a cap of £100,000 on their liability. The value of pipeline business (in other words new business up to the date of the agreement in respect of commission had not yet been received) was excluded from the sale.

40. It is important to note the provisions relating to the Pensions Review. By clause 3.2.2, there was expressly excluded from the sale and purchase "any liabilities of the Vendor of the Business pursuant to the pensions review". In the indemnity clause, it was provided that, "For the avoidance of doubt, no indemnity is being given by [Mr Townsend and Mr Rayner] for any liability of the Vendor … in respect of the pension review by any of the Regulators". It was being made quite clear therefore, that although The Slater Group plc was buying the business, liability for the pension review would remain with the Vendor, in other words with Townsend Rayner Associates Ltd.

41. Also on 20 October 2000, Consultancy Agreements were entered into between IFG Life and Pensions Ltd and Mr Townsend and Mr Rayner respectively. These gave effect to the arrangements by which the Applicants were to provide independent financial consultancy services to IFG, and be entitled to 50% commission on the business they generated. The Applicants gave various non-competition and non-solicitation covenants. There was reference to the warranty of renewal commissions in the APA, and Mr Townsend told us that the £100,000 cap applied here too.

Payment of the consideration

42. The purchase consideration was paid by the Purchaser to the Vendors' solicitors, Vincent Sykes, which on 23 October 2000 paid £370,000 into the account of Townsend Rayner Group Ltd. We reiterate that the APA did not allocate the consideration between the two companies named as vendor. Mr Spriggs explained the matter as follows: "It was clear from the sale negotiations that the consideration of £400,000 was being paid largely for the goodwill connection of the applicants and their ability to generate high levels of profit from their client base. The applicants had been utilising this asset through [Townsend Rayner Group Limited] for the benefit of both the financial services business and the mortgage broking business and although the client base was being acquired from the Applicants they wished to continue the right of access to this for the benefit of their mortgage business which the purchaser agreed to. The applicants agreed to accept payment of the goodwill via the holding company and contracted the sale on this basis". We note that Mr Spriggs does not refer to the minutes of the meeting of 1 January 2000 to justify the payment to Townsend Rayner Group Limited, which seems surprising if the goodwill was really transferred to the Group company as the minute suggests. In any case, we do not find the passage quoted to be a convincing explanation of why the money apparently being paid for the goodwill of the business was paid in its entirety to parties other than Townsend Rayner Associates Ltd whose business it was, and which was authorised to conduct such business.

43. So far as the reference to the negotiations in the passage from Mr Spriggs' evidence just quoted is concerned, in his witness statement Mr Fry suggested that, "IFG and I were responsible for acquiring the goodwill from Townsend Rayner Group Limited and the assets of Townsend Rayner Associates Limited". But we cannot accept this statement. In cross-examination, he claimed that he did not know where the money was going, saying that:

> Q. Were you aware at the time of the agreement - that is on 20th October - that that money was destined for the Group company, and not for TRAL?

A. No.
Q. In which case, I can understand why you did not necessarily take the point [about the amendment]. Because you would not know--?
A. No.
Q. --where it was going?
A. The consideration was paid to the lawyer. How the organisation would choose to distribute that consideration is entirely down to themselves.

44. For reasons we find puzzling, this aspect of the APA was clarified almost two years later in connection with the settlement of claims the Applicants had or may have had against IFG when the relationship between them came to an early end. By a Deed of Amendment and Termination dated 9 August 2002, it was provided that, "The agreed apportionment of the Consideration was £370,000.00 for the goodwill to TRGL [Townsend Rayner Group Limited] and £30,000.00 for the Fixtures and Fittings and the Computer System to TRAL [Townsend Rayner Associates Ltd]".

45. There is however no doubt that the £370,000 (or thereabouts) was in fact paid to Mr Townsend and Mr Rayner personally through the Group company. The justification, or otherwise, for this payment is at the heart of the case. For the moment, it is enough to say that on 23 October 2000, the account of Townsend Rayner Group Limited with Barclays was debited with two cheques for £186,950, issued to Mr Townsend and Mr Rayner respectively.

What the clients were told

46. After the deal, a letter went out to all the clients of Townsend Rayner Associates Ltd. We have seen a pro-forma version, without the letterhead. Mr Fry could not be sure, but thought that it would have referred to Townsend Rayner Associates. He accepted that he could not use the name of the company, since he had not bought the company. He told us that it was an IFG letter, and he signed it as Managing Director of IFG. Mr Townsend and Mr Rayner also signed. The purpose of the letter was to keep clients informed, and doubtless to keep them loyal. But the letter as we find was misleading in stating that Townsend Rayner Associates Ltd had decided to "merge" with the IFG Life and Pensions Ltd group of companies. There had been no merger. The deal had been structured specifically so that Townsend Rayner Associates Ltd did not come within the Group, and remained responsible for its own liabilities, including those under the pension review.

The company's premises

47. As mentioned above, the minutes of the meeting of the directors of Townsend Rayner Group Limited held on 1 January 2000 record a resolution to the effect that the premises at 2 Church Walk belonging to Townsend Rayner Associates Ltd should be purchased by the Group company for £89,076, "being the latest professional valuation of the premises."

48. Mr Dodge says that these references are not about the property transaction, which transaction was not relied upon by the Regulatory Decisions Committee of the FSA in issuing either of the Decision Notices. Whilst accepting the point he makes,

the property transaction is a relevant part of the sale transaction, and we therefore briefly set out the evidence with regard to it.

49. Mr Townsend referred to a valuation done a year earlier that valued the property at £80,000. He said the outstanding mortgage was about £40,000, and that he and Mr Rayner took it over. But there is nothing in the draft accounts of Townsend Rayner Associates Ltd for the year ended 31 December 2000 to show the receipt of the purchase money for the sale of the premises. Questioned about this, Mr Spriggs said that, "the receipt monies, the £89,076 would have been charged to Townsend Rayner Group Ltd in their intercompany account [with Townsend Rayner Associates Ltd] … and in that intercompany account, for example, would have been credited to the same account the mortgage that they took over in relation to the property, because that would be a liability they took over, and they would also have been credited with service charges that Group company would have made over the period of trading, which would have been credited to the company as well. In other words, you have a number of transactions going through Group Limited's current account, if you like, with Townsend Rayner Associates Limited, including which would have been the purchase of the property". Mr Spriggs' evidence therefore is that the receipt of the money can be accounted for by reference to the credits and debits arising from the dealings between the two companies. He supplied the Tribunal with a breakdown dated 19 July 2004 in this regard.

50. From the evidence of the Applicants, we appreciate that the purchaser of the business had no desire to purchase the premises, and that to permit future flexibility to lease the premises it was appropriate to transfer the property to Townsend Rayner Group Ltd, in anticipation of its eventual liquidation, and ultimate transfer to the Applicants.

51. To quote from the accounts of Townsend Rayner Group Ltd for the year ended 2000, the "company's premises were not included in the sale to IFG Financial Services Ltd and were accordingly transferred to the directors at the value acquired on the commencement of trading. It was considered that no appreciable alteration in value had taken place". Asked where the receipt of the money was shown in the accounts of the Group company, Mr Spriggs said that it was accounted for by transactions within the directors' loan account. It has to be said that the matter is hardly clear.

Other relevant events

52. As the above account shows, in August 2000 the Applicants had been told that their conduct of the Review had caused a referral to the Enforcement Division. Between 11 and 13 October 2000, the company had the visit we have described from the FSA team responsible for monitoring population identification. They were having considerable contact with the regulators at this time. At no time, however was the impending sale of the business disclosed to the FSA. The first communication of the sale so far as we can tell came after the event in the form of an undated letter from IFG received by the PIA on 15 November 2000 (according to the date stamp). We find this most surprising.

53. After the sale of its assets, the company ceased trading in October 2000. The company continued to work on the Pensions Review through a firm called Compliant Solutions Ltd, whose services it retained between November 2000 and April 2001. According to the Applicants' evidence, they put in hours of their own time in this regard. But these efforts did not appear to result in much progress, and certainly did

not impress the regulatory authorities. Sarah Harris returned to the premises on 3 April 2001 for what she called a "verification visit". She said that she found that progress since her visit the previous October to have been "disappointing". Nowhere is there any evidence that the company prepared a business plan to deal with outstanding aspects of the Review.

54. On 24 May 2001, Mr Rayner wrote to the Pensions Review Unit of the PIA in the following terms:

> "As you will be aware, Townsend Rayner Associates Ltd ceased trading on 20/10/00, and failed to obtain Professional Indemnity cover at our renewal date of 23/01/01. The company has continued to meet its obligations with regard to the Pension Review by using all its available resources and employing an outside compliance company to help. The company has now reached a situation where all monies have been exhausted and we are no longer in a position to carry on. Can you please advise correct course of action it should now take."

55. For reasons we explain below, it was not accurate to say that the company had used all its available resources to carry out the pension review, even if one treats those assets as limited to those remaining in the company after the APA transaction. Furthermore, although the Applicants have placed considerable store on the fact that they asked for advice, we are sceptical in that regard. We think that Mr Mayhew was right to submit on the basis of the interviews conducted with them in September 2002, that the advice they wanted was to send the papers to the Pensions Unit to take over the work of assessing the cases, with the Investors' Compensation Scheme (the predecessor of the Financial Services Compensation Scheme) picking up the cost of redress. As he put it, "The one bit of advice that they did get, if you could call it that, was: 'How about putting some more money in?' And that is the one bit of advice they did not want to hear."

56. We have not overlooked the fact that Mr Townsend did further work on the Pension Review in the run-up to the hearing. We have read his supplementary statement describing what he did in 2004, and indeed the points he made there were sufficiently cogent to prompt the revision of a table prepared by Mr Arnold of the FSA which we shall come to. But it is what happened in 2000 and 2001 that matters for the purposes of the References. In this respect, the parties are agreed as to a number of key issues that we must determine. These issues are as follows.

The status of the payment of £370,000

57. The first issue is whether the £370,000 paid to Mr Townsend and Mr Rayner personally for "goodwill" in fact represented in whole or in substantial part the proceeds of sale of property of Townsend Rayner Associates Ltd, and was therefore properly receivable by the company in whole or in substantial part, as the FSA contends, or whether it was the property of the Applicants, as they contend, and properly paid over to them.

58. Where shareholder-directors wish to sell a business they have built up, they can sell their shares for whatever price they can negotiate. The proceeds of the sale are theirs. But different considerations apply if the company sells its business, which was the situation implemented by the APA. The capitalised value of the business belongs to the

company, though the proceeds may be available for distribution to the shareholders, subject to the laws safeguarding creditors' rights.

59. The Applicants' case is that they saw the sum of £370,000 payable under the Asset Purchase Agreement as being a quid pro quo receivable by them personally as, in effect, consideration for agreeing to be locked into the Consultancy Agreements on what they say were disadvantageous (and, in the case of the warranties, potentially onerous) terms. Central to this argument was the evidence of their accountant, Mr Spriggs, who maintained that the payment was for goodwill which, he said, belonged to the directors personally. As to the question of the status of the renewal commission payable to the company, Mr Spriggs said that the offer of £400,000 was not based on renewal commission. He maintained that the £370,000 was paid for the goodwill only. As to the justification for the payment of the proceeds first to the Group company, and then to the directors personally we have set out his reasoning in paragraph 42 above. His evidence was supported by Mr Fry, who said that what he was really buying, was the ability of Mr Townsend and Mr Rayner to create new business.

60. We of course accept that Mr Fry wanted to acquire the services of Mr Townsend and Mr Rayner, and that, as he put it, he did "not think he would have proceeded" without them. But he did acquire their services through the medium of the consultancy agreements. Though the Applicants say that the rate of 50% of new business commission was substantially worse than they could have negotiated on the open market, we prefer the evidence of Mr Storey in this regard, who says that generous terms have become rarer in recent years. In any case, a modest rate of commission has to be regarded in the context of the fact that the Applicants were each receiving a substantial capital sum on the sale of the business.

61. Though he accepted that it could be used as a "tape measure" for valuing a business, Mr Spriggs maintained that renewal commission had no intrinsic value. He seemed to rationalise this on the basis that (as both accountants agree) in a continuing business, renewal commission would not be attributed with a value in the company's balance sheet. This however is different from saying that renewal commission has no value on a sale. We observe that he was bound to take the position he did, because following the amendment to the draft APA which we have described above, the entire amount of £370,000 was attributed to goodwill, and none attributed to renewal commission. Similarly, the Applicants' evidence is they did not regard it as having "any genuinely realisable value in TRAL's hands". However in our view, this position is untenable, and we reject their evidence and that of Mr Spriggs in this regard. We accept Mr Storey's evidence that an entitlement to an income stream, such as renewal commissions does have an intrinsic value, and is an asset that a purchaser would have been prepared to buy without necessarily retaining the services of the directors.

62. Furthermore, Mr Spriggs' evidence is inconsistent with the way the parties viewed the transaction. Mr Fry wrote his offer letter to the Applicants on 6 June 2000, in which he confirmed that he would make "an initial payment of £400,000, being four times current renewal". On 10 October 2002, by which time Mr Fry had left the company, and this particular transaction was under investigation by the FSA, IFG wrote to the FSA saying that, "the goodwill represented IFG's valuation of TRAL's client bank and the renewal commission". When asked about this in cross-examination, Mr Fry responded that the author of the letter "wasn't party to the whole negotiations".

However we think that IFG’s letter of 10 October 2002 more likely represents the true position.

63. Finally, the contention of the Applicants and Mr Spriggs that the goodwill capitalised in the sum of £370,000 belonged to the Applicants personally, is inconsistent with the terms of the APA itself. The APA describes the companies, not the Applicants, as Vendors of the ‘goodwill’, a fact of which Mr Spriggs was aware. He told us that, “on reflection I see no reason why they should not have been incorporated as vendors as well”. However as we find, the reason that they were not named as Vendors is that they were not Vendors.

64. We cannot therefore accept the evidence of Mr Spriggs, nor can we accept the Applicants’ case in this regard. We accept Mr Storey’s evidence that “the genuine ‘goodwill’ element of this transaction was probably quite minor and that the majority of value in this transaction arose from the renewal commission stream”. We also accept his evidence that the proceeds which were described as being paid for ‘goodwill’ were “properly the property of TRAL and should have been received by TRAL and accounted for by TRAL in the first instance”. Whilst it is doubtless true as the Applicants’ contend, that the goodwill had been built up by Mr Townsend and Mr Rayner, it had been built up in their capacity as directors of the company, not individuals.

65. In their evidence, the Applicants maintained that they had relied at all times on their professional advisers. Mr Dodge submits that at the date of the transaction, whatever the true position, the Applicants genuinely believed that the £370,000 did not properly represent the proceeds of sale of any asset which belonged to TRAL. In this regard, he submits that whilst a chancery lawyer might take exception to the confusion of a company with its members, such confusions do, in the real world, occur. He submits that with the benefit of hindsight, it would have been better for the form of the transaction to have been more fully thought through. However, he says that it is quite understandable that, at the time, neither IFG nor the Applicants (or, in practice, Mr Spriggs on their behalf) fully appreciated the potential significance of the extremely subtle distinctions which have occupied a substantial amount of time at this hearing.

66. With respect to the moderate and helpful way in which Mr Dodge has put the case for the Applicants, we do not accept this submission either. The evidence of both Applicants was that “we did not … see ourselves as benefiting personally from the sale of assets belonging to TRAL. Rather we saw ourselves as benefiting from something which it was ours to sell, namely our own personal ability to generate business in the future”. But we are satisfied that the Applicants were aware that all or even a substantial part of the consideration paid for the business could not be based on the Applicants’ earnings potential for the future. The Applicants were experienced financial advisers. They knew all about renewal commissions. Mr Fry’s offer letter of 6 June 2000 was addressed to Mr Townsend, and seen by Mr Rayner. They read there that the offer was to “acquire all the renewal bank, assets, goodwill, work in progress and debtor of Townsend Rayner Associates Ltd”. The corporate structure of their business had been remodelled twice between 1998 and 2000, and we are satisfied that they were fully aware of the distinction between a company and its members, and the distinction between the property of a company, and that of its directors. We do not think that the distinctions are particularly subtle. Mr

Townsend's evidence was that he understood from day one that the goodwill resided with him personally. However we do not accept that at the time of the sale, either he or Mr Rayner, believed that the payment of £370,000 was due to themselves. We find that they knew that that sum or a substantial part of it was properly due to Townsend Rayner Associates Ltd.

The cause of TRAL's inability to complete the pensions review

67. As already explained, on 24 May 2001, Mr Rayner wrote to the Pensions Review Unit of the PIA saying that "the company has now reached a position where all monies have been exhausted and we are no longer in a position to carry on", in other words to carry on to meet the company's obligations with regard to the Pension Review. The issue we turn to now is as to the cause of the company's inability to complete the Review.

68. Following the sale, Townsend Rayner Associates Ltd ceased trading. However its pension review liabilities remained with the company, and the Applicants' case is that at the time of the APA, they were conscious of the need to make provision for the Pension Review. They "did not suppose that TRAL would be unable to comply with its obligations under the Pension Review". There were two Phase 1 cases which had been passed to and accepted by the company's insurer. (However, we point out that monitoring of their Phase 1 work had just been conducted, and from the interview with Ms Harris on 13 October they were aware that further work was required.) We accept they had no means of knowing that insurance cover would be withdrawn, which unfortunately did happen in early 2001. The Applicants were also aware of twenty four potential Phase 2 cases. However, again they believed that in the event of any substantial claim arising, it would largely be dealt with by their insurers.

69. Their case in summary is that as at the date of the Transaction they believed that the company had received what it was entitled to receive, that its liabilities under the Review might well be relatively modest, that it did have resources in place which it would be able to use for the purposes of the Review, and that it would be able to rely upon its professional indemnity insurance policy.

70. We have already held that the company did not receive what it was entitled to receive.

71. However, we find that the position as regards the amount of its potential liabilities under the Review at the time of the APA is far from straightforward. We refer in this respect to the different calculations that have appeared from time to time in respect of Mrs Dunn and Mr Trzaskalski. Furthermore, the existence of a loss does not necessarily imply the existence of a liability on the part of the IFA. In that regard, Mr Townsend told us:

> A. Ernie and I believe we have always given extremely good advice. And that relates to every bit of information. So we did not see ourselves as having great liabilities then or in the future. That has proven to be the case.
>
> Q. So in relation to Mrs Dunn, for example, you say she is not entitled to any redress?
>
> A. That is a case that we would fight.

Q. OK?
A. You don't know the case, we do.

72. The FSA called Mr Arnold, a manager in the Outstanding Pension Review Completion department to give evidence on this issue. In his witness statement, he produced a table of twenty entries showing those investors who had refused a review, and of the remainder, showing an estimated total loss of approximately £168,000. However, when he began his oral evidence, it transpired that a substantial number of entries on the table had been linked in error to the Applicants, responsibility belonging to another firm. One such case (the amount concerned being £7,194.65) was included in those making up the total estimated loss. We were very surprised to hear that such error was made at this late stage. Given the mistake, it was perfectly reasonable for Mr Dodge to submit that the Applicants "retain considerable reservations as to whether even Mr Arnold's revised table provides any sort of realistic impression as to the amount of redress which might properly be payable by TRAL".

73. That there was some potential liability however is in our view beyond doubt. One aspect of it was the ongoing cost of the review itself. Mr Townsend was asked in cross-examination:

Q. So no doubt in your mind at that point that a major piece of work is going to have to be required of you, with major cost implications?
A. Correct.
Q. And those costs, in particular, were going to be the cost of outsourcing those calculations?
A. Yes.

74. As regards potential liability in the form of the cost of making redress where it was found to be due, Mr Townsend said:

A. But again we didn't see - you keep coming back to this. We knew, especially on a lot of phase 2, it was a matter of finding paperwork for the files to close them down. Which we did close a lot of them down. And as has been proved now the actual claims coming through are - I wouldn't say a minimum, they are substantial amounts of money, but ...
Q. At the time that you transacted the sale, you couldn't be certain that some of those liabilities wouldn't result in payments?
A. Couldn't be certain that some of them wouldn't, but we were very certain there were very few.
Q. Given what you had gone through from, really, June 1999, but more particularly once loss and redress team became involved, you knew, as you said a moment ago, this wasn't going to go away, it was going to cost you a lot of money to just do the review, and there was this unquantifiable potential liability.
A. I wouldn't say it was unquantifiable - it was unquantifiable because it could have been medium or low, but we didn't see it as high. We still don't see it as high.
Q. On any basis, Mr Townsend, you did not leave sufficient resources in TRAL to meet those liabilities?
A. We know that now.

Q. Well, you knew that on 20th October.
A. No, we didn't.

75. It is clear to us that the assessment of loss in these review cases is not an exact science, doubtless because of the variable factors involved. Nevertheless, we are satisfied on the totality of the evidence that at the time of the APA, Townsend Rayner Associates Ltd did have a substantial potential liability under the Pension Review. We are however not able on the state of the evidence to give a figure in respect of that liability. Our assessment of the Applicants' evidence in this regard, is that while they hoped that the liabilities would not be substantial, they were well aware of the possibility that they might be substantial, and further that the completion of the review would be costly both in time and in resources.

76. Given these liabilities, the question is as to the value of the assets left in the company to meet the exposure. Mr Townsend agreed that this was all-important. The Applicants provided a breakdown of the position between 20 October 2000 and April 2001, when on their own admission, the company ran out of money. Of the total consideration of £400,000 paid under the APA, Townsend Rayner Associates Ltd received £20,000 attributed to fixtures and fittings, and £10,000 attributed to the computer system, making £30,000 in all. The company's bank balance at the time was £24,894. The one source of continuing income was from pipeline commission as defined in the APA, which was estimated in Schedule 5 to be about £52,000. On the face of it, therefore, this left well over £100,000 to meet the company's liabilities.

77. Looking at the Applicants' breakdown, however, one sees a different picture. The breakdown is made up of roughly balancing credits and debits. The amount received during the relevant period is shown as about £65,000. However this included the payment of the £30,000 in respect of the consideration. (It was a smaller payment in net terms, because the solicitors took their fees from it.) But to get an accurate picture of receipts, one has to take account of the fact that in respect of payments out, an amount of £35,503 is shown as having been paid to IFG over this period. This we were told by Mr Townsend was because of errors on the part of IFG in accounting. In other words that Townsend Rayner Associates Ltd had received money that was not due to it. Once this figure is deducted from the £65,000 as well as the consideration, only a small amount is left in respect of receipts for pipeline commissions. Mr Rayner was unable to give us any explanation of this surprising discrepancy.

78. There are other features of the payments out that we comment on. A figure is shown for "wages" of £16,000. According to Mr Townsend, this was "payments that we took out in November". There is a figure of £4,000, which was apparently an *ex gratia* payment to Jane Townsend for "loss of office". Of the figures shown for payments out, the only one we can positively identify as attributable to the pension review is the sum of £7,044 paid to Compliant Solutions Ltd, whose services the company retained between November 2000 and April 2001. (When one looks at the itemised account from Compliant Solutions Ltd for work on the Pensions Review on behalf of the company, it is clear that a further £600 needs to be added to this sum, making £7,644.)

79. We asked Mr Dodge to comment on these matters in closing, but he was not able to shed much light on them. Despite the Applicants' denial, we think that when

they entered into the APA, the Applicants either knew that they had not left sufficient resources in place for the purposes of the Pension Review, or closed their eyes to that possibility, or at the very least should have known had they taken the most basic steps of due diligence as directors. We are also troubled by the fact that such resources as were left largely did not go towards the conduct of the review, but went to IFG and to the Applicants themselves.

80. However that is not a complete explanation of the Applicants' position, since one has to take account of the fact that in principle redress payments under the Pension Review should be covered by a firm's professional indemnity insurance cover. The Applicants reasonably placed considerable weight on the fact that the company had appropriate cover. The position as regards the cover is as follows. In 1998, the excess on individual claims was £2,500, but in January 1999 it increased to £10,000, which Mr Rayner said was pretty standard in the industry. It was however a significant increase, because smaller claims which had previously been covered in part might now fall outside the cover altogether.

81. However, unfortunately problems arose as regards the cover shortly after the sale. On 17 January 2001, Mr Townsend wrote to the FSA saying that it was experiencing extreme difficulties securing professional indemnity insurance cover because of the Pensions Review Monitoring Department visits. But worse was to come, because in February 2001, the insurers avoided the company's policy from its inception on the grounds of alleged non-disclosure. The company challenged this decision through its brokers without success, and in August 2001 the brokers suggested that it take its own legal advice (so far as we know this was not done). We have not explored in evidence the rights and wrongs of the insurer's action. Suffice it to say that we doubt that the Applicants' experience was unique in that regard. We accept their evidence that they had no warning of the problem prior to January 2001.

82. Our findings in respect of the insurance issue are as follows. Whilst it was reasonable for the Applicants to place reliance on the existence of the cover, there were limits as to how far such reliance could reasonably go. Insurers might or not accept individual claims, and even in respect of claims which were accepted, the company would have to pay significant amounts under the excess. Mr Townsend believed that an excess of £1,500 or £2,500 applied to the Dunn case and an excess of £10,000 applied to the Trzaskalski case, which were the only two to have been passed to the insurers prior to February 2001. It would certainly not be reasonable in our view to rely on the insurance alone to meet the company's liabilities. In any case, the insurers cancelled, and the cover has gone, and has not been replaced.

83. In summary on this issue, we are satisfied that the cause of the company's inability to complete the Pension Review was that most of its assets were sold in October 2000, and the consideration paid to the directors. As already indicated we are also satisfied that both Mr Townsend and Mr Rayner either knew that they had not left sufficient resources in place for the purposes of the Pension Review, or closed their eyes to that possibility, or should have known that after the APA there would be insufficient resources to complete the Review. In the result, the company ran out of money after only six months, and with little progress having been made on the Review, and no redress having been paid to any client.

The proportionality of the FSA's action

84. The action referred to the Tribunal consists of prohibition orders made against Mr Rayner and Mr Townsend by which they were prohibited from performing any controlled function relating to any regulated activity carried on by any authorised person, and in relation to Mr Townsend only, the withdrawal of his approval to perform the investment adviser function with a firm called Croesus Financial Services Ltd. The Applicants' case is that this action was disproportionate, and that they have been treated unfairly.

85. By way of explanation of the position as regards approval, Croesus Financial Services Ltd is a company set up by Mr Fry after he left IFG. Following their own parting of the ways with IFG in 2002, the Applicants decided to join Croesus. They applied for approval to the FSA, the provisions of the Financial Services and Markets Act 2000 ("FSMA 2000") being in force by then. Whereas Mr Townsend received approval speedily, Mr Rayner did not, and after five months withdrew his application. The reason for the disparity of treatment between the two, we are told, is that the system only picked up the fact that Mr Rayner was under investigation.

86. That leads us to this point. We made it clear during the hearing that the position of each Applicant has ultimately to be considered individually, and in his closing submissions, Mr Dodge says that although the references are being heard together, the Tribunal will wish to arrive at a separate decision in relation to each reference. He did not suggest that the decision should be in a different document, and in our view it should not be. Nor has he suggested that there is anything of substance requiring a differentiation between the position of the two Applicants. Both counsel have conducted the References on the basis that the Applicants sink or swim together, and we are satisfied on the evidence which we have heard that this is a proper approach in the circumstances.

Statutory provisions and guidance

87. We begin our consideration of the proportionality issue by setting out the relevant statutory provisions. (It is common ground between the parties that the transitional provisions following the coming into force of FSMA 2000 are not relevant to these References.) The FSA's power to make a prohibition order is contained in s.56 FSMA 2000, which so far as material provides that:

> (1) Subsection (2) applies if it appears to the Authority that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person.
>
> (2) The Authority may make an order ("a prohibition order") prohibiting the individual from performing a specified function, any function falling within specified description or any function.
>
> (3) A prohibition order may relate to -
>
> > (a) a specified regulated activity, any regulated activity falling within a specific description or all regulated activities;
> >
> > (b) authorised persons generally or any person within a specified class of authorised person.

(4) An individual who performs or agrees to perform a function in breach of a prohibition order is guilty of an offence and liable on summary conviction to a fine not exceeding level five on the standard scale.

88. The FSA's power to make an order withdrawing approval is contained in s.63 FSMA 2000, which so far as material provides that:

(1) The Authority may withdraw an approval given under section 59 if it considers that the person in respect of whom it was given is not a fit and proper person to perform the function to which the approval relates.

(2) When considering whether to withdraw its approval, the Authority may take into account any matter which it could take into account if it were considering an application made under section 60 in respect of the performance of the function to which the approval relates.

89. Thus the s.56 power to make a prohibition order and the s.63 power to withdraw approval both arise if the individual concerned is not a fit and proper person to perform the relevant functions. The issue in essence is the same. Is the individual a fit and proper person? This inevitably involves a value judgment, but it is not one which is made in the abstract. In determining the issue, regard is to be had to the guidance in the FSA's handbook, of which for present purposes there are two relevant sections, that relating to the Fit and Proper Test for Approved Persons (FIT), and that relating to Enforcement (ENF). In respect of both, the considerations which the FSA relies on in the present case are those relating to the Applicants' "honesty, integrity and reputation".

90. As regards the matters to which regard is to be had in determining a person's honesty, integrity and reputation in the Fit and Proper Test section of the Handbook, the FSA relies on in particular on the factors set out by way of guidance in FIT 2.1.1 G (5) and (13), namely:

(5) whether the person has contravened any of the requirements and standards of the regulatory system or the equivalent standards or requirements of other regulatory authorities (including a previous regulator), clearing houses and exchanges, professional bodies, or government bodies or agencies;

(13) whether, in the past, the person has been candid and truthful in all his dealings with any regulatory body and whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards.

91. At the time of the sale of the business, the relevant requirements and standards of the regulatory system were those of the PIA, and various references are set out in the FSA's opening submissions. We think that the FSA's basic point related to PIA Principle 1 which provided that, "A firm should observe high standards of integrity and fair dealing", along with PIA Rule 1.8.13(1) which provided that, "A registered

individual must not cause or assist in causing any member to break any of the Principles or Rules".

92. In the Enforcement section of the Handbook, the matter is put in similar but not identical terms. In the context of both withdrawal of approval and prohibition orders, "honesty, integrity and reputation" is said to include "an individual's openness and honesty in dealing with consumers, market participants and regulators and ability and willingness to comply with requirements placed on him by or under the Act as well as with other legal and professional obligations and ethical standards" (ENF 7.5.2 G, and 8.5.2 G).

93. Mr Dodge has made a number of submissions as regards the Enforcement provisions, with which we agree. He points out that it is clear from the final sentence of ENF 8.5.1A that a prohibition order will only be made against an approved person in the more serious cases of lack of fitness and propriety where the FSA's other powers are not sufficient to achieve the FSA's regulatory objectives. As regards the making of a prohibition orders against individuals employed or formerly employed by firms but who are not approved persons (in other words Mr Rayner), he points out that the FSA may prohibit the individual where it considers it necessary (he emphasises this word) to achieve its regulatory objectives of maintaining market confidence in the financial system, promoting public awareness, protecting consumers and preventing financial crime.

The Tribunal's approach

94. Proceeding in accordance with the guidance set out above, it is for the Tribunal to determine what (if any) is the appropriate action for the FSA to take in relation to the matter referred to it (s.133(4) FSMA 2000). In doing so, it may consider evidence relating to the subject matter of the reference, whether or not it was available to the FSA at the material time (s.133(3) FSMA 2000). Thus it for the Tribunal to reach its own decision on the reference. The statutory provisions reflect the fact that the Tribunal was conceived as a first instance not an appeal tribunal. The "function of the Tribunal, where an applicant challenges action taken by the FSA, is to consider the matter afresh and determine what is the appropriate action for the FSA to take in relation to the matter referred" (*Eurolife Assurance Co Ltd v FSA*, Financial Services and Markets Tribunal, 26 July 2002, paragraph 29).

95. In his closing submissions, Mr Dodge asked the Tribunal "to keep in mind in these proceedings the requirement of certainty in criminal proceedings as set out in Human Rights Act 1998, Schedule 1, Pt 1, Article 7. This is not a case in which it is alleged that the Applicants have done something which was expressly prohibited by clear words." When we asked him to cite authority on the subject, he responded that he was mentioning the 1998 Act "by analogy". Our view is that the action taken by the FSA against Mr Townsend and Mr Rayner is not properly to be regarded as involving a criminal charge or offence within Article 7: see *Fleurose v Securities and Futures Authority Ltd* [2001] EWCA Civ 2015, at paragraph 13. But issues as to certainty may equally arise in the case of civil proceedings under Article 6 (Right to a fair trial). We consider that the approach to be adopted in this respect in the present case is that set out by the Court of Appeal in *Fleurose* (paragraph 16), and ask whether the Applicants knew both what were the specific acts alleged and what was the state of mind alleged. On that basis, we are quite satisfied that no issues of uncertainty arise here.

96. Mr Dodge also "encourage[d] the Tribunal to have in mind the requirement under HRA 1998, Schedule 1, Pt 1, Article 6 of a fair trial 'within a reasonable time'. Whilst it may not have been the case that a fair trial had become impossible, there has already, as detailed by both Applicants in their witness statements, been very considerable interference with their ability to earn a living. The Applicants also describe the distress which has been caused to them and their families by the long drawn out enforcement process." Again, when we asked him to cite authority, he said that he was mentioning the 1998 Act "by analogy" in the context of ENF 8.5.2, and in particular as regards the "relevance, materiality and length of time since the occurrence of any matters indicating unfitness". We note that the Financial Services and Markets Tribunal was set up to ensure that the regulatory decision-making process as a whole was compatible with the European Convention on Human Rights by providing an independent, impartial tribunal. It is clear to us that a fair trial has not become impossible in the present case. We do however agree with Mr Dodge to the extent that the passage of time is a relevant matter which the Applicants are entitled to have weighed in the balance when considering the question of proportionality.

The parties' submissions on proportionality

97. In summary, the FSA submits that the actions of Mr Townsend and Mr Rayner meant that Townsend Rayner Associates Ltd did not have the assets available to meet the requirements of the Pension Review, whether as to the cost of completing the review or to paying any redress found to be due in respect of any of the cases which were still under review on 20 October 2000. They subsequently declined to use the proceeds of sale of Townsend Rayner Associates Ltd's assets which they personally had received in order to rectify the position. Their actions were deliberate and designed to avoid responsibility for the requirements of the Pension Review. Their personal interests were put in front of their clients' interests.

98. In summary, the Applicants submit that it now seems likely that, even had the whole of the £370,000 been paid to Townsend Rayner Associates Ltd, there would have been a surplus for eventual distribution to Group and thence to the Applicants. There was no reason to suppose that either of the Applicants had ever engaged in questionable selling practices, and the PRMD investigations were not triggered by any complaint about TRAL. The time that it has taken for the enforcement action to be pursued means that the Applicants lived for many months under the threat of a penalty which, on the FSA's case, would have been a multiple of the entire net asset value of the company.

99. Both the Applicants strongly resist any suggestion that they lack honesty and integrity or are of bad reputation. They emphasise the (unchallenged) evidence of their good relations with consumers and to stress the efforts which they made over the years to comply with the requirements of the Pensions Review. Whether or not they could have been expected to regard themselves as doing anything wrong was something which would have been dependant upon a degree of expertise in the analysis of corporate transactions, an expertise which they neither possessed nor professed to possess. They cited the unchallenged evidence of their record of service to consumers, and the fact that neither of them has been the subject of previous disciplinary proceedings. In the case of Mr Townsend, there is nothing, it was said, to suggest that Croesus could not or did not adequately supervise him between August

2002 and March 2003. Given their abilities as financial advisers, it is also argued that it is disproportionate for the prohibition order on the Applicants to extend beyond the management and control function.

Decisions

100. We have read and been impressed by the support the Applicants have received from clients, not only in the form of unchallenged witness statements tendered by Mr and Mrs Nason and Mr and Mrs Welsh, but in the very large volume of client responses and testimonials that have been produced by them for the hearing. Having observed them during the course of the hearing, we have no doubt about the conviction with which they have presented their case. We accept that from their perspective the Pensions Review process, as it applied to a small operation like theirs, must have seemed onerous, and that it must at times have seemed difficult for them to comply with the regulators' requirements. As regards the sale, we accept their case that the sale of the business was not conceived as part of a conspiracy to avoid the Applicants' responsibilities under the Pension Review. In that regard, they rightly draw attention to the fact that the prospect of a sale went back to 1998, at a time when they were not keen to sell. It may well be that an important driver for the form of the sale was perceived tax advantages.

101. But we are also satisfied that an important aspect of the sale from the Applicants' perspective was the release of capital in a form that would relieve them from the financial burden of the Pension Review. In that regard, they in effect capitalised the assets of Townsend Rayner Associates Ltd, and withdrew most of the money from the company, leaving it a near shell, but still responsible for the Pensions Review, liability for which was expressly excluded from the sale of the business. We do not accept that at the time of the sale, either Mr Townsend or Mr Rayner believed that the payment of £370,000 was due to themselves. We find that they knew that that sum or a substantial part of it was properly due to Townsend Rayner Associates Ltd. We find that when they entered into the sale agreement, they either knew that they had not left sufficient resources in place for the purposes of the Pension Review, or closed their eyes to that possibility, or at the very least should have known had they taken the most basic steps of due diligence as directors. We are troubled at the manner in which the company's remaining assets were disbursed over the few months following the sale. The failure to disclose the sale to the regulatory authorities prior to and immediately upon completion was a serious omission, amounting to a failure to deal openly and honestly with the regulators. We find that the Applicants hoped that the problem would be taken over by the Pensions Unit, and the loss picked up by the compensation fund, whilst they pursued a new career with Mr Fry's company.

102. In our view, compliance with the Pension Review was and is a matter of the highest importance for the firms concerned. The review involves the pension and therefore the security in old age of a substantial section of the public. As the Divisional Court put it in *R v Securities and Investments Board, ex parte Independent Financial Advisers Association* (12 May 1995), "It was not irrational for the SIB to impose blanket review procedures regardless of fault or the expensive and time consuming nature of the tasks or the potential for the cost of redress being substantial since the problem of widespread mis-selling which the SIB sought to confront was grave and of acute public concern. At stake was the reputation and credibility of the financial services industry and, of even greater concern, the reduction in the pension

entitlements of perhaps thousands of investors. That situation demanded the provision of proper, timely, effective and fair solutions."

103. Given the support expressed for the Applicants' abilities as financial advisers, we have considered carefully whether it would be right to make a prohibition order limited to the management and control function. But we have come to the conclusion that the facts as we have found them demonstrate a serious lack of integrity on the Applicants' part. We are satisfied that neither Applicant is a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person, and satisfied that Mr Townsend is not a fit and proper person to perform the function to which the approval he has been given relates. In the circumstances, we are satisfied that the decisions of the Regulatory Decisions Committee of the FSA both dated 17 October 2003 were correct.

104. Accordingly, under section 133(5) of the Financial Services and Markets Act 2000, we remit the matter to the Financial Services Authority directing that Mr Rayner be prohibited from performing any controlled function relating to any regulated activity carried on by any authorised person.

105. Under section 133(5) of the Financial Services and Markets Act 2000, we remit the matter to the Financial Services Authority directing that Mr Townsend be prohibited from performing any controlled function relating to any regulated activity carried on by any authorised person, and that Mr Townsend's approval to perform the investment adviser function with a firm called Croesus Financial Services Ltd be withdrawn.

106. This decision is unanimous.

William Blair QC

CHAIRMAN

RELEASE DATE:

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