Reference number: FS/2011/0022

FINANCIAL SERVICES – regulated mortgage business - whether applicant fit and proper to carry out any controlled function involving exercise of significant influence – prohibition order – FSMA 2000, s56

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

MICHAEL LEE THOMMES **Applicant**

- and -

THE FINANCIAL SERVICES AUTHORITY **Respondents**

TRIBUNAL: JUDGE ROGER BERNER
SANDI O'NEILL (Member)
PETER BURDON (Member)

Sitting in public at 45 Bedford Square, London WC1 on 29 – 30 August 2012 and following further written submissions of the parties

John Virgo, instructed by Michelmores LLP, for the Applicant

Simon Pritchard, instructed by the Financial Services Authority, for the Respondents

DECISION

1. By a Decision Notice dated 19 July 2011, the Authority informed Mr Thommes of its decision to prohibit him from performing any controlled function involving the exercise of significant influence in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm ("the Prohibition Order").

2. The decision to impose the Prohibition Order was made on the basis of the Authority's finding that Mr Thommes was not a fit and proper person to carry out any controlled function involving the exercise of significant influence in relation to such regulated activities. This followed an investigation into Mr Thommes' exercise of significant influence at General Finance Centre Limited ("GFC") between 31 October 2004 and 19 December 2008. The Authority asks the Tribunal to endorse that decision. In summary, the Authority says that the Applicant failed to appreciate his responsibility to protect against mortgage fraud and consequently failed to take adequate steps to ensure that GFC had adequate systems to prevent mortgage fraud. In addition, the Authority says that Mr Thommes failed to ensure that GFC's customers were treated fairly in respect of fees.

3. By a Reference Notice dated 12 August 2011 ("the Reference") Mr Thommes referred the matter to this Tribunal. By the Reference, Mr Thommes challenges the Prohibition Order on the following grounds:

> (1) adequate systems and controls were established and maintained at GFC;
>
> (2) the possibility that systems and controls might, in some instances, have not prevented potentially fraudulent mortgage applications being made does not support or justify the Authority's findings; and
>
> (3) in any event, the Prohibition Order is disproportionate.

Legal and regulatory framework

Financial Services and Markets Act 2000

4. Section 2 of the Financial Services and Markets Act 2000 ("FSMA") sets out the Authority's general duties. By s 2(2) the Authority must, so far as is reasonably possible, act in a way which is compatible with its regulatory objectives, and in a way which the Authority considers most appropriate for the purpose of meeting those objectives. Section 2(2) provides that those regulatory objectives include maintaining confidence in the financial system, protecting consumers and the reduction of financial crime.

5. The Prohibition Order has been made under s 56 FSMA. Under that section, 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 firm, the

Authority may make an order prohibiting the individual from performing a specified function, any function falling within a specified description or any function. By s 56(7), the Authority may, on the application of the individual named in a prohibition order, vary or revoke it.

FSA Handbook

6. The chapter of the Authority's handbook entitled Supervision ("SUP") identifies various controlled functions. Those applicable at the relevant time to Mr Thommes, and so material to this appeal, are the Director Function (CF1) and the Apportionment and Oversight Function (CF8). Each of these is a significant influence function (SUP 10.5.1G).

7. The director function (CF1) is described in SUP 10.6.4R as the function of acting as a director, other than a non-executive director, of a body corporate. SUP 10.7.1 explains that the apportionment and oversight function (CF8) is the function of acting in the capacity of a director responsible for either or both of the apportionment and oversight functions set out in the Senior Management Arrangements, Systems and Controls ("SYSC") chapter of the Handbook.

8. SYSC 2.1.3R explains that a firm must appropriately allocate the functions of dealing with the apportionment of responsibilities (under SYSC 2.1.1R) and overseeing the establishment and maintenance of systems and controls (under SYSC 3.1.1R).

9. SYSC 2.1.1R (clear and appropriate apportionment) provides that a firm must take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that it is clear who has which of those responsibilities and the business and affairs of the firm can be adequately monitored and controlled by the directors, relevant senior managers and governing body of the firm.

10. SYSC 3.1.1R (systems and controls) provides that a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business. The nature and extent of such controls will depend on a number of factors, including the nature, scale and complexity of the business and the degree of risk associated with each area of its business. The guidance at SYSC 3.1.2G explains that a firm must carry out a regular review of its systems and controls to enable it to comply with SYSC 3.1.1R.

11. SYSC 3.2.6R explains that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime. A firm must ensure that these systems are comprehensive and proportionate to the nature, scale and complexity of its activities.

Fit and proper

12. The chapter of the Handbook entitled Fit and Proper Test for Approved Persons ("FIT") sets out and describes the criteria that the Authority will consider when assessing the fitness and propriety of a candidate for a controlled function. The criteria are also relevant in assessing the continuing fitness and propriety of such persons.

13. FIT 1.3.1G provides that the Authority will have regard to a number of factors when assessing the fitness and propriety of a person to perform a particular controlled function. The most important considerations include competence and capability. When assessing fitness and propriety, the Authority will take account of the activities of the firm for which the controlled function is or is not to be performed, the permission held by that firm and the markets in which it operates (FIT 1.3.2G).

14. FIT 2.2.1G explains that, in determining a person's competence and capability the Authority will have regard to matters including (but not limited to) whether the person has demonstrated by experience that the person is able to perform the controlled function.

Statements of Principle and Code of Practice for Approved Persons

15. Section 64 FSMA provides that the Authority may issue statements of principle with respect to the conduct expected of approved persons. Statements of principle are binding on approved persons.

16. The chapter of the Handbook entitled Statements of Principle and Code of Practice for Approved Persons ("APER") sets out the Authority's statements of principle and its code of practice. It should be noted that the Authority is not seeking to exercise any of its disciplinary powers. Accordingly, it does not seek to prove that Mr Thommes is in breach of the statements of principle. We accept, however, that APER provides a useful guide as to the conduct expected of an individual undertaking a significant influence function. It is accordingly relevant to these proceedings.

17. Statement of Principle 2 provides generally that an approved person must act with due skill, care and diligence in carrying out his controlled function. Statements of Principle 5, 6 and 7 are directed towards approved persons performing a significant influence function. They are (APER 2.1.2P):

> *Statement of Principle 5*
> An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.
>
> *Statement of Principle 6*
> An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.

Statement of Principle 7
An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

18. APER 4.6 sets out types of conduct which, in the opinion of the Authority, does not comply with Statement of Principle 6 (see APER 4.6.2E). This includes APER 4.6.8E and 4.6.9E:

APER 4.6.8E
Failing to supervise and monitor adequately the individual or individuals (whether in-house or outside contractors) to whom responsibility for dealing with an issue or authority for dealing with a part of the business has been delegated falls within *APER 4.6.2E*.

APER 4.6.9E
Behaviour of the type referred to in *APER 4.6.8E* includes, but is not limited to:

(1) failing to take personal action where progress is unreasonably slow, or where implausible or unsatisfactory explanations are provided;

(2) failing to review the performance of an outside contractor in connection with the delegated issue or business.

19. APER 4.6.14G explains that, whilst an approved person performing a significant influence function may delegate the resolution of an issue he cannot delegate responsibility for it. The guidance also explains that where an issue raises significant concerns an approved person performing a significant influence function should act clearly and decisively.

The evidence

20. We had a considerable number of documents bundles before us, largely comprising the 20 files of GFC reviewed by the Authority. For the Authority, we had a witness statement, and received oral evidence, from Mark Wilson, a Manager of a supervision team within the Wholesale and General Insurance Department of the FSA. Prior to this role, Mr Wilson was Manager of a supervision team that specialised in combating mortgage fraud, within the Mortgages and General Insurance Department, which forms part of the Conduct Business Unit of the Authority. Mr Thommes also provided us with a witness statement and gave oral evidence.

21. The witness evidence of the Authority, or the lack of it, was an issue, which we now consider.

22. Mr Virgo argues that the regulatory materials do not specify with any degree of particularity the precise steps that an individual such as Mr Thommes was expected to take to counter the risk of financial fraud. He submits that the evidence of Mr Wilson, put forward by the Authority, in this respect is of little value as he has no active personal experience of the market place, having never been an approved person.

23. What Mr Virgo argues is that the safe determination of the relevant benchmark standards at the required level of detail requires expert evidence, which is absent from this case. He submits on this basis that there is an evidential lacuna in the Authority's case.

24. In support of this argument Mr Virgo relies upon the judgment of Evans-Lombe J in the High Court in *Barings PLC & Anor v Coopers & Lybrand (A firm) & Ors* [2001] PNLR 551 where he dismissed an application by the claimants to strike out the whole or certain parts of experts' reports sought to be relied upon by the defendants. The case revolved around the Barings crash as a result of liabilities incurred by the trader, Nick Leeson. The claimants sought damages from their auditors. The defendants' case was that the claimants ought to have been aware of Mr Leeson's trading from their own knowledge and investigations, and proposed to support that case by the expert evidence.

25. It was held that evidence was admissible under s 3 of the Civil Evidence Act 1972 as expert evidence whenever the court accepted there was a recognised expertise governed by recognised standards and rules of conduct capable of influencing the court's decision on any issue it had to decide, and the witness demonstrated sufficient knowledge and experience to render their evidence potentially of value. The management of investment banks engaging in futures and derivatives trading was an area where there was such a body of recognised expertise. There was no good reason to exclude the proposed expert evidence, even if the witnesses did express opinions on whether or not the claimants' officers were negligent.

26. At [47] Evans-Lombe J said that he regarded as very significant the fact that the case concerned an area of commerce that was highly regulated, practitioners in which were required to be licensed by the regulator and in respect of which the regulator had prescribed standards of required competence. He referred to disciplinary proceedings against some of the Barings' directors before a disciplinary tribunal of the Securities and Futures Authority ("the SFA"). Citing from the transcript of the decision in those proceedings, the judge said (at [51]):

> "… In expressing the reasons for the decision of the Appeal Tribunal to allow the appeal, Lord Bridge said this at page 21 of the transcript:
>
> 'The profession practised by Mr Baker was, it seems clear, one requiring a high degree of specialisation and an exceptional expertise. How then was it to be shown that he fell short of the standard required of a reasonably competent member of that profession and that in the situation which confronted him in January 1995, any competent member of the profession would have taken steps to monitor Leeson's conduct of the switching business beyond those which Mr Baker had taken and which the Tribunal appeared to have accepted as adequate 'throughout 1994'. It was, of course, for the Tribunal to find the primary facts which confronted Mr Baker. But by what criteria were they to judge what response should have evoked from 'reasonably competent members of the profession who had the same rank and professed the same specialisation as the defendant?' It seems to me that such a judgment must necessarily depend on the evidence of other

> members of the same profession qualified to speak as witnesses having the same expertise."

27. Mr Virgo argues that the witness statement of Mr Wilson describes at a level of abstraction the standards he says the Authority expects to see, but he volunteers no view as to whether GFC measured up to those standards. He submits that this is an evidential lacuna in the Authority's case which is incompatible with a safe finding that the allegations made against Mr Thommes are proved and with the sanction proposed being justified.

28. We do not accept Mr Virgo's submission that there is an evidential lacuna of the nature he has described. The Tribunal of course decides the matters requiring to be determined on the evidence it has before it. There can be no rule that matters of competence and capability require the assistance of expert evidence. On any application to admit such evidence the Tribunal will have regard to the nature of that evidence, and whether it is likely to assist the Tribunal.

29. As Mr Pritchard points out, this Tribunal is a specialist tribunal with special financial services expertise. Whilst it is of course the case that an understanding of particular market practices may be assisted by expert evidence on a particular application, there can be no general rule to that effect. In a normal case, such as the present, we consider that the Tribunal is well able itself to determine questions of competence and capability before it, without the assistance of expert evidence. We do not consider that arguments based on evidence that might be expected in a professional negligence case, such as *Sansom v Metcalf Hambleton* [1998] PNLR 542, are decisive in the context of an application to this Tribunal.

30. The evidence of Mr Wilson does not amount to expert evidence. It is evidence of the regulatory requirements in place at the relevant time and the nature of the systems and controls that were expected by the Authority in mortgage brokers such as GFC. The Tribunal places no weight on expressions of opinion by Mr Wilson on the possible discrepancies in GFC's files. Those are matters on which the Tribunal will come to its own view on the documentary evidence, and the evidence of Mr Thommes.

The facts

31. At the material time, GFC was a mortgage broker in the Dorset area. Amongst other business activities, which were not regulated by the Authority, GFC arranged regulated mortgage contracts on a non-advised basis.

32. GFC was authorised and regulated by the Authority from 31 October 2004 to 19 December 2008 to carry on the following regulated activities:

(a) advising on regulated mortgage contracts;

(b) agreeing to carry on a regulated activity;

(c) arranging (bringing about) regulated mortgage contracts; and

(d) making arrangements with a view to regulated mortgage contracts.

33. Whilst the majority of GFC's business related to unregulated commercial mortgages and loans, during the relevant period, the regulated business accounted for around 20% of the business.

34. GFC is now dissolved following the appointment of liquidators in December 2008.

35. Mr Thommes established GFC and was its managing director and majority shareholder. He held the CF1 (Director) and CF8 (Apportionment and Oversight) controlled functions from 31 October 2004 until the cancellation of GFC's permission in December 2008. As Mr Thommes in his evidence accepted, the consequence of him having the CF8 function was that he had overall responsibility for the compliance oversight of GFC's operations.

36. During the material period, GFC had two other directors who held CF1 controlled functions, a Mr James Austin (4 November 2004 to 2 April 2007), who was responsible for sales, and a Mr Martin Lafrance (15 November 2005 to 19 December 2008), operations director. GFC engaged external compliance consultants – Compliant Solutions – who visited the company on a quarterly basis.

37. In October 2005, the Authority was contacted by a whistleblower, who made allegations concerning the running of GFC. The allegations included claims that GFC submitted fraudulent mortgage applications, selected products on the basis of commission and kept inadequate records. In his witness statement, Mr Thommes challenged the motives of the person he assumed had been the whistleblower in October 2005. However, those motives are not material. The allegations of the whistleblower are not relied upon by the Authority. Those allegations were merely the catalyst for the processes that ultimately led to the action being taken by the Authority that is the subject of this reference.

38. The Authority made a supervision visit to GFC on 19 January 2006 as part of a high level review of the company's systems and controls and selling practices. The visit was not part of a formal investigation and was undertaken by the Authority's supervision department. It identified a number of concerns, which it set out in a letter to Mr Thommes dated 20 April 2006:

(1) The firm failed to understand the requirements for a non-advised sale process.

(2) The firm failed to monitor and implement the findings of the firm's external compliance consultants.

(3) Issues surrounding the firm's recruitment and ongoing compliance monitoring of its staff, including the fact that one of its employees was on street bail, having been arrested for causing actual bodily harm in December 2005.

(4) The firm had few systems and controls in place as required by SYSC 3.1.1R and SYSC 3.2.6R. The letter explained that "the firm is to ensure that it fully understands the requirements under these rules and implements processes and procedures to satisfy them."

(5) The files reviewed by the Authority confirmed several shortcomings in the firm's record keeping. Of "more serious concern" was the fact that any attempts to check files had failed to highlight and correct the shortcomings. The letter then summarised reviews of a number of customer files containing inconsistent information or demonstrating other shortcomings.

(6) The firm was unable to demonstrate that it had in place a procedure for dealing with complaints.

39. In his witness statement, Mr Thommes said that, although the Authority's visit identified teething troubles in the firm adapting to the new regulatory regime, "it is to be noted" that no concerns were expressed as to " 'systems and controls' within the company to detect possible mortgage fraud". In cross-examination, Mr Thommes was taken to the passage in the Authority's letter of 20 April 2006, at which, under the heading "Systems and Controls", it was stated that "Our findings indicate that the firm has few systems and controls in place as required under SYSC 3.1.1R or SYSC 3.2.6R. The firm is to ensure that it fully understands the requirements under these rules and implements processes and procedures to satisfy them." As we have seen (see [11]), SYSC 3.2.6R specifically relates to the establishment and maintenance of systems and controls for countering the risk of a firm being used for financial crime.

40. Mr Thommes stated in evidence that when reading the letter from the Authority he had looked at SYSC 3.2.6R. He understood at the time of the letter that the Authority was concerned that GFC had few systems and controls in place regarding financial crime. He accepted that, when preparing his witness statement that he had missed the relevant paragraph from the Authority's letter.

41. As a matter of fact, we do not accept Mr Thommes' explanation of this passage from his witness statement. We do not accept that, on receiving the Authority's letter of 20 April 2006, he took the trouble to find out what SYSC 3.2.6R said. It is more likely, we consider, and we so find, that Mr Thommes was at all times up to the hearing itself unaware that this paragraph from the Authority's letter concerned financial crime.

42. The 20 April 2006 letter also highlighted concerns over the adequacy of reports prepared by Compliant Solutions. The letter said: "External compliance consultants (sic) reports have been provided but fail to contain specific detailed information to highlight issues identified that are of concern, the remedial action to be taken and the findings thereafter."

43. GFC replied to the Authority's letter on 4 May 2006. The reply referred, in the context of monitoring the findings of external consultants, to the commencement of a design of a "non-advised script". This, it was explained, needed to be discussed with Compliant Solutions and then signed off by Mr Thommes as the CF8. The letter

stated that the non-advised scripted questions had been used since January 2008 for every regulated contract. It went on to refer to templated generic documentation provided by the compliance consultants, and personalised for the company's use, a consultation report from 30 January 2006, an initial disclosure document (IDD) setting out key facts about GFC's mortgage services and training and competence ("T & C"). The major part of the letter was devoted to comments on the findings made by the Authority regarding issues arising on the individual files.

44. Further correspondence ensued, culminating in a letter from the Authority dated 28 June 2006 in which it was stated:

> "Processes, systems and controls have been implemented with external compliance assistance to enhance and record the business transacted. However, there appears to still be some areas of misunderstanding within the sales processes which the firm should look to clarifying.
>
> The basis of the supervision visit findings stem from inadequate and incomplete record keeping. The issues brought to the firm's attention are due to file checking identifying discrepancies and drawing them to your attention for investigation and remedial action where necessary. The firm having installed a process to regularly monitor future files and sales processes will highlight and rectify any subsequent findings."

The letter concluded by saying that it was expected that the improvements made and future recruitment expectations would address the issues raised and improve compliance standards overall. A future visit would be scheduled to review the new procedures. The letter warned that should repeat breaches be identified, consideration would be given to referring GFC to the Authority's enforcement division.

45. Included within the information supplied by GFC to the Authority was an "Annual Compliance Plan" produced by Compliant Solutions. That plan identified Mr Thommes as having the Apportionment and Oversight (A&O) function. The plan included the following points:

> (1) Any non-compliance had to be reported to the A&O officer, who was responsible for any further investigation and remedial action. The A&O officer had to be informed of any significant compliance issues.
>
> (2) Generally, it was the responsibility of the individual appointed to the A&O function to ensure that all the tasks set out in the plan were completed satisfactorily. The A&O officer may delegate responsibility for some of the tasks to another senior individual within the firm.
>
> (3) The A&O officer would ensure that the resources of the Compliance T & C function was kept under review. He would also ensure that the firm's management information was retained so as to enable key data to be produced when required to assess the risks posed to the business in terms of individual employees and products.
>
> (4) Compliance meetings would be held at least annually, following the report of the A&O officer to the senior management committee/board. These meetings would review the report as well as covering all areas of

compliance highlighted in the plan to assess whether any changes were required to be made to the delegation of responsibility, the procedures adopted or management retained.

46. Following the visit of the Authority and the correspondence, in August 2006 Mr Brian Wright was appointed as compliance manager, reporting directly to Mr Thommes. No application was made for Mr Wright to be approved by the Authority; Mr Thommes himself retained the A&O function. According to Mr Thommes, Mr Wright's duties comprised dealing with all compliance matters, including training, recruitment, record-keeping, reporting and file checking. He was also expected to take an active role in the health and safety and human resources at the firm.

47. In his compliance role, Mr Wright prepared a compliance plan and associated procedures and reports with a view to GFC adhering to rules and procedures. He worked with Compliant Solutions when necessary. In the open plan environment that existed at GFC, Mr Wright was able to monitor for himself telephone conversations and staff discussions. His role, as described by Mr Thommes, included reviewing all files concerned with regulated business; he had unfettered access to all files. Mr Wright was described by Mr Thommes as an integral part of the management team, working closely with the directors on a daily basis. We heard that, behind only Mr Lafrance, Mr Wright was the second highest paid employee, earning about £30,000 a year. (Mr Thommes took a nominal salary only, but received dividends when profits were available.)

48. In respect of GFC's regulated business, the firm's general processes were as follows:

(1) An employee of the firm would first meet (or talk on the telephone to) potential clients who were interested in obtaining a mortgage. The employee would gather basic information from the client. At this meeting an initial fee would generally be taken from the client. One of the issues for us to address is the extent to which the fact that the fee was non-refundable was disclosed adequately to customers. During this meeting the sales team did not use a script to describe the nature of the fee.

(2) In general, the file would then, at this stage, be reviewed by Mr Thommes who would send a letter to the relevant client. The letter might also include documentation, including a fee agreement which the client was asked to sign. As a general matter, Mr Thommes' evidence was that this was the last time he would see the client file.

(3) The file was then passed to GFC's administration team who would process the relevant documentation and apply to the lender for funding. GFC might ask the client to obtain further documentation (including, for example and where relevant, an accountant's certificate) to satisfy the lender's criteria.

49. Despite the evidence that it was part of Mr Wright's responsibility to review all the files concerned with regulated business, there is no evidence, apart from Mr Thommes' professed understanding of the position, that he in fact did so. No

independent check was made of Mr Wright's work in this respect, or, if it was, there is no evidence of it. The best that can be said is that it appears that Mr Wright reviewed between 30% and 40% of the files. This is what Mr Wright himself told the Authority in interview on 3 March 2009, although he also said that it was possibly more on occasion. Mr Thommes surmised that Mr Wright was concerned, in interview, to protect his own position, and may not have been truthful. However, the figure of 30% to 40% tallies also with an objective analysis of the 20 files considered by the Authority; only 35% of those showed evidence of Mr Wright having performed a file review.

50. Although Mr Thommes told us that it was his understanding that Mr Wright reviewed all of the files, he accepted that he did not check whether he had done so. He could not confirm that Mr Wright in fact reviewed all the files, and he did not have formal meetings with Mr Wright to discuss how his reviews were going. Furthermore, although Mr Thommes told us that Mr Wright had never drawn any evidence of non-compliance to his attention, this fact did not alert Mr Thommes to the need to check what Mr Wright was doing. Nor were there any formal meetings with Mr Wright to discuss management information that might have been obtained from the client files reviewed by Mr Wright. Instead, Mr Thommes said he relied upon Mr Wright and Mr Lafrance to bring any matters concerning the files to his attention. However, Mr Thommes also told us that he could not recall Mr Wright ever having done so; and his evidence in this respect concerning Mr Lafrance was unconvincing, saying only that Mr Lafrance; "would have wandered into my office, as you say, and said: what about this; and I may have made some comment on that basis".

51. Nor was there any effective supervision of Compliant Solutions, despite the misgivings as to their reports which had been highlighted by the Authority. Mr Thommes told us that he would like to have said that Compliant Solutions were checking for everything, but he did not know. He did not know what they were checking for. He assumed they were checking for such matters as income variations and employment variations, because they had referred to such matters in earlier correspondence. But Mr Thommes had not made any specific enquiry of them in this regard. Although he met Compliant Solutions at the quarterly meetings, Mr Thommes only attended for the final 30 minutes of such meetings and did not ask any questions concerning individual files; he did not know what files Compliant Solutions had checked. Nor, in cases where the reports of Compliant Solutions referred to tasks which Mr Wright was expected to undertake, did Mr Thommes check with Mr Wright that those tasks were being performed, relying instead on his assessment of Mr Wright as conscientiously paying attention to detail.

52. It is also the case that Compliant Solutions raised issues with GFC on the need to check for income discrepancies. For example, on 4 October 2006, Compliant Solutions produced a compliance report for GFC which highlighted action GFC was to take. The report included an item on "Disclosure and Sales Processes", which noted that all GFC's cases were on a self-certification basis and income details should be evidenced if possible. The report listed the action required in this area as "ensure that in all cases the income and affordability has been looked at thoroughly and can be shown on file that it is acceptable". On the other hand, the comments column states:

"We have a responsibility to consider affordability – however self cert clients sign a declaration of affordability on application form and all sales are strictly non-advised. Ongoing continual process rather than specific timed reviews". Compliant Solutions also produced a compliance report on 6 February 2007 which again highlighted action GFC was to take. The report included an item on self-certification and sub-prime mortgages and stated that: "… currently the managers are responsible for analysing the information provided and whether the income matches the occupation etc. These are reviewed by Brian [Mr Wright] every 6 months".

Client files

53. As we have described, the Authority considered 20 of GFC's files over the relevant period dealing with regulated mortgage business. This represented more than one third of the total completed loans (54) in that period, but we accept that there were considerably more enquiries dealt with by the company for which no loan was completed. We do not have evidence of the exact number, but we accept what Mr Thommes said in this connection, namely that it would have been something like 300 applications in all.

54. It was the Authority's case, that 10 out of the 20 client files examined contained serious inconsistencies and discrepancies that called for further explanation. Except to the extent referred to below in respect of individual files, we accept that the client files disclose such inconsistencies and discrepancies. But the files do not evidence that any such explanations were sought or obtained. A number of specific issues on various files were put to Mr Thommes in cross-examination. He accepted in each case that there were discrepancies calling for explanation. Given that acceptance, the following is a truncated summary only.

Mr A

The file includes a letter to GFC dated 21 November 2007 from a company confirming that Mr A is employed by it.

A letter from Mr Thommes to Mr A a few days earlier, on 15 November 2007, confirming the provisional availability of a loan of £90,000 and acknowledging the initial fee of £200, asks Mr A for proof of his self-employment. The non-advised sales questionnaire, completed on 5 November 2007, has a circled "Yes" against the question "Are you self-employed or do you have more than one source of income?".

The mortgage application form is completed with reference to the self-employed section. Mr A describes himself as an "inventory director", the name of the business being given as the name of a limited company. His earned income is £51,000, but he also notes rental income of £8,400.

There is no note of the file having been reviewed by Mr Wright.

In evidence, Mr Thommes made the point that, in common with many directors of limited companies, it was quite likely that Mr A had simply described himself as self-employed. Nothing had been hidden from the lender. Nevertheless Mr Thommes accepted that a note should have been placed on the file to "satisfy the regulators".

In this respect, we are inclined to agree with Mr Thommes' analysis. We think it quite likely that Mr A was confused as to his status. His answer to the question on the questionnaire could equally have been referring to his second source of income as to his employment status. Nonetheless, what is shown is an absence of file review.

Mr and Mrs G1

In the financial details section of a mortgage application made by Mr and Mrs G1 on 15 August 2007, a negative answer is given to the question "Have you had three or more months arrears (cleared or not) on any secured or unsecured loan in the last 2 years?"

That application was refused. The potential lender declined the application because the client had an adverse credit history. A credit search had revealed three county court judgments (CCJs) and up to four months arrears. The file note states "Have to change lenders".

The initial enquiry form indicated that Mr and Mrs G1 had told GFC that there were arrears of only one month and no CCJs.

A further mortgage application, to a different lender, was made on 23 October 2007. The application answered no (for both Mr and Mrs G1) to a question about CCJs in the last 3 years. Mr Thommes accepted in evidence that this was a "gross error of administration", on the part, he said, of the employee who had revisited the client. He agreed that this was the kind of issue that ought to have been picked up on review. He also accepted that cases of multiple applications, where an application has been rejected by one lender and is then re-submitted to another, the position should be checked.

It does not appear from the file that it was checked by Mr Wright.

Miss H

In relation to the case of Miss H, the opening submission on behalf of Mr Thommes had asserted that there was no evidence that the reported level of income was overstated.

A mortgage application for Miss H was dated 17 September 2007. Against employment status the non-employed box was ticked, and this was confirmed in a later section dealing with income. No income is stated, and the section on self-employment has been struck through.

The file also reveals a further mortgage application to the same lender, typed but unsigned. On this occasion, the self-employed section is completed, with the nature of the business being given as "dressmaker" and the previous year's net profit as £22,000. Asked by Mr Pritchard in cross-examination whether he agreed that the two forms were inconsistent one with the other, Mr Thommes said:

> "I agree with you that this seems to be a blatant fraud which should never have been presented to the lending institution and upon reflection, I'm first of all surprised that my colleague, Martin Lafrance, didn't flag this immediately and reject it. I'm subsequently amazed that my colleague, Brian Wright, didn't flag this and bring it to my attention, and I'm disappointed in myself in hindsight that I didn't check this file and take some action in this respect."

Mr Thommes accepted that GFC's systems and controls failed in this case. Asked, however, if he accepted that he was responsible for the failure, he conceded only that he was ultimately responsible for the failure of the business.

Mr and Mrs G2

GFC customarily used commercial mortgage application forms to record the circumstances of clients. One such form was used in the case of Mr and Mrs G2. On that form there was recorded declared income of Mr G2 of £33,000 and for Mrs G2 £37,000.

On the enquiry form of the lender, by contrast, the income of Mr G2 is stated as £73,000. Mr Thommes accepted that this was a discrepancy.

In this case, as the mortgage term would extend beyond expected retirement age, the lender required further information on the basis of calculation of projected retirement income. This request was made by the lender to GFC itself, with a recommendation that the basis for the calculations should be retained by GFC for the full mortgage term.

Bank statements on the file show salary payments that do not equate with a salary of £73,000 for Mr G2. Mr Thommes accepted that this difference was not explained by the filed documents. However, his evidence was that GFC would not insist on seeing bank account details in order to verify income if the application was being underwritten on a self-certified basis.

Mr Thommes also accepted that there was an ambiguity over the purpose of the loan, and that this was something that should also have been raised as a concern. On the one hand it was stated as purchasing a property for investment; on the other it was evident that one of the purposes was to pay off credit card accounts. Mr Thommes accepted further that the correct information did not seem to have been provided to the lender in this case.

Mr and Mrs K

On this file there is a File Review Sheet signed by Mr Wright and dated March 2007. All items are recorded as having been satisfactorily completed.

An issue that arose on this file is that it appeared the income figure for Mr K in the mortgage application form had been altered so as to be increased from £7,500 to £47,500. Mr Thommes accepted that this was an issue that should have been looked into.

Mr Thommes also accepted that possible manuscript amendments to a letter from Mrs K to GFC dated 12 February 2007 ought to have been investigated. Mr Thommes expressed himself as surprised that the file had been administered in the way it appeared to have been, given the lender's own criteria.

This file was a further example of discrepancies appearing where more than one mortgage application was made. In the second application Mrs K's income is shown as £62,000, whereas in the first it was £25,000 to £30,000. Mr Thommes agreed that this was a discrepancy that ought to have been noted, but he made the point that he did not believe that the clients were "intentionally attempting to defraud" the lender.

Mr and Mrs L

Income discrepancies were also apparent in the file relating to Mr and Mrs L. Mr L had stated his income as increasing to £450,000 in 2007-2008, and anticipated to do so further in the following years. An accountant's report dated 15 January 2008, and faxed to the lender at 9.30am reported that Mr L's company's accounts showed a profit of £24,000 for each of the years to March 2006 and 2007. Although this was superseded by a further report faxed to the lender at 11.06am, the second report did not refer to the company's profit.

It is apparent that this was an application by Mr and Mrs L for a further loan from their existing lender. Among the lender's conditions precedent for the loan was for the applicant to explain the increase in income from £380,000 to £450,000 since the original loan. What appears from this is that, firstly, the original application had required support for an income of £380,000, and, secondly, that an explanation must have been given to the lender for the increase. Nonetheless, the file contains no statement explaining Mr L's income, nor any reconciliation of the apparent anomaly of the company profit evidenced by the accountant's first report.

Mr and Mrs W

In the case of Mr and Mrs W, the initial meeting notes of 26 February 2008 indicate that the clients wished to re-mortgage up to 90% to raise additional funds to purchase a glass-bottomed boat to set up a new business in the Caribbean. However, the application for a mortgage expresses the purpose as

"home improvements/repairs". Mr Thommes accepted that this was inconsistent and that questions should have been asked.

Furthermore, in subsequent correspondence, although the purchase of a boat was referred to alongside the home improvements, there is evidence of handwritten instructions not to mention, in a reply to the lender, that the boat was to be used in connection with a business in the Caribbean. It is not clear who wrote that instruction, but Mr Thommes accepted that it raised an issue that needed to be looked at. However, in accepting that, Mr Thommes based that acceptance on the fact that other lenders could have been approached for business funding of that nature.

Fees

55. On 6 March 2008 the Authority was contacted by a second whistleblower who made allegations that GFC was misleading customers in the way that it described its upfront fees. On investigation of the 20 client files examined by the Authority, in all cases there was found to be a lack of transparency regarding fees.

56. There was, we find, in the relevant period, a lack of clarity concerning the fees payable by clients to GFC. Those fees were variously described, in initial enquiry forms as a "valuation fee", in initial disclosure letters as an "initial fee" and in fee agreements as a sum of money "in consideration of the preliminary administration processing and out of pocket expenses to be incurred by [GFC]".

57. GFC and Mr Thommes regarded the upfront fee as non-refundable. However, documentation provided to customers was inconsistent regarding the right to a refund. For example, in a file of Mr and Mrs P, documentation provided to the client by the lender referred to the valuation fee as refundable if the valuation was not carried out. On the other hand, in the key facts provided by GFC, the same amount is described as an initial application fee, and as non-refundable.

58. Although GFC's documentation did in some instances make it clear that initial fees were non-refundable, on occasion GFC obtained payment of such fees before providing relevant documentation explaining the nature of the fees and obtaining the client's signature on the fee agreement.

59. We were taken to an example of a letter of instruction sent by GFC to surveyors. The letter refers to a fee of £145 "as per agreed fee scale". It goes on to say to the surveyor "Please do NOT discuss fees with clients under any circumstances". On the same file, key facts provided by the lender refer to a non-refundable application fee of £295 payable to GFC. The fee was sent to GFC at the same time as a signed fee agreement.

60. In his evidence Mr Thommes explained that the instruction to surveyors not to discuss fees with the client was not intended to obscure transparency. It was designed to ensure that clients themselves were not troubled by demands for additional fees

from surveyors when, in all likelihood, those fees would be met by GFC out of its expected commission.

61. In another case, that of Mr and Mrs B, it is clear from Mr Thommes' initial letter, dated 19 July 2007, which acknowledges the fee and at the same time sends Mr B the fee agreement for signature, that the fee was paid before a fee agreement was signed. Furthermore, the same letter enclosed the Key Facts Illustration and Initial Disclosure Document for signature and return.

62. This practice had been disapproved by GFC's external consultants, Compliant Solutions. For example, according to a note of a meeting with the consultants on 8 May 2007, which refers to the Authority's guidance at MCOB 5.5.4:

> "We discussed the collection of fees. This must not be done until disclosure and fee agreements have been provided to the client."

By way of further examples, in his annual compliance report for the year to December 2007, Mr Wright highlighted complaints that had been made concerning requests for repayment of the initial fee; in a paper prepared by Mr Wright dated February 2008 entitled "Treating Customers Fairly – Management Information", the main complaints issue was identified as the return of the valuation fee. Nonetheless the position taken in the paper is that GFC's position was well-documented and disclosed to the client.

63. Mr Thommes' evidence was that the occasions when fees were taken before a fee agreement had been given to the client were occasional errors of administration. He expressed the view that the client would have been made aware of the fees prior to completing and sending in their application, having received a key facts illustration and having had an interview with a representative of GFC. He accepted, on the other hand, that there was no specific script concerning the fees and their non-refundability; his evidence was that the staff had a very clear direction to outline the fees and their consequences.

64. In the period in question three complaints were made by clients to the Financial Ombudsman Service in relation to GFC's fees. In all three cases the client received redress.

The evidence of Mr Wilson

65. We have referred earlier to the relevance of the evidence of Mr Wilson in relation to the practice of the Authority in this area.

66. Mr Wilson told us, and we accept, that mortgage fraud is one of the most prevalent types of financial crime. It usually involves customers giving misleading information to mortgage lenders, or advisers enabling and assisting customers to provide misleading information to mortgage lenders. (Nothing of the latter is alleged against Mr Thommes or GFC.)

67. The view of the Authority is that all persons who work in the mortgage industry should be alert to the risk that customers may provide inaccurate information with a

view to obtaining a mortgage which they cannot afford. Accordingly, if a firm discovers any discrepancies in the information received from a customer those discrepancies should be investigated and clarified before the mortgage application is sent to the lender.

68. In publicising an initiative of the Authority to identify brokers concerned in mortgage fraud, a press article in April 2006 provided a list of examples of mortgage fraud that lenders and intermediaries should be vigilant in identifying. This included doubts about income and employment details. An article published in the industry publication, "Mortgage Solutions" on 11 June 2007 reiterated that:

> "… it is important that brokers have robust systems and controls in place to ensure their firm is not used as a channel for financial crime. We do not expect firms to be 'forensic experts', but we do expect them to look closely at documents supplied by clients, be vigilant and pick up irregularities."

69. In his evidence, Mr Wilson described (as he put it, as a matter of common sense) the types of systems and controls the Authority would expect a CF8 of a firm the size and nature of GFC to impose in order to prevent mortgage fraud:

(1) Vigilance on the part of staff processing the application, including:

(a) checking for suspected fraudulent documentation being used to support mortgage applications, for example bank statements, utility bills, wage slips, passports and driving licences, etc;

(b) common sense checks for whether the income level declared by the applicant is credible compared with their employment;

(c) cross-referencing the information provided on the mortgage application form with the other documentation received whilst processing the application;

(d) considering asking customers for wage slips and bank statements as part of the sales process, irrespective of whether the lender requires them and asking customers to provide original documentation; and

(e) finding out why a lender declines an application, rather than simply placing it elsewhere with another lender.

(2) Effective supervision of staff who process mortgage applications and training to ensure that staff are appropriately vigilant in relation to the warning signs of mortgage fraud.

(3) Consider file-checking by professional compliance personnel and monitoring the service provided by those compliance personnel to ensure that systems and controls in place are working effectively.

(4) Regular reviews of management information, such as new business register, watching out for links or trends identified between customers, for example multiple applications submitted within a short period of time and applications refused and then repeated with different lenders.

(5) Periodic spot-checking of mortgage application files by the SIF (person exercising a significant influence function) in question to ensure that the systems and controls in place to prevent financial crime are working effectively and that there are no obvious discrepancies which would suggest that the firm is being used as a vehicle for mortgage fraud.

70. We find that this is a reasonable and proportionate check-list of matters that properly fall within the responsibility of the CF8 in relation to the detection and prevention of mortgage fraud in a firm of the size and nature of GFC.

Discussion

A. Systems and controls in relation to financial crime

71. The Authority submits that Mr Thommes did not meet the minimum regulatory standards by establishing and maintaining adequate systems and controls to prevent financial crime.

72. Despite Mr Virgo's submission to the contrary, we have found Mr Wilson's check-list to be an appropriate yardstick by which to determine this question. Helpfully both parties addressed submissions to the systems and controls set out in that list. We propose therefore likewise to examine this question by reference to that list.

Vigilance of processing staff

73. Mr Thommes accepted that it was important to ensure that staff were vigilant.

74. For the Authority, Mr Pritchard submits that there is no evidence of vigilance on the part of GFC staff. He argues that given the flagrant nature of the discrepancies in the mortgage applications, even the most basic of checks would have identified the issues.

75. For Mr Thommes, Mr Virgo argues that Mr Thommes had no reason to conclude that his staff were not exercising due care in processing of the applications, having not been alerted to any problems by Mr Lafrance, Mr Wright or Compliant Solutions. This, effectively, summarises the essence of Mr Thommes' case, namely that he relied on the systems, people and organisations he had put in place.

76. That, in our view, is not for an individual authorised as a CF8 an answer to a complaint of lack of vigilance. It is clear from APER 4.6.14G that, whilst an approved person performing a significant influence function may delegate the resolution of an issue he cannot delegate responsibility for it. It was the responsibility

of Mr Thommes, as the CF8, not only to apportion the relevant tasks, but to exercise oversight over those to whom responsibility had been given.

77. Mr Virgo submitted that it was not alleged that any mortgage transaction did involve a fraud on a lender. He argues indeed that it is a curious feature of the Authority's case that the criticism made as to an alleged deficiency in the systems and controls in place to prevent fraud are not said to have facilitated any fraud; the criticism is that GFC is said to have lacked sufficiently robust systems and controls to prevent the occurrence of something which is not said to have happened.

78. In this regard, however, we agree with Mr Prichard's submission that there is no need for the Authority to prove, or even allege, actual fraud. It is enough if the Authority demonstrates obvious discrepancies in the client files that had not been identified by Mr Thommes or GFC where those discrepancies show a risk that GFC was being used as a vehicle for fraud. It is of no assistance to Mr Thommes that he was aware, for business reasons, of the need not to submit fraudulent applications. Nor does it matter that there was no evidence of any lender alleging that it was a victim of fraud.

79. We accept, as indeed Mr Thommes did in relation to a number of the files put to him in cross-examination, that in a number of cases discrepancies in declared income ought to have been followed up. Even if there were cases where the applicant was known to the firm, there is no substitute in our view for a robust, and properly documented, examination of any such discrepancy on the face of the information provided by the applicant.

80. Mr Virgo argues that the utility of cross-checking declared income against documentation is futile because, as Mr Thommes stated in evidence, businesses may not use just one account. We do not agree. As Mr Pritchard submitted, this merely emphasises the importance of applicants being asked for further information if there is a discrepancy between declared income and receipts shown on particular bank statements. If there is more than one account, that information may be readily obtained; if there is not, this might reasonably give rise to further enquiry whether a fraudulent application was being made.

81. We do not accept that the checking of income discrepancies is inappropriate in the case of self-certified mortgages. We agree with Mr Pritchard that the fact that mortgages were offered on the basis of self-certification meant that there was a heightened risk of a firm such as GFC being used as a vehicle for mortgage fraud. In those circumstances, common sense checking was all the more important. This was not something that, in our view, was appreciated by Mr Thommes. He did not to our minds understand the essential difference between doing what the lender required to be done (as a business matter), and operating properly from the regulatory perspective, that is to say exercising appropriate oversight over the systems to identify the risk of financial fraud.

82. Mr Virgo argues that the mere fact of multiple applications should not itself be regarded as giving rise to concerns about fraudulent applications. He says that, in

practice, lenders will indicate why an application has been declined, and that unless this is because of concern over the good faith of the applicant it is difficult to understand why other reasons for the application being declined would be relevant to the prevention of mortgage fraud. We consider that this misses the point. The evidence is that no special regard was paid by Mr Thommes or GFC to the question of multiple applications. Mr Virgo's submission admits of the possibility of multiple applications in some circumstances being indicative of fraud, but there is no evidence of any particular checks being carried out to identify any such cases. The absence of such checks is, in our view, a failure of oversight.

Effective supervision and training of staff

83. Mr Thommes accepted that it was important to ensure that staff were vigilant.

84. We were shown a copy of GFC's Training and Development Plan for its operations department for 2008. Mr Thommes explained in his evidence that the administration/operations staff were largely trained by Mr Lafrance on an ongoing day-to-day basis. This consisted of those members of staff being given tasks to complete, dependent on their abilities and development, and review by Mr Lafrance to ensure those tasks were done properly. As far as the administration staff were concerned there was less formal training than there was on the sales side.

85. In fact, we find that there is little evidence of any formal training on the administration side of the business. Although Mr Thommes referred in evidence to formal training including regulatory aspects, his evidence in this connection described only the provision of templates prepared by Mr Wright. Mr Wright did not have any formal training sessions with the administration staff. Mr Thommes was unable to confirm to us whether the training included anything specific on fraud and financial crime. The Training and Development Plan includes nothing on the warning signs of mortgage fraud. Mr Thommes had no involvement in training on the administration side, and he was not involved in devising any of that training.

86. The evidence of Mr Thommes on the sales side of the business is that he was involved to a great extent in that training. This included training on a one-to-one basis over a period of days or weeks, depending on the individual's abilities. At the initial stages of employment of a member of the sales staff Mr Wright would attend appointments along with the staff member. The sales staff were trained in what was expected from a regulatory point of view. Mr Wright provided the relevant templates for them to read and consider, and they were tested on those.

File-checking

87. Mr Thommes points to the steps he took to check the files and monitor the services provided by GFC. He relies on his use of professional compliance personnel, both internal in the form of Mr Wright and external in the case of Compliant Solutions. We heard evidence of meetings with Compliant Solutions on a quarterly basis, and were shown examples of their reports. However, although Mr Thommes told us that he would join those meetings near the end, we find that he did not engage

substantially in any process of review. It is material, in our view, that Compliant Solutions were in place at the time when the original visit of the Authority unearthed the discrepancies we have described earlier. That ought reasonably to have prompted a person in the role of CF8 to have more closely monitored the work being carried out by Compliant Solutions. There is no evidence that Mr Thommes engaged in any real monitoring of Compliant Solutions.

88. Mr Thommes acknowledged in cross-examination that he failed to monitor Mr Wright, and, through Mr Virgo's closing submission, he repeats that acknowledgment. He expresses profound regret, and says that a lesson has been learned. This, as Mr Pritchard pointed out, was in contrast to the position adopted by Mr Thommes in his witness statement, where he said that he "refute[d his] admittance during the FSA interview that [his] lack of supervision on Mr Wright was a failing."

89. We find in this respect that the file-checking carried out was inadequate to enable GFC properly to monitor whether the risk of financial crime was being appropriately managed. If Mr Wright was meant to review all files, it is evident, both from Mr Wright's own interview with the FSA, and from the files themselves, that he did not do so. Mr Thommes was unaware this was the case. He would have become aware if he had adequately monitored and supervised Mr Wright, or if he had spot-checked a random selection of files, or files where the risks were perceived as greater, such as multiple applications. The discrepancies, as Mr Thommes admitted in evidence before us, were plain to see from the files themselves. There was, in our view, at the relevant time a singular lack of appreciation on the part of Mr Thommes as to the vigilance required by him in order properly to perform his oversight function as the CF8.

Regular reviews of management information

90. In closing submissions, Mr Virgo concedes on behalf of Mr Thommes that "it may be said that" Mr Thommes could have been more pro-active in eliciting information than on relying on Mr Wright, Mr Lafrance or a "processor/field operative to bring matters to his attention". As we said in the previous paragraph, this is a finding we ourselves make. Mr Virgo, however, invites us to bear in mind that GFC was a small operation in which Mr Thommes was actively engaged on a day-to-day basis such that he would be likely to be aware of transactions aborting and the reasons simply by virtue of his physical presence in and the proximity to the business being undertaken.

91. As Mr Pritchard points out, this submission is unsupported by the evidence. We heard that Mr Thommes' office was close to his staff, and that he would wander around the office reasonably regularly to ensure that calls being made by sales staff were being conducted properly, but the evidence points clearly against his becoming aware of any of the discrepancies arising from the files that would have been obvious if reasonable monitoring had been undertaken.

92. Mr Virgo argues further that the fact that transactions were referred to Mr Thommes from time to time, coupled with the absence of any complaints from the lenders approached for mortgage products can only have given comfort that there

were no real grounds for concern as to the manner in which the business was being conducted. He submits that it would be wrong in this context to judge Mr Thommes too harshly relying, as he put it "on the omnipotent gaze of hindsight".

93. We do not accept this submission. In evidence Mr Thommes could not recall Mr Wright ever having drawn his attention to inconsistencies on any file. Mr Thommes did not think it odd that there had been no such example; he expected that the underwriting policy would have been adhered to correctly and that all the files were fully compliant. We consider this is an example of Mr Thommes' laissez faire approach to his responsibilities as a CF8. The absence of any report to him of file discrepancies should, if he was engaged with those responsibilities, have raised a question in his mind as to why not. Proper monitoring and supervision would have immediately revealed discrepancies such as we have described. If Mr Thommes genuinely believed that silence on this front was a cause for inaction on his part, that was an abrogation of his oversight responsibilities. No hindsight is required to judge Mr Thommes in this way.

Spot-checking of files

94. Mr Thommes acknowledges that he failed to check the files. He says that he has learned from this and that the failing would not be repeated in the future. He has also recognised "in hindsight" that spot-checking is a critical step in judging the performance of external service providers such as Compliant Solutions. Mr Virgo argues in this respect that there is no reason to conclude that Mr Thommes has not learnt from the experience or that he lacks the common sense insight to "spot" where a file raises questions meriting further investigation.

95. When presented with the evidence in cross-examination Mr Thommes accepted the discrepancies that arose on the relevant files. We accept that Mr Thommes is able to identify discrepancies meriting further investigation. However, the evidence presented to this tribunal in the form of his witness statement does give cause for concern as to the extent of his understanding of the responsibilities a review entails. His focus is often misplaced. In one case he refers to the fact that it would be unlikely that income would have been exaggerated, having regard to the lender's criteria, and there being no benefit to anyone from the distortion of the particular applicants' income. This theme appears again when Mr Thommes refers to the practice, if an application was presented on a self-certification basis, to present and request whatever information the lender required. The focus is on doing what the lenders require, which is a commercial focus, rather than on ensuring that the business was run in a manner compliant with its regulatory responsibilities.

B. Fees and treating customers fairly

96. We find that there is evidence of a clear lack of transparency concerning GFC's initial fee at the time that fee was taken from the client. Although Mr Virgo argued that the evidence demonstrated "beyond peradventure" that Mr Thommes was very alive to the potential for clients not to be given accurate information as to fees, a situation, it is said, that he was at pains to avoid, we do not accept that to be the case.

97. We do accept that Mr Thommes was aware of the fees issue. He had been advised that there had been complaints about the collection of fees by Compliant Solutions and by Mr Wright. He was also aware of the complaints upheld by the Financial Ombudsman Service. However, we agree with Mr Pritchard that Mr Thommes had failed to put in place systems and controls to protect clients, by providing the sales staff with a script or process guide explaining the firm's fee structure, or by taking action when he discovered that fees had been collected without a fee agreement, contrary to the advice of Compliant Solutions.

98. Mr Virgo refers to the fact that the initial contact with the client was generally by telephone. In those circumstances he refers to MCOB 4.4.7R(2), under which a firm must send the customer a copy of an initial disclosure document (IDD) or combined initial disclosure document, and any other information required to be provided, in a durable medium within five business days of the telephone call. Mr Virgo argues that this five day rule means that the IDD need not necessarily be provided until after the fee has been collected. That may be so, but it is not an answer in a case where the client has not been given information about the fees before making payment.

99. We do not accept Mr Virgo's assertion, on behalf of Mr Thommes, that in any case where the fee agreement form had not been signed at the meeting both the IDD and the lender's key facts illustration (both clearly outlining fees) had been presented to and signed by the customer prior to the fee being taken. There is evidence to the contrary; on occasion fees were taken from clients before documentation explaining the fee had been provided to the client, and before any fee agreement had been signed. We have, for example, referred earlier to the letter to Mr and Mrs B, which acknowledged the fee and at the same time sent the clients the Fee Agreement, Key Facts Illustration and IDD. Mr Thommes said in evidence that this was a case where the firm's representative would have presented the Key Facts Illustration to the client at the meeting. However, there was no evidence that this had taken place.

100. The letter in question was dated 19 July 2007. Although we accept that changes were made to the firm's IDD consequent upon advice from Compliant Solutions, such changes would only represent a solution to a perceived problem over transparency of fees if proper processes were in place to ensure that fees were not taken until the relevant documentation had been provided to the client, and that the application of those processes was properly monitored. In the case of Mr and Mrs B, there is no evidence of the file having been checked by Mr Wright. A file check completed by Mr Lafrance on 30 July 2007 merely records the IDD, Key Facts Illustration and Fee Agreement as having been provided; it does not comment on the breach of the company's policy.

101. In relation to the FOS determination in the case of Mr P and Miss H, Mr Virgo made the point that the confusion arose, not because of any lack of transparency in the fee agreement, which expressed the initial fee, for administration and out-of-pocket expenses, to be non-refundable, or GFC's Key Facts Illustration, which was to the same effect, but because the key facts document provided by the lender referred to the valuation fee (included within GFC's initial fee) as refundable if the valuation was not carried out. We accept that is the case. However, the FOS determinations are merely

examples of how confusion could arise because of inconsistent information being provided. Those determinations, along with the advice being given by Compliant Solutions and Mr Wright, should have prompted Mr Thommes, as a CF1 and as the CF8, to ensure that the firm's procedures were strictly complied with. The evidence is that he failed to take the necessary action in this respect.

Fit and proper

102. The Authority's case, based on the evidence, is that Mr Thommes is not fit and proper to perform any controlled function involving the exercise of significant influence as he fails, contrary to FIT 2.2, to meet the minimum regulatory standards in terms of his competence and capability.

103. The Authority say that this is evidenced by the fact that, during the relevant period, Mr Thommes:

(1) Failed to establish and maintain adequate systems and controls to prevent financial crime at GFC, by failing to ensure that:

(a) common-sense checks were undertaken to verify the accuracy of information provided by customers and identify blatant irregularities in mortgage applications, which indicated transactions of an inaccurate and misleading nature, and ensure that information included on mortgage applications was supported by the information on the customer files;

(b) where multiple mortgage applications were submitted for customers over short periods of time, steps were taken to check whether changes in employment details had been made and, if so, whether they were genuine and accurate; and

(c) documents provided in support of mortgage applications were not fabricated or distorted to misrepresent relevant material facts, income details were not inflated in mortgage applications and all relevant customer information was sent to lenders.

(2) Failed adequately to supervise and oversee the general conduct of the firm by failing to:

(a) ensure that adequate systems were put in place to ensure that customers were treated fairly in respect of the payment of non-refundable upfront fees;

(b) supervise and monitor GFC staff and compliance personnel adequately; and

(c) ensure that GFC had robust compliance procedures in place to ensure that it met its regulatory responsibilities.

104. It is also submitted that Mr Thommes failed to meet the minimum regulatory standards in terms of competence and capability because he fails to understand (and

has failed to take adequate steps to find out about) his responsibilities as an approved person associated with regulated mortgage business, especially his responsibilities as a director holding a significant influence controlled function.

105. Mr Virgo submits that the Authority's case is focussed on the degree and extent of Mr Thommes' "oversight". He argues that in essence the case reduces to his acceptance that he did not and now fully appreciates that he ought to have requisitioned files for the purposes of spot checks. We do not agree. The failings of Mr Thommes that we have found on the evidence before us, although they include his failure to check files in order to monitor the activities of Mr Wright and Compliant Solutions, are more fundamental than that single issue. We have summarised those failings above.

106. Mr Virgo also submits that Mr Thommes was clearly aware of his responsibilities as a CF1 director and as a CF8. He repeatedly referred in evidence to the buck stopping with him. We do not consider that Mr Thommes' use of this terminology demonstrates the level of understanding required of his regulatory responsibilities. It shows only a high-level understanding of the ultimate responsibility inherent in the controlled functions. It does not demonstrate any awareness of the implications of that responsibility in terms of the establishment of robust systems to ensure proper compliance. And it was telling that, on being asked by Mr Pritchard, in relation to the file of Miss H, a case which Mr Thommes himself described as a blatant fraud, whether he accepted that he was responsible for the failure of GFC's systems and controls, Mr Thommes was prepared only to answer in terms of responsibility for the failure of the business of GFC itself, and not in terms of regulatory responsibility.

107. We conclude therefore that the Authority has established its case that Mr Thommes failed to meet the minimum regulatory standards required in terms of competence and capability and accordingly is not a fit and proper person to carry out any controlled function involving the exercise of significant influence. We turn now, finally, to the proposed sanction of partial prohibition, and whether, in the circumstances of this case, that is proportionate.

Proportionality

108. The decision of the Authority, in its decision notice of 19 July 2011, was to prohibit Mr Thommes from performing any controlled function involving the exercise of significant influence in relation to any regulated activity carried on by any authorised person, exempt person, or exempt professional firm. It is thus a partial prohibition order, limited in its scope to the exercise of significant influence functions.

109. In his closing submissions on behalf of Mr Thommes, Mr Virgo says that Mr Thommes now accepts that he ought to have requisitioned files for the purpose of making spot checks. He argues that, this lesson having been learnt by Mr Thommes, there is no reason to assume that there would be any re-occurrence of the weaknesses in systems and controls that would have been uncovered by such checks.

110. Mr Virgo submits that Mr Thommes does not lack the ability to discern discrepancies in files meriting investigation. He argues that this is supported by the evidence which showed that:

(1) Mr Thommes appreciated, in the case of Mr and Mrs G1, the need to identify an accurate credit history of a mortgage applicant to a lender, and accepted that the fact of a loan being declined by one lender and then referred to another lender might signal some issue with the application.

(2) He was concerned over the fact that Mr Lafrance and Mr Wright had not brought discrepancies in the employment and earning history of an applicant to his attention in the case of Miss H. Whilst Mr Thommes might be criticised for not requisitioning this file (although Mr Virgo remarks that the case would not be an obvious one to call for spot-checking), he had no difficulty himself in identifying the discrepant information on the file requiring investigation. Mr Virgo submits that Mr Thommes does not lack the requisite tools to supervise or oversee.

(3) Mr Thommes has accepted that the information as to earnings on the face of the file of Mr and Mrs G2 required investigation with the results being documented on file, and he was concerned at the absence of a paper trail.

(4) He was concerned over the manner in which Mr Lafrance had written the mortgage business relating to Mr and Mrs K. Likewise he expressed concern over the manner in which the business in the case of Mr and Mrs W was written. Mr Virgo submits that this evidence shows an insight into both the manner in which compliant business ought to have been conducted and in hindsight that he could and should have taken steps by way of spot-checking of files to make sure it was being so conducted.

(5) Mr Thommes has also accepted that he ought to have taken more steps to supervise Mr Wright.

111. Mr Virgo argues that, whilst in hindsight Mr Thommes might have done more, and he candidly accepts that more was required, particularly in relation to the spot-checking of files, this is not a case where no serious attempt was made to meet the high level regulatory requirements of the Authority. Nor, submits Mr Virgo, is this a case of complete dereliction of duty to another.

112. Mr Virgo makes the further submission that the mere fact that in the instances accepted by Mr Thommes as occasions when things went wrong they did so whilst he was the CF1 and CF8 approved person should not lead to an automatic conclusion that he is not fit for the future to conduct regulated business. Accepting the buck of responsibility does not, he argues, mandate the complete sacrifice of a future career.

113. Mr Virgo referred us to the Authority's Enforcement Guide (in force at August 2007). Before turning to Mr Virgo's arguments in this respect, we note that the purpose of the ENF guidance is expressed in ENF 8.1.2G as follows:

> "The power to prohibit individuals who are not fit and proper from carrying out functions in relation to *regulated activities* helps the *FSA* to work towards its *regulatory objectives* of protecting *consumers*, promoting public awareness, maintaining confidence in the *financial system* and reducing *financial crime*. The *FSA* may exercise its power to make a *prohibition order* where it considers that, in order to achieve any of those objectives, it is necessary either to prevent an individual from carrying out any function in relation to *regulated activities* or from being employed by any *firm*, or to restrict the functions which he may carry out or the type of *firm* by which he may be employed."

114. Mr Virgo points to ENF 8.5.2G which sets out the factors which the Authority will consider in deciding whether to exercise its power to make a prohibition order. Those factors include whether the individual is fit and proper, applying the usual FIT criteria. Those criteria include honesty, integrity and reputation, and financial soundness, neither of which is in issue in this case, and competence and capability, which is, and in respect of which we have found that Mr Thommes is not fit and proper. Mr Virgo argues that credit should be given for the fact that there is no question as to Mr Thommes' honesty, integrity, reputation or financial soundness.

115. We do not consider that is the right approach. The question is whether Mr Thommes is, or is not, a fit and proper person to perform functions in relation to regulated activities. That can be established by reference to any, or any combination, of the relevant criteria. The nature of the conduct by which an individual has been judged not to be fit and proper is of course a relevant factor in determining the appropriateness of any particular sanction, but such an exercise cannot be reduced to simply assessing the number of FIT criteria on which that judgment has been based.

116. The same analysis applies to Mr Virgo's submission, referring to ENF 8.5.2G(2), that it has not been alleged against Mr Thommes that he has failed to comply with the Statements of Principle or been knowingly concerned in a contravention by the relevant firm of a requirement imposed on the firm by or under FSMA (including the Principles and other rules). It is true that no disciplinary proceedings were brought against Mr Thommes. Mr Thommes conduct must nonetheless be judged in the context of the regulatory regime as a whole. We agree with Mr Pritchard that no inference can be drawn from the Authority's decision not to commence disciplinary proceedings in addition to seeking a prohibition order. It is Mr Thommes' conduct that must be considered in determining the appropriate sanction, and not the particular actions that have been taken, or not taken, by the Authority.

117. Among the factors to be considered are the relevance, materiality and length of time since the occurrence of any matters indicating unfitness (ENF 8.5.2G(3)). Mr Virgo agues, in relation to relevance and materiality that, properly analysed, this is a case where a set of systems and controls which ought to have been adequate let Mr Thommes down. He says this is a failure for which Mr Thommes accepts responsibility so far as it relates to the lack of spot-checking of files that were largely the responsibility of his co-director, Mr Lafrance. As regards the length of time since the matters in question, Mr Virgo urges that Mr Thommes has learnt from the

experience and argues that there is no reason to assume a lack of diligent attention to the operation of systems and controls in the future.

118. The severity of the risk which the individual poses to consumers and to confidence in the financial system is a further factor (ENF 8.5.2G(5)). Mr Virgo submits that Mr Thommes poses no risk at all to consumers. He is not authorised or approved at the moment to perform any regulated activity.

119. Finally, Mr Virgo reminds us that Mr Thommes has no previous adverse disciplinary record (ENF 8.5.2G(6)).

120. We have found that Mr Thommes is not a fit and proper person to carry out significant influence functions. We regard Mr Thommes' failings which have led us to that conclusion as serious. As we have said earlier, we do not regard those failings as being confined to an absence of spot-checking. There was a material lack of proper oversight which extended well beyond that.

121. Indeed, we find it of concern that, even at this late stage of what have been protracted proceedings, Mr Thommes' acceptance of his responsibility is, as Mr Virgo's submissions make clear, confined to the spot-checking issue. Furthermore, he continues – as he did throughout the giving of his evidence – to seek to deflect blame, and hence responsibility, onto others, including Mr Lafrance, Mr Wright, other less senior members of his own staff, the lenders, and even the Authority.

122.We do not regard Mr Thommes' acceptance that he might have done more as candid. It was we find, by contrast, begrudging, belated and partial. He appeared to us unable to distinguish the needs of the business, in terms of not submitting bogus applications to lenders so as not to prejudice those relationships, from the regulatory need to prevent financial crime. He had a number of opportunities to show genuine appreciation of the failings of GFC's systems and controls, and his own failings as a CF1 and as the CF8, from the earliest time of the Authority's visit in January 2006, and the clear warnings that were given by the Authority, up to the making of his witness statement for the purpose of these proceedings.

123. As Mr Virgo argued, it is evident that, when faced with the evidence of the relevant files in cross-examination, Mr Thommes was able, for the first time in these proceedings, to accept that there were discrepancies that merited investigation and would have been identified by proper systems and controls. Although Mr Virgo submits that Mr Thommes has the ability to discern such discrepancies, the mere ability to do so in those circumstances is not enough to convince us that Mr Thommes would have sufficient understanding of the regulatory requirements to do so in an ordinary commercial situation, nor to establish the necessary systems and controls for this purpose. We have doubts over Mr Thommes' attitude to risks such as those identified in this case. We have to take into account his justification up to the hearing for what appeared on the face of the files to be discrepancies that needed investigating in the context of the risk of mortgage fraud. A belated acknowledgement of those issues is not enough to persuade us that Mr Thommes does not pose a risk to consumers. In our view, despite his belated acknowledgement of a number of

failings, Mr Thommes continues to manifest a basic misunderstanding of the true import of the oversight function in a regulatory context.

124. We do not accept that Mr Thommes cannot be regarded as not posing a risk to consumers because he is not presently authorised or approved to perform any regulated activity. The application of the factor at ENF 8.5.2G(5) does not depend on the present status of the individual. It must be viewed objectively, irrespective of whether the individual is at that time in a position to be an immediate risk. In an appropriate case a prohibition order may be made whether or not the relevant individual is engaged at all in the regulated industry. We agree with the Authority's submission that the risk of harm to the public remains unless Mr Thommes is prohibited from carrying out significant influence functions whether or not he is presently approved. The Prohibition Order has the effect of protecting the industry and ensuring that Mr Thommes cannot carry out significant influence functions, unless he makes an application under s 59(7) FSMA to revoke the prohibition order and thereafter seeks approval.

125. In our view, Mr Thommes must, on the basis we have described, be regarded as posing such a risk, such as to justify a prohibition order of the limited nature proposed in this case. We take into account that the scope of the Prohibition Order is relatively narrow, being confined to the exercise of significant influence functions. It does not prevent Mr Thommes from working in the regulated financial services sector at all, but only in the holding of a significant influence function. In our view, a sanction of that nature in this case is entirely proportionate. It recognises the actual failings which have led to the conclusion that Mr Thommes, in his capacity as a CF1 and CF8, has failed the test of fitness and propriety, but it goes no further than that.

126. In reaching this conclusion it has not been necessary for us to rely upon final notices issued in other cases. We were referred to a number of examples, said by the Authority to be consistent with the approach of the Authority in this case but said by Mr Virgo for Mr Thommes to be very different. Whilst it is no doubt tempting to search for comparators and indeed for differences in other cases where similar sanctions have been made or contemplated, each case must be determined according to its own facts and circumstances. We have not derived any assistance from a consideration of cases determined on different facts.

Decision

127. For the reasons we have given, we dismiss this reference and we direct the Authority to issue to Mr Thommes a Final Notice in similar terms to the Decision Notice dated 19 July 2011.

ROGER BERNER

UPPER TRIBUNAL JUDGE
RELEASE DATE: 12 December 2012