

QUESTIONS AND ANSWERS

Malcolm Murray interviews founder, largest shareholder and Executive Chairman, Mike Howard, about the FSA fine announced on December 8th 2011.

Malcolm Murray: Mike, the FSA has fined Integrated Financial Arrangements plc, the provider of Transact. What did we do wrong?

Mike Howard: There are two core issues, Malcolm. One relates to how, in the past, we managed customer trades. And the other to documents that we must hold in respect of client money accounts.

On trading, our operational process is to place buy orders for clients as soon as we know that they will have enough cash to pay for them. Sometimes, a client does not actually have the cash on hand when we place the order but we do know that the cash will be there when the time comes to pay because, for example, the proceeds of a sale are due or a cheque is clearing at the bank.

However, sometimes we have to settle the buy trade before the in transit cash arrives. In that circumstance, what we should have been doing is putting our money, corporate money, into the client money pool temporarily to fund the trade in the short term. A similar situation arises when a customer has deposited a cheque which has not yet cleared or has an overdrawn position on their account. That's what the notice means when it says "failed to fund any shortfall".

I'm afraid that we misapplied the rules and, although we conducted reconciliations, we allowed those positions to unwind in the normal course of operations – by waiting a few days for the expected sales proceeds to arrive or for the cheques to clear. This is not compliant as we were not using our own money to cover these timing differences. However, we have since taken steps to ensure we have funded any such shortfalls on a daily basis.

On documentation, client money must be segregated from corporate money and held in trust. Documents confirming that segregation must be obtained from the banks where the money is deposited within 20 days of the account being opened and must conform to certain wording. We have 28 client money bank accounts and, although all client money has always been held in different bank accounts from corporate money, in one instance, we took 29 days to obtain documentation and in two other cases, the trust documents obtained did not conform to the required wording.

Of course, I must emphasise the very important point that no client suffered any loss or detriment. The FSA makes this clear in its notice. It also states that we maintained records in respect of client money, recorded all client money transactions and matched those to bank statements.

In other words, the notice does not indicate that we failed to account for client money but that we failed to account for it in full compliance with the client money regulations.

Malcolm Murray: OK, that makes things clearer. We failed to follow some rules about accounting and documentation, but no clients lost any money. So why then have the FSA fined us £3½m?

Mike Howard: Good question.

First, let me say that we accept the FSA's findings. We accept that we did not completely fulfil our regulatory obligations. We also accept that having failed to do so, it is not surprising that we were fined.

The FSA considers full compliance with the rules to be a matter of the utmost importance and we have no argument with that.

Over the course of the last couple of years, there have been several fines that relate to client money breaches and the FSA has used a particular approach to them. Essentially, their position is that if you do not comply with the rules you put the client money pool at risk. The basis for punishment then is a fine based on 1% of the average balance of client money held over the period.

Since this has been the practice in several recent cases, it's not surprising that the same approach was used in our case. That calculation results in a fine of £3½m.

So the size of the fine reflects the fact that we are the largest wrap service in the UK. We hold more client money than does any other wrap.

Malcolm Murray: Do you think that's harsh?

Mike Howard: Malcolm, as a regulated firm, we know that we must follow the rules - and, in this instance, we didn't.

So, I think we have let ourselves down and that's very disappointing. Having worked so hard to build the business over the last decade from exactly nothing into being the biggest wrap in the platform sector and then do something like this is very frustrating.

Worse, what this will do, potentially, is worry our clients unnecessarily.

So, our whole focus is on making sure everyone understands what actually happened and to make it clear that the problem is in the past, fixed and behind us.

Malcolm Murray: It is fixed, Mike?

Mike Howard: It is. We have changed and upgraded procedures. The FSA has been made aware of the changes and BDO LLP, has reported to the FSA on their implementation.

Malcolm Murray: What do you have to say to our advisers and their clients, Mike?

Mike Howard: First, I'd like to apologise for any anxiety that this caused them. We take the matter very seriously and are chastened by what has happened.

Second, I'd like to emphasise that no clients suffered loss or detriment and that the

problem is fixed.

Finally, and I think this is very important, I want to say that we have become a successful business because we believe in and always strive to deliver quality service.

That hasn't changed.

Last year we won 6 quality awards and this year we have won another 8. In total, since we began, we have won more than 30. In a recent Money Marketing survey, in the 18 qualitative categories highlighted in the coverage, we were top 3 in all 18 categories and first in 12. I don't want to get carried away with that but it all helps make us want to continue doing what we are doing.

So, having learned our lesson, we'd like to put this behind us as quickly as we can and get back to continually adapting and improving the business.

Malcolm Murray: Thank you for those thoughts, Mike. In closing, I'd like to add some thoughts of my own.

I joined Transact back in 2000 because they were doing something different that I felt would appeal to the many progressive advisers that I had met over the years. That proved to be the case as the steady support that Transact enjoyed in the early years grew rapidly as more advisers saw the benefits. Nothing has occurred to change that view and I am sure that we will continue to provide a first class service to advisers and their clients.