
Parliamentary Commissioner for Administration

FIRST REPORT — SESSION 1989–90

THE BARLOW CLOWES AFFAIR

*Presented to Parliament Pursuant to Section 10(4) of the Parliamentary
Commissioner Act 1967*

Ordered by The House of Commons to be printed 19 December 1989

Parliamentary Commissioner for Administration

FIRST REPORT—SESSION 1989–90

THE BARLOW CLOWES AFFAIR

*Presented to Parliament Pursuant to Section 10(4) of the Parliamentary
Commissioner Act 1967*

Ordered by The House of Commons to be printed 19 December 1989

LONDON
HER MAJESTY'S STATIONERY OFFICE
£11.00 net

PARLIAMENTARY COMMISSIONER ACT 1967

Following the collapse, in May 1988, of the Barlow Clowes group of companies, many Members of Parliament referred to me complaints from investors alleging maladministration by the Department of Trade and Industry. I carried out a single investigation into these complaints. In view of the public interest in the matter I have decided, as I am empowered to do by section 10(4) of the Parliamentary Commissioner Act, to lay my report before each House of Parliament.

ANTHONY BARROWCLOUGH
*Parliamentary Commissioner
for Administration*

December 1989

Contents

Page 1	Introduction
	General
	Jurisdiction
	The Barlow Clowes Portfolios
	The composition and marketing of the funds
	Chapter 1
5	Legislative Background
	Chapter 2
18	Policy and practice
	The background to the legislation
	Enforcement
	Staffing
	Procedure
	The scope of licensing
	Powers of revocation and refusal
	Overseas businesses
	Chapter 3
24	1975–1983
27	Findings
	Chapter 4
30	October 1983–October 1985
92	Findings
	October 1983–November 1984
	December 1984
	February–April 1985
	April–October 1985
	Chapter 5
102	March 1986–March 1987
109	Findings
	Chapter 6
111	April 1987–October 1987
138	Findings
	Chapter 7
141	November 1987–June 1988
163	Findings
	Chapter 8
164	Conclusions
	Early licensing errors
	The Jersey partnership
	The legitimising licence
	Erosion of capital
	The 1987 licence
	Summary
168	Compensation

Barlow Clowes

Introduction

- General** 1. After the Barlow Clowes group of companies collapsed in May 1988 a large number of Members of Parliament referred to me complaints from members of the public who contended that the actions or omissions of the Department of Trade and Industry (the Department) in connection with its surveillance and licensing of Barlow Clowes under the Prevention of Fraud (Investments) Act 1958 had caused them to sustain financial loss. On 14 June 1988 the Secretary of State for Trade and Industry appointed Sir Godfray Le Quesne QC to investigate the Department's handling of matters relating to the Barlow Clowes group. The Secretary of State gave Sir Godfray the following terms of reference:

“ On behalf of the Secretary of State for Trade and Industry to investigate and establish the facts relating to the exercise by the Department of Trade and Industry since 1 January 1983 of its regulatory functions in respect of the carrying on of investment business by Barlow Clowes and Partners (a partnership) and its successors Barlow Clowes and Partners Ltd and Barlow Clowes Gilt Managers Ltd, and if appropriate by Barlow Clowes International Ltd, with particular reference to the need for licences under the Prevention of Fraud (Investments) Act 1958, the granting and renewal of such licences and the monitoring of the activities of the licence holder, and to provide a report as soon as possible to the Secretary of State. ”

2. Following publication of Sir Godfray's report on 20 October 1988, I decided to carry out a single investigation into the complaints referred to me concerning Barlow Clowes (in which expression I included Barlow Clowes and Partners, Barlow Clowes and Partners Ltd—later Barlow Clowes Gilt Managers Ltd—and Barlow Clowes International Ltd).

3. During the course of my investigation many representations were made to me by or on behalf of investors who had suffered in the collapse of Barlow Clowes. In particular I mention in this connection the contribution made by Alexander Tatham, solicitors acting for the Barlow Clowes Investors Group, who sent me detailed submissions and evidence for which I am most grateful. I hope it will be understood by all those who were good enough to make contact with me or my office that it would have been impracticable to make reference in my report to every one of the many detailed complaints or arguments presented to me. I sought, however, to ensure that each argument or piece of evidence proffered to me was considered and taken into account, and given such weight in directing the thrust of my enquiries as seemed appropriate. In that connection, there is a general point I feel it is right to make—namely, that any reference in the body of this report to expressions of opinion or findings of fact by any person are not intended, and should not be regarded, as evidence of any matters which are to be determined by the criminal courts.

4. In the course of my investigation I and my officers interviewed a large number of witnesses, both from the Department and from outside the Department. In addition, persons who had given evidence to Sir Godfray Le Quesne helpfully agreed that I might treat that evidence as if it had been given to me. (Where I mention in my report that a person “ said in evidence ”—as distinct from said in evidence to me or to my officials—that indicates that I have drawn on the evidence which had been given to Sir Godfray.) I should record indeed that throughout I received the fullest co-operation not only from the Department but also from all

others concerned. I wish also to record that I have received helpful and expert accountancy advice, to which reference will appear below, from Mr R J C Pearson of Pannell Kerr Forster, for which I am most grateful.

Jurisdiction 5. I should draw attention to certain features of my jurisdiction as defined in the Parliamentary Commissioner Act 1967. In the first place, my function is limited to investigating complaints of maladministration by departments or authorities which are listed in Schedule 2 to the Act. A number of the bodies which, as will be seen, played a part in the events described in the report, such as the Bank of England, the Stock Exchange and FIMBRA (formerly NASDIM), are not listed in Schedule 2 and so were outside my investigative remit. Also outside my remit, of course, were the firms of solicitors and accountants who were involved in events. It follows that I have not—and indeed could not have—examined the actions of these organisations with a view to determining whether they were in any sense blameworthy. Accordingly, such consideration as I have given to their actions has been aimed solely at evaluating the effect of those actions on the Department or, if relevant, any other department within my jurisdiction.

6. In the second place, section 12(3) of the Parliamentary Commissioner Act, provides that “nothing in this Act authorises or requires the Commissioner to question the merits of a decision taken without maladministration by a government department or other authority in the exercise of a discretion vested in that department or authority”. Such decisions as whether to grant or refuse an application for a licence, or whether to revoke a licence, under section 5 of the Prevention of Fraud (Investments) Act 1958—see 1.5 below—fall into this category. It follows that mere disagreement on my part with such a decision would not provide me with any basis for questioning the decision. I could only do so if I had found fault in the processes by which the decision was reached.

The Barlow Clowes Portfolios 7. Since there will be frequent reference in my report to the products that were marketed by Barlow Clowes, it is convenient to give here a brief description of the most significant of those products in most of which bond-washing played a major role.¹ The most important of the United Kingdom based (“onshore”) funds were Portfolios 30, 78 and 37.

Portfolio 30

Portfolio 30, marketed by Barlow Clowes and Partners from 1982 to June 1985 and by Barlow Clowes and Partners Ltd from July 1985 to October 1987, attracted more than 12,000 investors during the years in which it operated. The Portfolio 30 brochure guaranteed a fixed rate of income without deduction of income tax until the end of the investment term, when a return of the “maturity proceeds” was guaranteed. On making an investment in Portfolio 30 a client authorised Barlow Clowes to manage a chosen Government stock on a fully discretionary basis. After making an investment in Portfolio 30, Barlow Clowes sent the client a statement showing the nominal amount of the stock which had been chosen by the client and purchased by the application of his investment monies, less an initial fee of 3.5% plus VAT. The statement guaranteed half-yearly distributions until maturity of the chosen stock, equating (save for minor deductions for commission etc.) to the gross amount of the half-yearly interest payable in respect of that stock. On maturity of the chosen stock, repayment of the nominal amount of the stock originally purchased was also guaranteed. (Under variants of Portfolio 30 the guarantee was that on maturity the amount of the original investment would be repaid. Under these variants the interim distributions were at a lower rate.) Investors were able to terminate their investment before maturity, but there was no

¹Bond-washing was the practice of deriving interest from gilts in the form of a capital gain realised on the sale of the stock immediately prior to a dividend becoming due, the gain representing the accrued right to the interest due.

guarantee of what would be paid in such circumstances. The manner in which the cash-in value would be calculated was not explained, either in the brochure describing the scheme, or in the statement sent to new investors.

Portfolio 78

Portfolio 78 was marketed by Barlow Clowes and Partners from December 1983 to June 1985 and by Barlow Clowes and Partners Ltd from July 1985 to October 1987, more than 2,500 clients having invested in it during the years when it operated. Investors—who again authorised Barlow Clowes to purchase British Government stock on their behalf and manage it on a fully discretionary basis—were notified at the beginning of each month what minimum rate of return they would be guaranteed for that month and what higher rate was expected to be earned that month. In the month following investors were notified of the return actually achieved. Investors could opt for their return to be reinvested each month or to be paid to them on a monthly basis. Withdrawal of monies invested was permitted at any time, repayment being promised within two working days. The brochure did not make clear the amount of capital to be returned but some documents (see, for example, paragraph 4.20 below) indicated that the full amount of the original investment was guaranteed. Losses arising from gilt dealing within Portfolio 78 led Barlow Clowes to conclude in 1986 that it should be run down and closed. This was attempted initially by reducing the rates of return to such a low level that investors would choose to cash in their investments (or transfer them to another portfolio). However, a number of investors took no action, so it was decided to repay all those remaining. This occurred prior to the liquidation of Barlow Clowes Gilt Managers Ltd.

Portfolio 37

Portfolio 37 was marketed by Barlow Clowes Gilt Managers Ltd between October 1986 and October 1987 (and attracted some 216 investors). It was designed for those investors who, following the introduction with effect from February 1986 of the Accrued Income Scheme (which was designed to ensure that, in certain circumstances, the interest element of gilts realised as a capital gain on the sale of the stock was taxed as income), wished to invest sums that would purchase gilts with a nominal value in excess of £5,000. Its features were similar to those of Portfolio 30, although a proportion of the periodic withdrawal paid to investors could be subject to basic rate income tax.

The main offshore funds were Portfolios 28 and 68. (The latter was introduced in February 1986 in succession to Portfolio 28, to which it was very similar, but the number 28 was retained in respect of funds invested through certain intermediaries.)

Portfolio 28–68

These funds were essentially the same as Portfolio 78 described above. They originated in 1977 and at the date of liquidation there were more than 10,000 client contracts. The administration of the funds—in so far as it was from outside the United Kingdom—was from Jersey between 1978 and late 1985, then from Geneva and later still from Gibraltar. Transfer of the administration to Gibraltar—where the funds were promoted by Barlow Clowes International—was not complete until March 1987 and there was considerable overlap between the offshore operations.

The composition and marketing of the funds

8. The liquidators of Barlow Clowes Gilt Managers and the liquidators and receivers of Barlow Clowes International have provided me with an overall picture of the amounts and sources of the funds invested and it is clear from what they have told me that no new money went into the onshore funds after 31 October 1987 (although it is possible that some new money intended for the onshore funds went into the offshore funds). It is also evident that a gross sum of about £34.5 million of new investment went into the offshore funds after that date. (The net sum will of course have been lower—account needing to be taken of withdrawals by some investors.) At the date of the collapse investors' claims against the onshore funds

(1) the applicant or the holder of the licence has not, on the occasion of the application or, as the case may be, at any prescribed¹ time during the currency of the licence, furnished to the Board such information relating to him, and to any circumstances likely to affect his method of conducting business, as may be prescribed, being information verified in such manner, whether by statutory declaration or otherwise, as the Board may require, or

(2) it appears to the Board that –

(a) by reason of the applicant or the holder of the licence, or any person employed by, or associated with, the applicant or holder for the purposes of his business,

(i) having been convicted within Her Majesty's dominions of an offence his conviction for which necessarily involved a finding that he acted fraudulently or dishonestly, or

(ii) having been convicted of an offence under this Act or the Prevention of Fraud (Investments) Act 1939, or

(iii) having committed a breach of any rules made by the Board under this Act or that Act for regulating the conduct of business by holders of licences, or

(b) by reason of any other circumstances whatsoever which either are likely to lead to the improper conduct of business by, or reflect discredit upon the method of conducting business of, the applicant or holder or any person so employed by or associated with him as aforesaid,

the applicant or holder is not, or, as the case may be, is no longer, a fit and proper person to hold a licence;

and the Board may also revoke a principal's licence at any time, if the holder of the licence is not carrying on in Great Britain the business of dealing in securities.”

1.6 Section 6 of the Act provided that where the Department proposed to refuse or revoke a licence under section 5(2) it had to serve on the applicant or licence holder a written notice of its intention specifying the particular matter upon the consideration of which the decision would be based and inviting him to notify the Department in writing within fourteen days if he wished his case to be referred to the tribunal constituted under section 6(2). If he so notified the Department the case had to be referred to the tribunal for them to investigate the case and report thereon to the Department, after affording a reasonable opportunity for representations to be made by or on behalf of the person in question. The Department was required not to make a final decision in the matter until it had received and considered the tribunal's report. And it was not permitted either to refuse to grant the licence or to revoke the licence if the tribunal's report contained a recommendation that the licence should be granted or remain in force, as the case might be.

1.7 Section 8 of the Act made it an offence not to notify the Department of certain information—such as the appointment of a new director or the cessation of business in Great Britain—during the currency of a licence.

1.8 Section 13 of the Act read as follows:

“ 13 (1) Any person who, by any statement, promise or forecast which he knows to be misleading, false or deceptive, or by any dishonest concealment of material facts, or by the reckless making² [(dishonestly or otherwise)] of any statement, promise or forecast which is misleading, false or deceptive, induces or attempts to induce another person—

(a) to enter into or offer to enter into—

(i) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting securities³ ..., or

¹“ Prescribed ” meant prescribed by regulations made under section 21 of the Act.

²Words inserted by Protection of Depositors Act 1963 (c.16) s.21(1)(a).

³Words repealed by Protection of Depositors Act 1963 (c.16) s.1(3).

- (ii) any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities...

shall be guilty of an offence, and liable to imprisonment for a term not exceeding seven years.”

1.9 Section 14 of the Act made it an offence, subject to the saving provisions of that section, to distribute or cause to be distributed any documents which were known to be circulars containing any invitation to persons to enter into an agreement for acquiring or disposing of securities or any agreement the purpose of which was to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities or any circular containing any information calculated to lead directly or indirectly to such an agreement. The section expressly did not prohibit, however, the distribution or possession of any document by reason only that it contained an invitation or information “made or given with respect to any securities by or on behalf of a member of any recognised stock exchange or recognised association of dealers in securities, or by or on behalf of the holder of a principal’s licence.” Nor was the section contravened by reason only that a person distributed documents to persons whose business involved the acquisition and disposal, or the holding, of securities (whether as principal or as agent), or caused documents to be distributed to such persons (section 14(5)).

1.10 “Dealing in securities”, as defined in section 26(1) of the Act, meant “doing any of the following things (whether as a principal or as an agent), that is to say, making or offering to make with any person, or inducing or attempting to induce any person to enter into or offer to enter into—

- (a) any agreement for, or with a view to acquiring, disposing of subscribing for or underwriting securities or lending or depositing money to or with any industrial and provident or building society, or
- (b) any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities.”

1.11 Section 7 of the Act enabled the Department to make rules regulating the conduct of business by licence holders. A breach of the rules was not itself an offence but it was a matter which could be taken into account when considering whether to revoke or not to renew a licence (1.5 above). The Licensed Dealers (Conduct of Business) Rules 1960 (S.I. 1960 No 1216) replaced the previous rules of 26 July 1939. Rule 7 required a licensed dealer (with an exception relating to take-overs) to issue a contract note to the purchaser or vendor with whom he contracted in respect of every transaction of sale or purchase of securities, whether as principal or agent. Rules 10 and 11 specified the books of account and records and details of the transactions required to be kept by a licensed dealer, and rule 12 required him to retain all such records for at least seven years together with every contract note received by him and a copy of every contract note issued by him. Rule 13 required a licensed dealer to supply on demand a copy of all entries in his books relating to a transaction made on a client’s behalf and to have the relative contract notes and vouchers readily available for inspection at any time. These rules remained in force until 1983 when they were replaced by the much more extensive Licensed Dealers (Conduct of Business) Rules 1983 (S.I. 1983 No 585), the most important of which (in relation to the present case) were the following:

- (a) Rule 3

“Client money

3. (1) The holder of a principal’s licence who neither is, nor acts on behalf of, an authorised institution, shall not deal in securities unless, to the extent that he accepts client money—

- (a) he does so on the basis that it will be applied solely for specific purposes agreed when or before the holder accepts it (whether or not such purposes include any element of discretion or the acquisition of property other than securities); and

- (b) pending such application it is paid without delay into and held in a client account maintained by the holder in accordance with these rules; and
- (c) a separate client account is maintained by the holder in accordance with these rules in relation to any client money for which he is liable to account to any of his connected persons.

(2) The holder of a principal's licence who is, or acts on behalf of, an authorised institution, shall not deal in securities unless any client money is accepted and held—

- (a) in accordance with paragraph (1) above; or
- (b) by the authorised institution in the ordinary course of its deposit-taking business.

(3) A client account is maintained in accordance with these rules if it is a client account—

- (a) into which money other than client money is paid only—
 - (i) if it is the minimum required for the purpose of opening or maintaining the account; or
 - (ii) to restore in whole or in part any money paid out of the account in contravention of these rules; or
 - (iii) if it is received in the form of a cheque or draft including client money and is without delay withdrawn from the account; and
- (b) in respect of which written notice has been given to the institution concerned that any money therein (apart from money received in the circumstances mentioned in paragraph (3)(a)(i) or paragraph (3)(a)(iii)) is held on trust for clients of the dealer.

(4) The holder of a representative's licence shall neither accept nor hold client money unless he does so on behalf of a holder of a principal's licence and in the course of employment under a contract of service with that holder or with a corporation of which that holder is a wholly-owned subsidiary.

(5) Money is not required by these rules to be paid into a client account—

- (a) if it is—
 - (i) received in the form of a crossed cheque or crossed draft expressed to be payable only into, or is paid by direct transfer to, an account in the sole name of the client concerned at an authorised institution, being an account from which withdrawals may be made only in the circumstances mentioned in paragraph (5)(a)(ii) and, in the case of a cheque or draft, is forthwith upon receipt paid into such an account; and
 - (ii) withdrawn from that account only by the client or with the written authority of the client for each withdrawal or, on presentation of a stockbroker's contract note, by a cheque or draft for the amount concerned payable to the stockbroker or to the licensed dealer as agent for the stockbroker or, on presentation of a provisional or renounceable allotment letter, or on an offer to the public of securities which is conditional on these securities becoming listed securities, by a cheque or draft for the amount concerned payable to the receiving banker; or
- (b) if it is—
 - (i) received in the form of cash or in the form of a cheque or draft which is either not payable to the dealer or immediately indorsed by the dealer; and
 - (ii) without passing through any account under the control of the dealer, immediately paid to or to the order of the client or otherwise applied for specific purposes agreed when or before the dealer receives it.”

(b) Rule 4

“Client investments

4 (1) The holder of a principal’s licence shall not retain any document of title in respect of any client investment except in accordance with this rule.

(2) A document of title in respect of a client investment is retained in accordance with this rule if—

- (a) the fact that it does not belong to the licensed dealer is readily apparent from the document or from the manner in which it is held; and
- (b) where the client investment is capable of registration in the name of any person—
 - (i) if a register is kept for those investments in the United Kingdom (other than a subsidiary register), the client investment is registered in the name of the person to whom it belongs or, with the written agreement of that person, in the name of a corporation whose sole business consists in acting as a nominee, or in the name of a trust corporation; or
 - (ii) if a register is not so kept, the client investment is either so registered or, without prejudice to sub-paragraph (c), any document of title is held by, or to the order of, an authorised institution; and
- (c) reasonable steps are taken to ensure that the document of title is at all times effectively safeguarded.

(3) A client investment may be charged, pledged or otherwise encumbered to a third party only with the written consent of the person to whom it belongs specifying that investment and the terms of the charge, pledge or other encumbrance to which the consent relates.

(4) The holder of a representative’s licence shall not retain any document of title in respect of any client investment unless he does so on behalf of a holder of a principal’s licence and in the course of employment under a contract of service with that holder or with a corporation of which that holder is a wholly-owned subsidiary.

(5) For the purposes of this rule, a licensed dealer retains a document of title if he has, or is entitled (without further authority from the person to whom it belongs) to obtain, possession of it.”

(c) Rule 6

“Notices after first instructions

(1) Where a licensed dealer takes instructions from a client for the first time, he shall send the client written notice of any of the information referred to in paragraph (2) of which he has not previously been sent written notice.

(2) The information mentioned in paragraph(1) is—

- (a) whether, if applicable, money is to be held in a client account maintained in accordance with these rules or is to be dealt with under rule 3(5); and
- (b) what is proposed for the custody or forwarding of any document of title in respect of any client investment; and
- (c) whether or not there are any arrangements in force with a view to ensuring that, if he fails to account for any money or investments to the client, his liability or a part thereof will be made good by another, together with an indication as to whether the arrangements cover misappropriation or negligence or both and of any significant limitations on any such arrangements; and
- (d)

(3)A licensed dealer shall, on the request of any person or of the agent of any person on whose behalf he holds any client money or retains any document of title in respect of any client investment, inform that person or agent of the current position on the matters referred to in paragraph (2)(c).”

(d) Rule 7

“Investment management contracts

7 (1)

(2) In this rule ‘investment management’ means the management of the whole or part of a portfolio, whether or not on a discretionary basis and ‘investment management contract’ shall be construed accordingly.

(3) The form prescribed for making under the authority of a licence any investment management contract is any form of written contract which sets out—

(a) if the contract includes provision for discretionary dealing—

(i) the extent of the discretion vested by the client in the holder, any limitation on any such discretion and any policy to be followed by the holder in the exercise of such discretion; and

(ii) if the client is not a 14(5) person¹, a statement that the contract is terminable by the client at any time without penalty or, in any other case, a statement as to the manner and circumstances in which the authority of the holder to deal with or for the client may be terminated; and

(b) if the holder is to have the custody of any money or investments belonging to the client—

(i) any circumstances in which the holder is to be entitled to retain any interest on any client money forming the whole or part of the portfolio; and

(ii) the name in which any document of title in respect of any client investment is to be registered and the arrangements for custody thereof; and

(iii) the arrangements for the payment of any interest or dividend to the client; and

(c) in any case—

(i) the amount or method of calculation of any payment or other benefit in money or money’s worth which the holder or any of his connected persons will be entitled to receive under, or in consequence of anything done under the contract, whether from the client or from any other person, and the circumstances in which that payment or benefit will be receivable and any circumstances in which the holder is to be entitled not to account for any such payment or other benefit; and

(ii) the manner in which any instructions by or on behalf of the client in relation to any transaction are to be given to the holder; and

(iii) if the client is not a 14(5) person, a provision which requires that, not less than once a year, a report is sent to the client on his portfolio, together with a valuation of the contents of the portfolio and a statement indicating how those contents were valued or, in any other case, a statement as to any arrangements for valuation and report;

and in this paragraph, references to ‘the holder’ include the holder of the licence under the authority of which the contract is made and the holder of any representative’s licence who acts on his behalf.

(4)

¹Defined in rule 2 as “any of the persons mentioned in section 14(5) of the Act whose business involves the acquisition and disposal, or the holding, of securities (whether as principal or as agent)”.

(5) Before entering into a contract in the form prescribed in paragraph (3) a licensed dealer shall send the person with whom he proposes to enter into the agreement the written notice referred to in rule 6(1).”

(e) Rule 19

“ Contract notes

19 (1) The holder of a principal’s licence shall, subject to paragraph (2) issue a contract note in respect of every transaction of sale or purchase of investments to the client with or for whom he contracts, whether as principal or agent, forthwith upon that transaction being effected.

(2) Paragraph (1) shall not require the holder of a principal’s licence to issue a contract note—

- (a) to a 14(5) person; or
- (b) in respect of any transaction arising from a takeover offer, if he is not otherwise required to issue a contract note in respect of that transaction.

(3) Every contract note shall include the following particulars—

- (a) the name in which that holder is authorised to carry on business and the address at which he is carrying on business;
- (b) where that holder is a person to whom section 28 of the Companies Act 1981 applies, the matters specified in section 29(1)(a) of that Act (as qualified by section 29(3) thereof);
- (c) where that holder is a corporation incorporated in any country other than Great Britain, the name of the place in which it is incorporated and whether or not it is incorporated with limited liability;
- (d) a statement that that holder is acting in the capacity of principal when he is so acting;
- (e) the name of the client;
- (f) the date of the contract;
- (g) the amount and description of the investments which are the subject-matter of the contract;
- (h) the unit price of the investments;
- (i) the amount of the consideration and, where any conversion from a foreign currency is involved, the rate of exchange;
- (j) if any commission is charged the rate and amount thereof;
- (k) the amounts of all fees, taxes and duties (if any); and
- (l) the date of settlement.

(4) All contract notes issued by a holder of a principal’s licence shall be signed by him or, where he is a corporation, by a duly authorised officer or agent, and duly stamped.

(5) The requirements of this rule shall be taken to be satisfied, where a holder of a principal’s licence has effected a transaction as an agent, if the client is sent the original, or a copy, of a contract note for the transaction concerned issued by any person who is or acts on behalf of a stockbroker, a member of a recognised association of dealers in securities, an exempted dealer, a manager of an authorised unit trust or another licensed dealer, so long as that contract note was duly stamped and the original or copy issued to the client, together with any document attached thereto, contains the particulars required by paragraph (3).”

(f) Rule 21

“ Client money books

21. (1) The holder of a principal’s licence who accepts or retains client money shall keep such books, accounts and other documents as are sufficient to shew and explain readily at any time—

- (a) any dealings with client money in date order; and

(b) any dealings with client money relating to a particular client.

(2) Without prejudice to the generality of paragraph (1) above, the books, accounts and documents referred to therein shall shew—

- (a) each amount accepted, the name of the person from whom it was received, the date of receipt, the name of the client on whose behalf it was accepted and the purposes for which it was accepted;
- (b) the whereabouts of any amount within sub-paragraph (a) above which has not been applied or paid out by the licensed dealer;
- (c) each amount applied or paid out, the name of the person to whom it was paid, the date of payment, and the name of the client for whom and the purposes for which it was applied or paid out; and
- (d) a reconciliation account, made up not less than once in each month, shewing, at the date to which it is made up, the amount of client money held for each client, the total amount held for clients and a reconciliation of that total with statements issued by each authorised institution where client money is held.”

(g) Rule 22

“ Client investments books

22. (1) The holder of a principal’s licence shall keep such books, accounts and other documents as are sufficient to shew and explain readily at any time the whereabouts of any document of title which he retains in respect of any client investment by reference to—

- (a) the name of the investment; and
- (b) the name of the client; and
- (c) the place where any such document of title is held.

(2) Without prejudice to the generality of paragraph (1) above, the books, accounts and documents referred to therein shall shew—

- (a) the name of the person to whom the investment belongs and, if different, any name in which it is registered;
- (b) the nature of the document and the description and amount of the investments it concerns;
- (c) the whereabouts of every such document of title, including the name of any person by whom it is held; and
- (d) a reconciliation account, made up not less than once in each year, shewing a reconciliation of the information recorded in the books, accounts and other documents maintained under this rule as to the documents of title which, as at the date to which it is made up, the holder of the licence retains, with a statement or statements issued by each person who has any such document of title in his possession; provided that, where a holder of a principal’s licence operates a system under which every such document of title is held by an authorised institution with notice of the client to whom it belongs and of the fact that the holder proposes to rely on this proviso, those books, accounts and documents may contain separate reconciliation accounts so made up for each client for whom such a document of title is held.”

1.12 Regulations were made from time to time under section 21 of the Act (see footnote to 1.5 above), the most significant being the Prevention of Fraud (Investments) Act Licensing Regulations 1944 (S.R. & O 1944/119) and the Dealers in Securities (Licensing) Regulations 1983 (S.I. 1983 No 587) which superseded the 1944 regulations. Both the 1944 and 1983 regulations specified the information required on application for a licence to deal in securities under the Act, different forms being required from corporations and individuals (who could carry on business either alone or jointly with other individuals). The 1944 application forms were designed as statutory declarations to be sworn before a

Commissioner for Oaths. Additionally applications from individuals were required to be supported by three references. Common to both the 1944 and 1983 regulations were questions relating to the nature of the business, its controllers and directors, its bank accounts and related businesses. Personal information required included details of bankruptcies, convictions and unsuccessful applications to professional bodies or associations of dealers in securities. Both the 1944 and 1983 regulations required a licence holder to notify the Department of changes such as a change in management. Regulation 4 of the 1983 regulations required applications for licence renewals to be made in writing between three and six months before the expiry of the existing licence stating any change in information given in the previous application. Late applications could be entertained provided good cause for the delay in applying could be shown and there was sufficient time left for the application to be considered. Late applications were otherwise treated as not properly made. The 1983 regulations called for more information on application about the business (“ a business plan”) than had hitherto been the case. Part I of Schedule 1 required:

“ 1. A description, in sufficient detail to disclose the nature and scale of the business or proposed business, (including where relevant indications as to the approximate number, percentage or amount within any category and as to any significant changes which may have occurred in the previous five years), of—

- (a) the sources, or expected sources, of the applicant’s business (for example, responses to advertising or circulars, references by solicitors, accountants, bank managers or other professional advisers);
- (b) the types of business which the applicant does or proposes to do (for example, investment management limited to listed securities and effected only through a stockbroker, other investment management, investment advice, acting as principal in relation to dealing in listed securities, acting as principal in relation to dealing in other securities, broking, underwriting, new issues);
- (c) the type of clients with whom the applicant does, or expects to do, business (for example, private, overseas, pension funds, investment companies); and
- (d) the form of organisation which the applicant has adopted or proposes to adopt for the purposes of its business, including the number and functions of any employees, any internal rules concerning employees dealing on their own account and the avoidance or resolution of conflicts of interest, and any disciplinary procedures.”

1.13 Other significant requirements (in relation to the present case) introduced by the 1983 regulations were that during the currency of a licence a “ monitoring return ” was required (see 1.14 below) and that on application further verification was required as provided by paragraphs 1 and 2 of Part VIII of Schedule 1 to the regulations as follows:

“ 1. The information required by each of the paragraphs other than paragraphs 2 and 3 of Part I and by each of the paragraphs in Parts II to VII of this Schedule shall be accompanied by a statement signed by a solicitor of at least five years standing who is not concerned in the management or conduct of the affairs of the applicant (other than in his professional capacity) that—

- (a) before the application was signed—
 - (i) he went through the information with the person proposing to sign the application and, if and to the extent that he was not satisfied that the person appreciated the import of the requirements, he provided such explanation as seemed to him necessary; and
 - (ii) he took such steps as seemed to him necessary to satisfy himself that the person proposing to sign the application had directed his mind to each and every such requirement and as regards information which that person stated was not within his knowledge, to what enquiries it would be reasonable for him to make to obtain the information;

(b) it appears to him that if all the directors of a corporation or, as the case may be, partners in a partnership, are not proposing to sign the application, the person proposed to sign is expressly authorised by the remainder; and

(c) having taken such steps, he is reasonably satisfied that, if proper disclosure has not been made, it is not by reason of ignorance of what is required.

2. The information required by paragraph 2 of Part I of this Schedule [see below] shall have annexed thereto a report to the applicant signed in the case of a company within the meaning of the Companies Act 1948 by the auditor of that company, and in any other case by a person such as is mentioned in Part II of Schedule 2 hereto [see below], stating that—

(a) he has inquired into the applicant's state of affairs; and

(b) he is not aware of anything to indicate that the statement made is unreasonable in all the circumstances".

The information required by paragraph 2 of Part I of Schedule 1, which the auditor's certificate (the "going-concern certificate") was required to support was: "Whether, having regard to the business which the applicant proposes to do during the currency of the licence, if granted, and to the amount and character of the financial resources expected to be available to the applicant during that period, the applicant can reasonably be expected to be able to continue to carry on the business as a going concern throughout that period, and if not, details of the reasons why it cannot be so expected."

1.14 Regulation 8 required the holder of a principal's licence to send the Department information about his handling of client money, client investments and client portfolios within six months of the end of his last completed financial year. This information became known as the "monitoring return". Paragraphs 2–5 of Part I, and Part II of Schedule 2 of the regulations specified the required information as follows:

Part I

"2. Whether during the relevant period the holder of the licence has accepted or held—

(a) any client money; or

(b) any document of title in respect of any client investment.

3. In the case of the holder of a licence who has held any client money during the relevant period—

(a) whether, other than in respect of trivial breaches due to clerical errors or mistakes in book-keeping which were immediately rectified on discovery without loss to any client, he has in respect of that client money complied with the obligations referred to in rules 3 and 21 of the Licensed Dealers (Conduct of Business) Rules 1983;

(b) in respect of any failure so to comply—

(i) the amount of client money involved;

(ii) the nature of the failure;

(iii) an explanation for the same; and

(iv) the steps, if any, which have been taken to remedy the same and to reduce the likelihood of such a failure recurring; and

(c) the following details of client money accepted or held during the relevant period otherwise than in accordance with rule 3(5)(a) of the Licensed Dealers (Conduct of Business) Rules 1983—

(i) the amount held at the beginning of the period;

(ii) the amount received during the period;

(iii) the amount applied in making investments for clients;

- (iv) the amount paid to the holder of the licence for his own account with the client's agreement;
- (v) the amount paid to clients;
- (vi) any amount paid other than as above;
- (vii) the amount, if any, held at the end of the period, broken down to show the amount held at authorised institutions and the amount, if any, held in any other way (with details of the manner in which it is so held).

4. In the case of the holder of a licence who has retained any document of title in respect of any client investment during the relevant period—

- (a) whether, other than in respect of trivial matters which were immediately rectified on discovery without loss to any client, he has in respect of such document of title complied with the obligations referred to in rules 4 and 22 of the Licensed Dealers (Conduct of Business) Rules 1983; and
- (b) in respect of any failure so to comply—
 - (i) the value of the client investment or investments involved;
 - (ii) the nature of the failure;
 - (iii) an explanation for the same; and
 - (iv) the steps, if any, which have been taken to remedy the same and to reduce the likelihood of such a failure recurring.

5. If the holder of the licence has carried on investment management during the relevant period, the number and total value of client portfolios he administered at the expiry of the relevant period, broken down to show the number and aggregate value of client portfolios in each of the following portfolio value bands—

- (a) not more than £50,000;
- (b) greater than £50,000 and not more than £250,000;
- (c) greater than £250,000

Provided that, if the holder of the licence has valued any client portfolio at any time other than at the expiry of the relevant period (not being earlier than six months before the expiry of the relevant period), in compiling the analysis required by this paragraph it shall be sufficient to include that portfolio at the most recent date on which it was valued before the date on which the information is furnished.

Part II

The information required by Part I of this Schedule shall have annexed thereto a report by a person who either is, or, if the holder of the licence were a company within the meaning of the Companies Act 1948, would be, qualified to act as his auditor under section 161(1) of that Act and is not or would not be disqualified from so acting under section 161(2) of that Act, that having—

- (a) made such enquiries as to the book-keeping system at each office in Great Britain where business is carried on; and
- (b) examined or made such test-checks on such of the books, accounts and other documents kept by the holder of the licence; and
- (c) made such further enquiries and obtained such explanations;

as appeared to him to be requisite, it is his opinion that the information given complies with the requirements of Part I of this Schedule.”

1.15 The PF(1) Act, with its subordinate legislation, was repealed on 29 April 1988 when the Financial Services Act 1986 (“FSA 1986”) became fully operative and the regulatory system described above ceased to exist. Certain sections of the FSA 1986 had already come into force before 29 April 1988, notably sections 105

and 106 which came into force on 18 December 1986. Under section 105 the Secretary of State has power to order the investigation of an investment business "in any case in which it appears to him that there is good reason to do so". Section 106 allows the Secretary of State to appoint investigators to carry out a section 105 investigation. The provisions of FSA 1986 which first came into force on 29 April 1988 included section 65, which gives the Secretary of State power to impose prohibitions on the conduct of an investment business by the person authorised to carry it on, if it appears to the Secretary of State, *inter alia*, that the exercise of the power is desirable for the protection of investors or that the authorised person is not fit to carry on investment business. In accordance with the provisions of FSA 1986 the Secretary of State delegated to the Securities and Investments Board ("SIB"), with effect from 19 May 1987, most of his functions under FSA 1986. The functions so delegated included his powers under section 65 and, subject to a reservation that these powers were to be exercisable by the Secretary of State concurrently with SIB, the powers under sections 105 and 106. Transitional arrangements enabled an investment business to continue trading, after the coming into force of the main provisions of FSA 1986 on 29 April 1988, provided that it had applied to join a self-regulating organisation before 26 February 1988.

1.16 Before the coming into force of FSA 1986 the only powers available for investigating or winding up a licensed dealer were those provided by the companies legislation. Under section 447 of the Companies Act 1985 (previously section 109 of the Companies Act 1967) the Secretary of State can direct a company to produce books and papers and to provide an explanation of any of them. If from documents or information so obtained the Secretary of State thinks it expedient in the public interest that the company should be wound up he may under section 440 of the Companies Act 1985 present a winding-up petition to the court. It is generally the practice to apply at the same time for the appointment of a provisional liquidator of the company. (This legislation is available in respect of companies or corporate bodies; it is not applicable to individuals or partnerships.)

1.17 Section 1 of the Banking Act 1979, which prohibits anyone not authorised under that Act from carrying on a deposit-taking business, reads as follows:

" 1.—(1) Except as provided by section 2 below, no person may accept a deposit in the course of carrying on a business which is a deposit-taking business for the purposes of this Act.

(2) Subject to subsection (3) below, a business is a deposit-taking business for the purposes of this Act if—

- (a) in the course of the business money received by way of deposit is lent to others, or
- (b) any other activity of the business is financed, wholly or to any material extent, out of the capital of or the interest on money received by way of deposit.

(3) Notwithstanding that paragraph (a) or paragraph (b) of subsection (2) above applies to a business, it is not a deposit-taking business for the purposes of this Act if, in the normal course of the business—

- (a) the person carrying it on does not hold himself out to accept deposits on a day to day basis; and
- (b) any deposits which are accepted are accepted only on particular occasions, whether or not involving the issue of debentures or other securities.

(4) Subject to subsection (5) below, in this Act "deposit" means a sum of money paid on terms—

- (a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and

(b) which are not referable to the provision of property or services or to the giving of security;

and references in this Act to money deposited and to the making of deposits shall be construed accordingly.

...

(7) Any person who accepts a deposit in contravention of subsection (1) above shall be liable—

(a) on summary conviction to a fine not exceeding the statutory maximum; and

(b) on conviction on indictment to imprisonment for a term not exceeding two years or to a fine or both.

...”

Chapter 2

Policy and Practice

The background to the legislation

2.1 The 1958 Act had been a consolidation of a 1939 Act of the same title, and legislation amending it. In 1974 the Department embarked on a review of the arrangements for supervising the securities market and this review resulted in a consultative document (Cmnd 6893) being presented to Parliament in July 1977. This document recognised the deficiencies of the Act, which had been designed to deal with the commercial and financial practices in the 1930s, and outlined relatively modest proposals for improving the efficacy of the system. In 1979, however, following that year's change of Government, a Bill proposed for the 1979–80 session could not be found space in the legislative programme. Other options were therefore considered instead. In July 1981 (following the failure of one particular investment company and of other licensed dealers in 1980) the Secretary of State for Trade and Industry appointed Professor L C B Gower to review the statutory protection required by investors, and to advise on the need for new legislation. At the same time, the Government decided—as an interim measure—to tighten up and update the Conduct of Business Rules and the Licensing Regulations (within the limits of the powers given by the 1958 Act).

2.2 In his discussion document of January 1982, Professor Gower recognised the changing nature of the securities industry and the defects in the old regulatory system. He reported to the Government in 1984 and a White Paper was issued in January 1985. The legislative outcome was the Financial Services Act 1986 which repealed the existing legislation and established a new regime for the conduct of investment business; most of its provisions were brought into effect in April 1988, though—as described in Chapter 1 above—some came into force earlier. In giving me his comments on this case, the Principal Officer of the Department said: “against this policy background of probable reform and up-dating of the legislation in the 1970s, policy effort at that time was not directed at improvements in the existing framework (either through changes in subordinate legislation or administrative procedures) since more fundamental changes were expected and being worked out. As a consequence, the licensing system remained largely unaltered until the more stringent rules and regulations took effect from mid-1983”. The 1983 rules and regulations, which had themselves been preceded by the issue of a consultation document in 1982, were thus regarded only as an interim measure, designed to tighten up the terms under which licensed dealers could operate pending the provisions of the new legislation.

Enforcement

2.3 So far as enforcement was concerned, the Department have said in evidence that they distinguished between two main types of contravention: unlicensed dealing, and regulatory breaches by licensed dealers. As to the former, enforcement was based on the investigation of complaints and of other information and the monitoring of the financial pages of the press: if there was reason for concern about clients' funds or the probity of the subject, prosecution would be considered; but having regard to the fact that prosecutions were lengthy and difficult the Department's general view was that, in the absence of evidence of dishonest conduct, breaches of the licensing provisions of the Act should be regarded as “technical”. In particular the run-up to the introduction of the new rules and regulations in 1983 had—because of publicity at the time—led to a great increase in the number of licence applications, many of them from dealers who had previously been operating in contravention of the licensing provisions. The Principal Officer told me that “unless there was strong suspicion of wrongdoing or that investors' funds were at risk—the policy was to bring hitherto unlicensed

dealers within the regulatory net, so that dealers would be subject to Conduct of Business Rules aimed at protecting investors' interests. It was not the general policy to prosecute formerly unlicensed dealers for breaches of the Act". As to monitoring of the press in the Department for possible breaches of the licensing provisions, this was carried out on an *ad hoc* basis until systematic monitoring was begun in November 1984, when the Department adopted a policy of sample monitoring of advertising in the national and financial press.

2.4 In the case of regulatory breaches by licensed dealers, monitoring returns and complaints were the two main sources of information. Late or unsatisfactory monitoring returns were pursued actively with the licence-holder, and if no satisfaction was obtained, revocation of the licence under section 5(1) of the Act could result. The Department said in evidence that revocations for failure to provide a monitoring return took place several times a year; and they added that, if a monitoring return was outstanding at the time of renewal, a fresh licence was normally refused. In the case of complaints generally to which the licence-holder made no satisfactory response, where there appeared to be no immediate risk to clients' funds, the normal course was either to serve notice of intention to revoke the licence (under section 5(2) of the Act) and to allow an investigation by the tribunal to follow, or (in the case of a company) to investigate under statutory powers with a view to presenting a winding-up petition under section 440 of the Companies Act 1985 if appropriate. The Department had no investigative powers in relation to partnerships.

Staffing 2.5 Throughout the Act's history, the Licensing Unit remained small in number and its members had no special skills or training. Like many general administrators serving in other parts of the Civil Service, officials were generally posted to the unit for about three years. The Licensing Unit had originally formed part of the Department's Companies Division, which later became known as the Financial Services and Companies Division ("FSCD"). The Principal Officer told me that, following the consultative documents issued in January and September 1982, and from June 1983 when the new regulations took effect, there had been a substantial increase in the number of licence applications and also an increase in the amount of information sought from applicants and licence-holders. He said that, against a background of substantial reductions in departmental staff numbers of some 20% from 1980 to 1985, the staff of the licensed dealers unit had nonetheless been doubled to deal with the increased workload. In 1985 the unit became part of a newly created Financial Services Division ("FSD").

2.6 In 1986 an Internal Audit team reviewed the systems of the Licensing Unit and they reported in April 1986. They concluded that if greater assurance was required that licences were being issued only to "fit and proper persons", the unit would need specialist staff or training and a closer relationship would need to be developed with those whom the Department consulted about licence applications (see 2.7) and the market. However, in view of the proposed transfer of the regulatory function to SIB (see 1.15) they restricted their recommendations to those which they felt would be worthwhile in the short term. In responding to the report, the unit attributed many of the shortcomings identified by the Internal Auditors to the inadequate legislation. They agreed that the extent to which it was worth introducing staffing or other changes was affected by the limited future of the Licensing Unit which was thought (in June 1986) to be no more than about twelve months. In April 1987 when full implementation of FSA 1986 was still a year away (see 1.15) the situation was reviewed. Ministers agreed that minor changes which might have aided enforcement of the Act should not be introduced at that time.

Procedure 2.7 I have seen from the Department's papers that it was their practice on receipt of an initial application for a principal's licence (or when new directors or controllers were notified to the Licensing Unit) to consult various external bodies including the Stock Exchange, the local police, the fraud squad and, from 1 January 1985, NASDIM (the latter having by then been recognised as an

association of dealers in securities for a full year during which time *ad hoc* consultation had taken place) and to consult other parts of the Department, notably Companies Registration Office, Companies Investigation Branch and the Insolvency Service. In the case of applications from overseas businesses it was the Department's practice to consult regulatory authorities abroad. The purpose of these enquiries—which were not repeated when processing licence renewal applications unless some change in relevant information was reported (such as a change of controller)—was to ascertain if anything was known to the detriment of the applicant and to check if information provided on the application form was correct. Failure to make timely applications for licence renewals or to provide prescribed information did not necessarily lead to refusal of a licence or to the immediate revocation of an existing licence: on occasions licences were issued without prescribed information having been provided, if it was adjudged that the missing information was relatively trivial and would be provided as soon as possible.

2.8 The senior executive officer (“SEO”) in the Licensing Unit said in evidence that when a backlog of applications built up (from 1982 onwards, but more especially in 1983 and 1984) the Department's response—apart from increasing staffing as referred to in 2.5 above—had been twofold: it had given a measure of priority to the recognition as a regulatory body (as from 31 December 1983) of NASDIM (which had applied for recognition in September 1983), in the expectation of thereby exempting from the licensing regulations some 200 firms of intermediaries; and it had reduced its own consultation procedures, so that no enquiries were to be made about some non-directors applying for representatives' licences, unless there was some specific cause for concern. Other steps were also taken to improve the efficiency of administration. In November 1983, in order to speed up the procedures, and ensure better control, a review system was established under which new applications were regularly reviewed. The expectation was that applications would be decided within 13 weeks of receipt. If, at that stage, replies from consultants were still outstanding, consideration was given to whether, in the circumstances of the case and in the light of the consultants' replies that had been received, it was appropriate to proceed to a final decision without waiting for the outstanding reply or replies. A further reduction in checks and a streamlining of procedures was recommended in March 1985 by an internal O and M team, and these were (except in relation to checks with outside bodies) largely implemented by the unit.

The scope of licensing

2.9 I have seen from the Department's papers that the Department held the view that the mere offering of advice did not necessarily constitute “dealing in securities” as defined in section 26 of the Act (see 1.10). In the 1970s it appears to have been believed that investment advisers who had no interest in the transactions and who charged a flat rate fee for their services did not contravene the Act, while those who charged a fee on a percentage basis or who shared in the profits of transactions fell within part (b) of the section 26(1) definition. This reasoning was extended to cover the case of investment managers as well as investment advisers. Thus the standard form of advice to enquirers, in common use in the years 1974 to 1976, is exemplified by the following letter sent by an official in the Licensing Unit in answer to an enquiry in November 1975:

“I refer to our recent telephone conversation about portfolio management.

Your attention is drawn in particular to head (b) of the definition of ‘dealing in securities’ in section 26(1) of the Act. The interpretation of an Act of Parliament is in the last resort a matter for a court of law, but subject to this proviso, I am to say by way of general guidance, that the Department is of the opinion that investment advisers and portfolio managers do not deal in securities if they have no interest *of any sort* either in securities which are the subject of their advice, or in any transactions which may result. If, however, the fee charged for advice/management is related to the return, eg a percentage of profits resultant or of capital appreciation, or where there is

commission sharing, then the Department takes the view that the persons are dealing in securities, and should consequently be licensed or otherwise authorised under the Act.”

2.10 The consultative document of July 1977 (see 2.1) reflected and perhaps even extended this same thinking, saying in paragraph 6:

“6. The term ‘dealing in securities’ is defined in the Act; but the scope of the licensing system does not at present embrace a number of investment advisers and investment consultants, whose activities may include investment on behalf of clients. Their numbers and activities have greatly increased in recent years and the distinction between those requiring to be licensed and those free to operate without a licence has become blurred. The Government proposes therefore that persons offering an advisory service for the management or investment of securities in return for a fee (whether related to the value of the securities or not) should be licensed either under the same system as dealers in securities or under a separate system but with similar terms and conditions to those applied to dealers. It is not intended however that those who advise their own clients on such matters incidental to their professional function (for example, solicitors and accountants) should be brought within an extended licensing framework. An amendment on these lines would also permit licensed investment consultants to distribute investment circulars to their clients without risk of contravening section 14 of the Act.”

2.11 On 15 December 1981, however, a departmental solicitor advised that in the case of investment managers it was misleading to concentrate on the method of remuneration, which was relevant only to pure advisers. He went on:

“But where the arrangement is that the client agrees to deposit funds with someone with a view to that person acquiring securities on his behalf (whether in that person’s name or in the client’s name) then my view is that the entering into that agreement is itself a transaction which constitutes dealing in securities as defined and that such a transaction is not effected with or through the agency of any of the persons mentioned in section 2(2)(a).” He concluded: ‘I find it difficult to see how any portfolio manager can avoid the need for a licence’. In February 1982, the same solicitor advised that for the purpose of replying to letters the Department should say firmly that they found it difficult to imagine any case in which investment management could be conducted without requiring a licence, even if the individual transaction was effected with or through a stockbroker, unit trust manager etc. And, as will be seen in Chapter 3, reservations were already being expressed about the Department’s earlier interpretation of the Act by the member of the Solicitor’s Office who advised the Licensing Unit on an enquiry about licensability made by Barlow Clowes in 1975.

Powers of revocation and refusal

2.12 I have seen from the Department’s papers that when in November 1984 a stock letter—designed to be sent out when a monitoring return was overdue—was being drafted, the matter was referred to the Solicitor’s Office and a departmental solicitor commented that the draft implied that the Secretary of State might refuse to renew a licence under section 5(1) of the Act for failure to submit a monitoring return required to be submitted during the currency of an existing licence. She advised:

“I do not think that this is the case. An application for renewal of a licence is, in terms of the PF(I) Act, an application for a new licence. It follows from this that the Secretary of State may refuse to grant the licence on the grounds set out in section 5(1) of the Act only if the applicant has failed to furnish on the occasion of the application, the requisite information prescribed by the licensing regulations. It is true that section 5(1) refers to a failure to furnish information ‘at any prescribed time during the currency of the licence’, but in the context of the provision, those words seem to me to refer to ability of the Secretary of State to revoke an existing licence and not to provide a ground on which he can refuse to grant a new one. The licensing regulations

do differentiate between applications for first licences and applications for renewal, but only to the extent that the holder of a current licence may furnish the requisite information by stating that there has been no change in information furnished in connection with a previous application. There is no requirement that, on an application, the holder of a current licence must furnish the information specified in Schedule 2 of the licensing regulations in respect of any period falling within the term of his existing licence. Therefore, while it is possible under section 5(1) to revoke an existing licence on the ground that the licence holder had not submitted the information specified in Schedule 2 at the prescribed time during the currency of the licence it is proposed to revoke, it is not possible under section 5(1) to refuse to grant the licence holder a new licence for that reason. Failure to submit a monitoring return during the currency of a licence is, however, a circumstance which you may take into account in considering whether a notice of intention to refuse the grant of a new licence should be served on the ground that the applicant is not a fit and proper person to hold a licence.”

2.13 This last mentioned procedure would, of course, involve reliance on section 5(2) of the Act, which carried a right of recourse to the tribunal (see 1.6). Revocation of an existing licence under section 5(1), on the other hand, did not carry any such right. The Department’s statistics show only 25 cases as having been referred to the tribunal throughout the history of the Act. In evidence the Assistant Treasury Solicitor, commenting that the tribunal was not an appeal forum from the Secretary of State’s decisions but was required to carry out an inquiry into an applicant’s fitness to hold a licence, said that—as far as he was aware—the tribunal had never considered a case “remotely as complex as Barlow Clowes” and that it would have been “extremely unlikely” that the tribunal would have reported within twelve months had it had to consider the case.

Overseas businesses 2.14 The prohibition, in section 1 of the PF(1) Act, of carrying on or purporting to carry on the business of dealing in securities except under the authority of a licence did not extend to activities outside Great Britain (the Act was expressed not to apply to Northern Ireland, and on ordinary principles it could not, in the absence of express provision, extend to acts done outside the United Kingdom). However an overseas business (whether carried on by an individual, a partnership, a corporation or other legal entity) could nevertheless, by reason of activities in Great Britain, contravene section 1 if unlicensed. It would seem that where an overseas business, on a regular basis, solicited investments by direct approaches to investors in Great Britain, the Department would have regarded it as carrying on in Great Britain the business of dealing in securities. The position was less clear, however, in cases where the approach to investors in Great Britain came through authorised intermediaries (1.3 above). In such cases section 2(2) of the Act (*ibid*) appeared to permit the overseas business, without the need for a licence, to effect transactions through the agency of the authorised intermediaries; but this was subject to the proviso that “Nothing in this subsection shall be construed as authorising any person to hold himself out as carrying on the business of dealing in securities”. Given that an overseas business by, for example, providing authorised intermediaries with promotional material might well be regarded as holding itself out, to the intermediaries and through them to the public, as carrying on the business of dealing in securities, it seemed that such a business might require to be licensed, despite the provisions of section 2(3).

2.15 Because of this uncertainty, and also because the Principal Officer of the Department, in giving me his comments on the complaint, had told me that “it was probably the case” that Barlow Clowes International Ltd (“BCI”) had been dealing in securities in this country—although the Department, he said, had not known that, I sought to discover from the Principal Officer what the views of the Department had been in the period between 1984 and 1987 on the licensability of overseas businesses dealing through authorised intermediaries in Great Britain. In response he told me that neither the general files nor the Barlow Clowes case files contained any evidence which provided a precise indication of the Department’s

view of the licensability of overseas businesses in this context. I therefore took evidence on the point from the two principals who had been in charge of the Licensing Unit between 1983 and 1987 and the member of the Solicitor's Office who had been chiefly responsible for advice on the Act. When I asked the two principals what view they had formed on the need for licensing an overseas business which dealt through authorised intermediaries, they said that they could not recall any case in which the issue had arisen and consequently it had not been necessary for the Department to form a view. When I asked the solicitor what his view had been during the period in question he said that so far as he could recall he had not been asked formally to advise on the point. He had however looked at the point in some detail in connection with his work on the Financial Services Act. He said that the first question would have been whether the overseas business could be regarded as carrying on business here. His view had been that it was possible for an offshore firm to be carrying on a business of dealing in securities in Great Britain without having a place of business here. However, if the firm's dealings were through authorised intermediaries, the exception in section 2(2) of the PF(I) Act would apply unless the firm was "holding itself out". The "holding out" proviso had, however, to be construed as subject to the same territorial limitation as section 1, namely that it applied only within Great Britain. If an authorised person were to seek out the offshore business in its home state, and obtain information, he would then be able to advertise the product in question in Great Britain so long as he was doing so on his own initiative and not as the agent of the offshore business. The solicitor said that he thought it would also be permissible for an offshore business to hold itself out in Great Britain as carrying on the business outside Great Britain, either on the basis that it would not then be carrying on business within Great Britain or, less clearly, on the construction of the proviso. Broadly, it could be said that an authorised person could sell offshore products so long as it took the initiative but that it was very much more difficult, both in terms of the basic prohibition in section 1 and the proviso to section 2(2), for an offshore business actively to solicit business through an authorised intermediary. The solicitor added that the whole subject was a difficult one, the "holding out" proviso being extraordinarily difficult to construe and particularly so in relation to offshore business. Too restrictive an interpretation would have outlawed a large amount of the business on which London's position as an international financial centre depended. That was not, he said, just a policy point although he thought that where legislation was ambiguous it was permissible for the executive to apply policy considerations; faced with an interpretation which would have had such an effect on the position of the City he would expect the courts to apply the same principles.

Chapter 3

1975–1983

3.1 Mr Peter Clowes of Barlow Clowes and Partners first contacted the Department in April 1975, seeking guidance, so far as section 14 of the Act was concerned, about the distribution of a circular describing their Gilt Edged Management Service. The names of the partners which appeared on the firm's notepaper at the time were E E Barlow and P Clowes. A higher executive officer ("HEO") in the Companies Division wrote to the partnership on 15 May asking for more information about the scheme before commenting further. Following a telephone enquiry in August 1975 from Barclays Bank seeking the Department's advice as to whether the partnership, who were seeking custodian trustee facilities, needed a licence under the Act, Mr Clowes sent three leaflets to the Department on 10 September. One, as before, concerned the Gilt Edged Management Service, the second concerned the partnership's three year Guaranteed High Income Plan and the third was a Professional Adviser's Guide to the Gilt Edged Management Service marked "for private circulation only". The Gilt Edged Management Service leaflet incorporated an application form in which the investor would state the amount for which he enclosed his cheque (minimum £1,000) and would "authorise Barlow Clowes and Partners to manage British Government Stock" on his behalf. The leaflet indicated that sums sent would be invested by the partnership, that they would register the securities "in a major bank's nominee company", and that "each client is the beneficial owner of his securities". The schemes invited clients to invest through their professional intermediaries. On 22 October an official telephoned Mr Clowes to find out how the registration of securities with the nominee company was carried out and he recorded in a minute that Mr Clowes had told him that the partnership purchased a large block of stock, registered it at the nominee company in the name of the partnership and allocated it in their books among the respective portfolios. Officials in Companies Division had difficulty in establishing the nature of the schemes, in particular whether the partnership was operating an unauthorised unit trust and they were uncertain as to whether distribution of the three circulars constituted an offence under section 14 of the Act. On 24 October, therefore, the matter was referred to the Department's solicitors for advice, the minute concluding (in accordance with the view then held in the Department—see 2.9), "Our understanding has been that an investment adviser is not carrying on the business of dealing in securities if he has no interest whatever in the securities in question and does not share commission on deals. Barlow Clowes seems to fall into that category".

3.2 A departmental solicitor, replying on 24 November, said that in his view distribution of the first two leaflets constituted an offence under section 14 of the Act because each contained an invitation to enter into an agreement for, or with a view to, acquiring Government securities. He considered that distribution of the third leaflet might be a similar offence because not all professional advisers—to whom the leaflet was directed—fell within the exemption in section 14(5) of the Act (see 1.9) and the leaflet contained information calculated to lead directly or indirectly to the making of an agreement for acquiring securities. The solicitor considered that the scheme did not constitute a unit trust because the client retained the beneficial ownership of his securities. But he went on to say that it followed from what he had said that Barlow Clowes were dealing in securities as defined in section 26(1) of the Act (see 1.10) and were therefore in contravention of section 1 (1). Noting that hitherto the Department had considered that an investment adviser was not dealing in securities if he retained no interest in those securities he said that Barlow Clowes had apparently no interest in the securities, which passed directly into the beneficial ownership of the client, nor did they have an interest by way of charging a "performance fee". But he concluded his minute,

“Nonetheless, on a literal interpretation of the s.26(1) definition, I think Barlow Clowes must be dealing in securities. If this differs from your present understanding of the position, I should like the opportunity of reconsidering it in the light of any previous advice on the subject”. The SEO in Companies Division to whom the note was addressed minuted that on reflection he was inclined to agree with the solicitor’s conclusion and he instructed the HEO to write to Barlow Clowes advising them that the Department considered that they should obtain a licence in order to conduct their business lawfully.

3.3 The HEO understood the solicitor’s advice as indicating that it was by virtue of the distribution of the circulars that Barlow Clowes were dealing in securities. Thus he wrote “due to dist of the circes ?” in the margin against the sentence in the solicitor’s advice “Nonetheless, on a literal interpretation of the section 26(1) definition, I think Barlow Clowes must be dealing in securities”; and when he wrote to Barlow Clowes on 3 December, after conveying the solicitor’s advice that distribution of two of the leaflets contravened section 14 of the Act and distribution of the third leaflet might also be an offence, he went on to say “As I think I explained to you, if a person has an interest of any sort in the securities which are the subject of his advice, he is, in our view, dealing in securities. From an examination of the documents sent with your letter it appears that you have no interest in the securities. However, it is our view that the distribution of the documents will itself constitute dealing in securities and consequently Barlow Clowes should be licensed. The necessary forms for each partner are enclosed”. Mr Clowes replied on 8 December stating that distribution of all three circulars had ceased. He indicated that he was obtaining the relevant legislation and would write again. On 2 January 1976 he wrote saying “... we would like to clarify the following points:

1. Given that we have no interest of any sort in the securities which are the subject of our management service, we are not dealing in securities.
2. The distribution of documents may constitute dealing in securities, and solely for this reason we should be licensed.

However, as stated in our letter dated 8 December, we have withdrawn all literature and we would suggest that in respect of point 2 above, it may not now be necessary for us to become licensed. We should be grateful for your opinion on the above”. The HEO, replying on 21 January, recited the Department’s view of the position in substantially the terms used in the letter I have quoted in paragraph 2.9 above. He added that if documents which were circulars invited persons to do any of the things mentioned in the definition of “dealing in securities” the distribution of such documents would also constitute dealing in securities and might in addition contravene section 14(1) of the Act. Mr Clowes did not reply and the Department did not take the matter any further.

3.4 Barlow Clowes and Partners next came to the attention of the Licensing Unit in an indirect way in June 1979 when the firm Farrington Stead & Co Ltd applied for licences to deal in securities under the Act. Application was made for a principal’s licence for the company and representatives’ licences for two of the company’s directors, Mr G W Farrington and Mr H Stead. In making his personal application Mr Farrington gave the name of Barlow Clowes and Partners as one of the employers for whom he had worked during the previous five years. He described the nature of their business as “gilt edged management” and the capacity in which he had been employed as “statistical research and systems development”. Mr Stead’s application showed that his only employment during the previous five years had been with Barlow Clowes and Partners, whom he described as “portfolio managers”. His own job had been “stock analyst and administration manager”. Mr Stead stated that from January 1976 until December 1978, he had been a director of three companies, Barlow Clowes (Services) Ltd, which provided administration to Barlow Clowes and Partners, Barlow Clowes (UK) Ltd, which marketed services provided by Barlow Clowes and Partners, and Megerberry Ltd which was a property investment company. The principal’s licence application listed Hedderwick Stirling Grumbar & Co among the names of recognised stock exchange members with whom the firm had transacted business in securities during the previous five years and a partner of that firm gave individual personal

references to Mr Farrington and Mr Stead in support of their representative licence applications. In considering the licence applications, the SEO noted that both applicants had had some experience in the securities business. Apart from this oblique reference, no further interest was taken in Barlow Clowes and Partners at this time. A licence, taking effect from 23 January 1980, was issued to Farrington Stead & Co Ltd and renewed the following year.

3.5 Barlow Clowes and Partners next came to the Licensing Unit's attention when, at a meeting with the Association of Licensed Dealers in Securities in November 1980 the attention of the assistant secretary to whom the Unit reported was drawn to the list of independent investment managers included in the last (April 1980) annual survey carried out by "Planned Savings" magazine. This showed that sixteen firms (including Barlow Clowes and Partners—who were described as a member of the Association of Independent Investment Managers (AIIM)) out of the forty firms listed were not annotated as being licensed dealers. The assistant secretary expressed concern at this finding and he called for a letter to be drafted and sent to these people making clear what the Department's attitude to licensable activities was. The SEO charged with this task retired shortly thereafter and his successor submitted a draft letter on 30 December 1980. He also made enquiries and found that Barlow Clowes and Partners' membership of AIIM had ceased. The draft letter was submitted to the Solicitor's Office on 9 March 1981 for comment. A departmental solicitor advised that he thought a less controversial and possibly more effective approach would be for the Department to issue a notice on the subject and this proposal was pursued with the press office. During 1981, however, consideration was being given to an announcement of the impending review of the Act and in July the assistant secretary decided that the matter would be better dealt with in conjunction with the Department's consultation procedures concerning the proposed amendments to the Licensed Dealers (Conduct of Business) Rules which he was expecting to take place later that year. The proposed letter was therefore never sent to any of the unlicensed investment managers on the list.

3.6 Meanwhile, Barlow Clowes had again come to the notice of the Licensing Unit in a more direct way on 15 April 1981 when, following the collapse of Farrington Stead & Co Ltd through their indebtedness to Hedderwick Stirling Grumbar & Co—who were themselves hammered on 10 April 1981—the Stock Exchange's Official Assignee, Hedderwick's liquidator, spoke to the newly appointed SEO in charge of the Licensing Unit. While promising to keep the Department informed of his enquiries so far as Farrington Stead & Co Ltd were concerned, the liquidator mentioned another "associate" of Hedderwicks who traded in a similar way to Farrington Stead. This firm was Barlow Clowes and the liquidator expressed surprise that they were trading without a licence. (I note here that Alexander Tatham & Co have suggested on behalf of investors that significance should have been attached to the involvement with Barlow Clowes of Mrs Elizabeth Barlow. Information referred to in the following paragraph indicates that Mrs Barlow left the partnership in 1978. The liquidator of Hedderwicks told my officers that a summons for the arrest of Mrs Barlow was issued late in 1981 with a view to her being questioned about her role in the Hedderwick collapse; he told my officers that Mrs Barlow had left the country and that he believed that the warrant for her arrest still remained outstanding.) The Department considered what action they should take regarding Farrington Stead, the assistant secretary responsible for the Licensing Unit having expressed concern in a minute dated 16 April to a departmental solicitor about what he had heard about Barlow Clowes Ltd (*sic*). He added "I think that we should follow up the possibility that they have been dealing without a licence but I am not sure whether a section 109 enquiry would be appropriate". Following a discussion on 27 April with the liquidator of Hedderwicks, the Department's Companies Investigation Branch ("CIB"), to whom the assistant secretary's minute had been copied, instigated an enquiry into Farrington Stead & Co Ltd under section 109 of the Companies Act 1967 (see 1.16). Inspectors were appointed on 8 May, and the file minuted that Barlow Clowes Ltd [*sic*] should be regarded as a watching brief. The Inspector of Companies noted in this connection that "it will be interesting to see what is discovered in the Farrington Stead enquiries about inter-company dealings". The Licensing Unit noted the position on 8 May.

3.7 During the course of the investigation into Farrington Stead certain information about Barlow Clowes came to light, mainly from confidential sources. This information served to reinforce the view that Barlow Clowes were dealing in securities. It also indicated that around 1977 Mr Clowes had formed a separate partnership with a Jersey partner and that in 1978 Mrs Barlow had left the UK partnership. On 2 July 1981, over a month before the section 109 report was signed, an executive officer ("EO") in CIB's general office minuted the principal examiner in the following terms: "On your suggestion, I spoke to [the senior investigating officer]. Nothing in his enquiries into "Farrington" necessitates further interest in "Barlow Clowes". Therefore may we now mark the latter "NPW" [not proceeded with]?" The principal examiner replied "Yes" and the same day returned the file to the senior investigating officer concerned. The latter has told me that the purpose of a watching brief was to accumulate information about a company about which the Department had doubts which were insufficient in themselves to justify an inquiry. While he agreed that the information about Barlow Clowes that had come to light during his investigation into Farrington Stead might have been of interest to the Licensing Unit, he told me that he could not recollect having been aware that the reason for the watching brief was the Licensing Unit's concern that Barlow Clowes were trading unlicensed. However, he said that because much of the information had been obtained outside his statutory authority, it could not in any case have been used for the purposes of his section 109 enquiry and nor could it have been disclosed to the Licensing Unit without the authority of his senior officers or the Department's solicitors. In the case of some of the information, the officer would additionally have required the permission of the Official Receiver in Bankruptcy before disclosing it.

3.8 The Farrington Stead investigation report was signed on 5 August and referred to a solicitor for consideration of three outstanding issues, one of which was what to do about the Farrington Stead licences. As regards the latter, a copy of the report and the covering minute were simultaneously sent to the Licensing Unit explaining that as the enclosures to the report were voluminous they, or any specific enclosure, would be copied to them only on request. No such request appears to have been made by the Licensing Unit who seem to have confined their action to dealing with the question of the Farrington Stead licences. Thus the watching brief on Barlow Clowes came to an end. So far as Farrington Stead were concerned, CIB awaited the outcome of garnishee proceedings before putting away their papers on 20 May 1983 having first checked that neither Farrington Stead & Co Ltd nor Barlow Clowes Ltd [*sic*] appeared on the published list of licensed dealers and informed the principal to whom the Licensing Unit reported that "in view of the outcome we are putting our papers away". The principal concerned told me that he had no recollection of having received this message. He added that CIB's limited interest in Barlow Clowes had not been brought to his attention until sometime after the Barlow Clowes advertisement had come to the attention of the Department in December 1983 (see 4.1).

Findings 3.9 In considering first the advice given to Barlow Clowes in 1975-76, I note that the Secretary of State in a statement made on 20 October 1988 conceded that the partnership "received advice which due to a misunderstanding within the Department did not adequately cover the point at issue and it did not then apply for a licence to deal in securities". Reflecting this view, the Principal Officer of the Department told me: "There is no doubt that the guidance the Department gave to Barlow Clowes in 1975-76 was based on a misunderstanding of a departmental solicitor's advice (advice which the Department now believes was right)". For my part, I can understand how the view taken about investment advisers—that they were dealing in securities within the section 26 definition only if they charged a fee on a percentage basis or shared in the profits of transactions (2.9)—might have been seen as possibly extending to some categories of persons who could be described as "investment managers". But I find it difficult to comprehend how the idea can have gained currency within the Department that this could apply to undertakings who obtained money from the public with which to purchase securities to be held and managed in the name of the undertaking—albeit on the footing that beneficial ownership would reside in the members of the public

concerned (3.1). Nevertheless, that was evidently the view held, at least outside the Solicitor's Office, and it led to the advice given by the solicitor being misunderstood. It seems to me, however, that the solicitor's advice was expressed in terms which left no room for doubt that he wished to be consulted again if his advice differed from the administrators' current understanding of the position, so that he could reconsider it in the light of previous advice on the subject. For the Department to have subsequently rehearsed their view in letters to Barlow Clowes on 3 December 1975 and 21 January 1976 (3.3) without modification—or, alternatively, without first seeking further legal advice—was in my view a clear case of maladministration. The effect of this misunderstanding, so far as the partnership were concerned, was to allow them to proceed on the basis that they did not require a licence when, on a correct interpretation of the law, they did. More generally, I note that this mistaken view persisted in the Licensing Unit at least until late 1981 (see 2.11).

3.10 I turn now to the Licensing Unit's handling of the Farrington Stead application for a licence in June 1979 (3.4) in which the nature of Barlow Clowes and Partners' business was described as "gilt edged management" and "portfolio managers". If it had been appreciated within the Licensing Unit that investment with portfolio managers would generally be found to be dealing in securities (2.11) it would not have been unreasonable, in my view, to have expected alert officials dealing with the application to have checked whether Barlow Clowes themselves were licensed and to have made enquiries of them if not. That this apparently did not happen must probably be seen as the result of the erroneous view held within the Licensing Unit.

3.11 In November 1980 Barlow Clowes was one of the sixteen firms of unlicensed investment managers brought to the notice of the Licensing Unit by the Association which was later to become NASDIM (3.5). I have described how the original intention of writing to each of these firms individually was shelved in favour of dealing with the matter in conjunction with the consultation procedures which were then in contemplation in connection with the proposed amendments to the Licensed Dealers (Conduct of Business) Rules. I found no indication, however, that this had been done. Another opportunity to bring the partnership within the regulatory net thus came to nothing.

3.12 In April 1981, as a result of information coming from the Stock Exchange's Official Assignee, the assistant secretary of the day—in a minute to the Solicitor's Office which was concerned principally with another matter—said, in relation to "Barlow Clowes Ltd": "I think that we should follow up the possibility that they have been dealing without a licence but I am not sure whether a section 109 enquiry would be appropriate" (3.6). Except that on 8 May the Licensing Unit noted the file, the only indication of further action on their part is a marking on the cover of the 1975–76 Barlow Clowes papers which suggests that the SEO referred to them on 2 August 1981. A possible explanation for the lack of any further action is that the same error was made about the need for a licence as had been made in 1975–76 (3.9). Another possibility is that the decision to which I have referred in the preceding paragraph was seen as covering the position. But, whatever the reason, the result was that the firm were allowed to continue without any intervention by the Department. As I see it, that can only be regarded as maladministration. I would add that I have seen no indication that, following receipt of the solicitor's very firm advice in late 1981 and early 1982 (2.11), any attempt was made to identify, and deal with, cases in which incorrect advice had earlier been given. I find this surprising, and a cause for criticism.

3.13 I consider at this point whether there is any reason to suppose that, if Barlow Clowes had been given the correct advice in 1976 and had then applied for a licence, they would not have obtained one and thereafter have had it regularly renewed. In giving me his comments on this aspect of complaint the Principal Officer said that, given the limited requirements of the licensing system at the time and the policy background against which it operated (see Chapter 2 above) it was virtually certain that no information would have come to light which would have prevented the issue and regular renewal of a licence. He said that the only potential

relevant information, so far as he was aware, that might have come to light had Mr Peter Clowes and Mrs Elizabeth Barlow applied for principal's licences in 1976 was that until 1973 they had been employed with one of the firms in the crashed International Overseas Services group of Mr Bernie Cornfeld. He said however that this information of itself would have been unlikely to cause their application under the PF(I) Act to have been rejected. The Principal Officer added that the collapse of Farrington & Stead was, of course, known to the Department; but the fact that Messrs Farrington and Stead were former employees of Barlow Clowes would not, he said, have affected any licence applications submitted by Barlow Clowes. For my part, I did not dissent from the Principal Officer's view here. It seemed to me that nothing which was known about the partnership in the period from 1975 to the time when in 1983 they came again to the Department's notice was of a nature likely to have led to their being treated as "not fit and proper". It appeared to me, nonetheless, that it did not follow that the faults which I have identified as regards the licensing of the partnership had necessarily had no consequences for investors. That is a matter to which I shall return in Chapter 8.

Chapter 4

October 1983—October 1985

4.1 On 11 October 1983 an assistant solicitor sent a minute to the principal responsible for the Licensing Unit together with a number of press cuttings taken from the weekend newspapers. Among them was a cutting about Barlow Clowes which had appeared in the Sunday Times Business News on 9 October. The principal (much later, he has told me) wrote in the margin of the solicitor's minute (against his reference to the Barlow Clowes cutting) "dealing". On 25 October the assistant solicitor referred to the principal a letter and other material he had received from Barlow Clowes in response to a telephone call he had made to an answering machine. He also referred to the principal for agreement a draft letter which he proposed to send to the firm. The letter which the assistant solicitor had received from Barlow Clowes of Warnford Court, Throgmorton Street, London EC2 was dated 18 October and concerned their Gilt Monitor Service, an advisory service which offered to advise clients when it would be suitable to switch investments in order to get a better return. The solicitor's draft letter—which was never sent—said that Barlow Clowes's letter appeared to be a clear breach of section 14(1)(a)(ii) of the Act, which restricted the distribution of circulars. The draft letter invited their comments and went on to point out that their notepaper did not give the full names of the partners, a requirement under section 29 of the Companies Act 1981. On 28 November the solicitor informed the principal that an item about the same Barlow Clowes advisory service had been broadcast that weekend on the BBC Moneybox programme. The following month the solicitor referred some more Barlow Clowes material (without looking at it, he told me) to the principal. This material consisted of a letter to the solicitor dated 7 December from Barlow Clowes and Partners of 39 Don Street, St Helier, Jersey (on which the names of the partners were shown as P Clowes and Conwin Services Ltd) concerning Barlow Clowes's Portfolio 28 service and an enclosed leaflet about the service, together with an additional one which it was suggested might be of interest to a friend or relative. The leaflet described Portfolio 28 as the perfect service for security (mentioning that "for safe keeping all stock and cash will be lodged with the securities department of a major London clearing bank") and offered high guaranteed returns added to capital each month, profit as capital gains not interest, concise monthly statements, a high monthly income option and easy withdrawal of capital at any time. The leaflet described the tax advantages to UK residents and the application form, designed to be returned to the Jersey address, catered for UK residents by inviting them to state their estimated top rate of tax. Applicants were invited to enclose a cheque made payable to "Barlow Clowes and Partners Clients' Account". All of the officials concerned, including the solicitor, when interviewed by me or my officers said that they had not noticed the names of the partners shown on the letter of 7 December (from which it could have been inferred that there was a separate Jersey partnership operating under the same name as the UK partnership). The solicitor explained to me that it was not his job—in fact he said, it was nobody's job—to answer advertisements in the national press as he had done (see however 2.3 above). He said that at the time he had been taking a particular interest in the financial regulatory systems partly because he had been joint secretary to the Gower review, though his job as a departmental solicitor had also included advising FSD on the legalities of the Act.

4.2 On 20 January 1984, Mr A R Bridges of John Scott & Partners Ltd, a firm of investment consultants, wrote to the Department enclosing leaflets about the Barlow Clowes Gilt Monitor Service and Portfolios 30 and 78 (see paragraph 7 of Introduction). Both the Portfolio 30 and Portfolio 78 application forms required applicants to make their cheques payable to "Barlow Clowes and Partners Clients'

Account” and send them to the partnership’s London address. Mr Bridges made the following comments:

- “(a) ‘Bond-washing’ will *not* work—the gains will be taxed as income.
- (b) Will the gilts be bought in my name?—presumably not.
- (c) What does ‘fully discretionary basis’ mean?
- (d) Who are Barlow Clowes and Partners?—what is *their* guarantee worth?
- (e) Are they allowed to advertise and sell in this way?—surely not.
- (f) If not, how can they be stopped?”

On 23 January the SEO referred these papers to the principal, commenting that Mr Bridges had telephoned a few days previously “grumbling about Barlow Clowes”. He referred his principal to the other papers he had already received and about which, he said, “you were going to write”.

4.3 Among the many people from whom I took evidence was Mr Adrian Collins, now Chief Executive of Royal Trust Asset Management Ltd, but who was, at the time of these events, Chief Executive of the Gartmore group of companies. He told me that the principal, accompanied by his SEO (responsible for unit trust matters), had attended a business lunch at Gartmore on 10 April 1984. Mr Collins and a colleague had also been present. He said that during lunch there had been a lengthy discussion about Barlow Clowes and in particular about their advertising, which it had been felt must have been very expensive—there had been a rumour circulating at the time that Barlow Clowes were bankrupt to the tune of £4 million. Mr Collins told me that his company, as a competitor of Barlow Clowes, had been put under pressure by firms of intermediaries wanting schemes offering the same kinds of guarantee as Barlow Clowes. Because of this demand, he had looked very closely at the Barlow Clowes product and had concluded that it was inconceivable that Barlow Clowes could fulfil both their income and capital return guarantees while at the same time paying commissions to brokers and themselves taking a fee. Mr Collins explained that Barlow Clowes had guaranteed both a fixed level of income and a capital return at the end of the contract. He said that the income guarantee on its own would have caused no problems because income could be paid by “robbing” capital—rather like the way that annuities were managed. In such cases there would be no complaint that capital had been eroded because a capital return would not have been guaranteed. But, if capital was guaranteed in addition to income (as in the Barlow Clowes case) then his calculations had shown that it was impossible for both the guaranteed income and capital amounts to be paid—as well as brokerage charges and Barlow Clowes’s own fee. Mr Collins told me that he could not remember whether he had shown his actual calculations to the DTI officers during the lunch on 10 April, but they had discussed the viability of the Barlow Clowes product at length. He said that he had also passed on the rumours circulating in the city about the firm and thought that this had not been the first time that the DTI officials had heard these rumours. Mr Collins said that if Barlow Clowes had been operating the kind of business it claimed on a large scale then it would have been a major buyer and seller of gilts; but he had never come across a single broker who had had substantial dealings with Barlow Clowes. In fact he knew of a major firm of gilt specialists who had refused to do business with Barlow Clowes many years before. He said that he had been dubious of the legality of the schemes on offer because they had been similar to those which had been marketed some years earlier by Farrington Stead & Co Ltd, a collapsed firm of licensed dealers well known to the city (and to the Department—see Chapter 3). Another rumour which had been circulating at the time and which, he said, he had passed on to the DTI officials was that Barlow Clowes had not filed accounts for some years. Mr Collins told me that this had been the kind of message he had put across to the DTI officials at lunch. Mr Collins said that he had also been concerned at the unlicensed state of Barlow Clowes at the time. The principal told me that he recalled this lunch and accepted that Barlow Clowes might well have been mentioned in the conversation, though his recollection was that it had primarily concerned unit trust matters. He thought that Mr Collins could not have given him any written calculations because he would certainly have placed them

on the file. He has also told me that at that stage the Department had very little information about the firm and certainly not enough to enter into a "discussion" with Mr Collins, even if it had been proper to do so. He added that as the Department had not at that stage received any "rumours" about the firm, those concerned could hardly have given the impression that they had already heard of them.

4.4 On 25 April the principal instructed the SEO in charge of the Licensing Unit to write to Barlow Clowes asking them why they considered themselves not to be in breach of section 1 of the Act. He said that he had held up action on the case because he had understood that the partnership had applied to NASDIM for membership. Mr Grant (the then Chief Executive of NASDIM) had he said "told me a couple of weeks or so ago that the ball is in B Clowes court". But, according to FIMBRA, the NASDIM/FIMBRA records reveal no such application or consideration or rejection of such an application. Mr Grant himself has said that he has no recollection of such an application ever having been made. The principal told me in evidence that NASDIM became a recognised association of dealers in securities on 31 December 1983 and that it was recognised by Mr Grant and himself that during the transitional period there would be a number of dealers known to the Department who would wish to apply for NASDIM membership and about which the Department might have information. Regular meetings with NASDIM at the beginning of each month were therefore put in train to exchange information about common issues and common cases. It would, he said, have been during the course of these meetings and other contacts with Mr Grant that he would have gained the impression that Barlow Clowes had been enquiring about NASDIM membership and since there was nothing, he said, to suggest at this stage that the firm was different from other similar cases, it was reasonable, he thought, to wait a while to see the outcome of the approach to NASDIM. (Mr Grant, for his part, has said that he recalls no enquiry about membership having been made to NASDIM by Barlow Clowes but has explained that whereas he would definitely have known about an *application*, he would not necessarily have been told of an enquiry by a would-be applicant.) The SEO wrote to Barlow Clowes and Partners at their London address on 22 May. He said that from the various advertisements and brochures seen by the Department, and in view of the wide definition of "dealing" in section 26 of the Act, the partnership appeared to be carrying on the business of dealing in securities. As they were neither licensed nor otherwise exempt from licensing, they appeared to be in breach of section 1 of the Act—a criminal offence. He invited the partnership to explain why they felt that they did not need a licence. The SEO explained in evidence to my officers that although he had noted the Jersey address from the Portfolio 28 brochure he had assumed that its full relevance would have become clear once the firm had applied for a licence (see also 4.25 below). Between receiving his instructions on 25 April and writing the letter on 22 May, the SEO had checked with CIB (on 30 April) that their earlier enquiries into Farrington Stead had not revealed anything of significance about Barlow Clowes (see 3.7).

4.5 In the meantime Barlow Clowes had come to the attention of both the Stock Exchange and the Bank of England. On 24 May a Stock Exchange official telephoned the Bank, reporting that the Stock Exchange could not understand how Barlow Clowes could be offering such high returns. He said that they had also had some complaints from clients about slow settlement when making withdrawals and that a number of firms had complained to the Stock Exchange about Barlow Clowes's activities. The Bank official subsequently checked to find that the Bank had not received any complaints. The Stock Exchange official later expressed concern to the Bank that Barlow Clowes did not appear to be subject to any regulatory body and was told that the Bank would consider whether the partnership's activities fell within the Banking Act's definition of "deposit-taking". On 30 May the Bank official telephoned the Department and spoke first to the SEO responsible for unit trusts and then to the Licensing Unit SEO. Neither of the DTI officials made a note of the telephone conversation (and the latter told my officers that he had no recollection of it). The Bank's note of the conversation is to the effect that the Bank official had asked the Department if Barlow Clowes were operating an unauthorised unit trust and that the DTI official had replied that

DTI were currently interested in the firm believing it possible that they might be dealing in securities without a licence. On 31 May the Stock Exchange official telephoned the Licensing Unit SEO saying that a vague feeling of unease about Barlow Clowes and Partners was developing in the Stock Exchange. He reported that some brokers had found them to be slow payers and that only one broker was currently taking orders from them. He said that Barlow Clowes had been investigated but cleared of impropriety in the Hedderwick affair but that they were running the same kind of business as Farrington Stead—which was in fact a hive-off from Barlow Clowes. The Stock Exchange thought that the partnership would have difficulty in paying the high minimum rate of return offered in the current market conditions without eating into capital. He also thought that Barlow Clowes were pooling clients' funds. He estimated that they had many millions of funds under management. The SEO told him that the firm had come to the Department's attention through its advertising but that they had not heard any rumours of liquidity problems. The SEO said that he was waiting to hear from them in reply to his letter and he promised to look at the answer "with jaundiced eye".

4.6 On 11 June another Bank official telephoned the principal who told him that the Department had not pressed Barlow Clowes to apply for a licence because they had understood the firm to be applying to NASDIM. The principal said that DTI knew nothing against the firm. The Bank thereupon decided to write to Barlow Clowes about their position under the Banking Act but did not actually do so until 23 July—see 4.8 below. Meanwhile, in early June 1984 the Stock Exchange passed on to the Bank of England information which they had received that Barlow Clowes had been refused authorisation in Jersey. And on 8 June the Bank telephoned the Economic Adviser's Office in Jersey to check the position. They told the Bank that Barlow Clowes had been refused permission to advertise their services from a Jersey address because they did not like the content of their advertisements. On 12 June the Economic Adviser's office wrote to the Bank. They said that in addition to the fact that Barlow Clowes did not have a licence to trade in the island they had not been happy with the content of advertisements relating to their activities in Jersey but they understood that all correspondence was now being handled by a Swiss accountant and that what little link had existed between Barlow Clowes and Jersey had now been extinguished. Neither the Bank nor the Stock Exchange appear to have passed this information on to the Department; nor did the Jersey authorities who have told me, however, that if the Department had approached them for information about the Jersey partnership they would have seen no difficulty about passing on such information as they had about the Jersey activities and the action they had taken or were intending to take.

4.7 On 15 June the SEO sent the partnership a reminder letter which resulted in a telephone call on 19 June from Mr Clowes who said that he found the Act unclear and had had conflicting legal advice about it. He said that all of his dealing was done through stockbrokers and that he was minded to await the new investor protection legislation and "fitting in" to that regime. The SEO, however, told him that if he wished to deal in securities now, as it appeared from his literature that he did, then he should regularise his position straightaway. Mr Clowes told the SEO that he had considered joining the Stock Exchange, becoming an exempt dealer, or joining NASDIM or becoming licensed. He claimed to have substantial indemnity insurance and asked if he might attend the Department to discuss their current interpretation of the Act. The SEO said that their interpretation had not changed much over the years but that the Department would be ready to meet him if he were first to write in outlining the purpose of the meeting. In an undated letter, received by the Department on 2 July 1984, R J Anders & Co (solicitors) on behalf of their clients, Barlow Clowes and Partners, claimed exempt status under section 16 of the Act—dealing with special exemption for traders only part of whose business constituted dealing in securities—on the grounds that (i) Barlow Clowes's main business was statistical analysis and (ii) the greater part of the business of dealing in securities was effected through the agency of a member of the Stock Exchange. R J Anders asked for an appointment to discuss the matter. Replying on 6 July the SEO said that exempt status under section 16 could not be assumed; an order of exemption was required and this would only be issued if the Secretary of State was

satisfied that the applicants' business met the necessary criteria. The SEO said that no application had been received from Barlow Clowes and Partners but that his view was that, if it were, it would be unlikely that exempt status would be considered appropriate. He invited further written comments before arranging a meeting, on what steps the partnership were taking to avoid infringement of sections 1 and 14 of the Act. R J Anders & Co replied on 18 July promising to write again shortly, after they had discussed the matter with their clients. On 24 July they wrote again saying that their clients had decided to apply for a licence and they asked for the necessary application forms. The SEO sent these on 31 July.

4.8 The Bank of England wrote to the partnership on 23 July drawing their attention to section 1 of the Banking Act. They sought some response by the end of August and suggested that a meeting might be helpful. Barlow Clowes replied to the Bank on 30 August requesting a meeting about their position under the Banking Act. Meanwhile, "an apparent professional" had telephoned the HEO in the Department's Licensing Unit asking if Barlow Clowes and Partners were licensed. He said that the firm were prominent gilt traders advertising a number of schemes. He said that he and his colleagues were concerned because recent advertisements and circulars had sought deposits in Swiss bank accounts "under nominee accounts initially drawn in favour of the company". He promised to send a specific advertisement or circular. On the following day the HEO received a note from Mr Bob Webb of Financial Management Services referring to their telephone conversation. Mr Webb enclosed an advertisement and said that many people had asked him if Barlow Clowes and Partners were sound. He said that he was reluctant to answer such enquiries when the firm appeared neither to be licensed nor a member of NASDIM. He hoped that they had some sort of exemption. The advertisement he enclosed with his note was in respect of the Gilt Monitor Service and it invited people to write for more information to the Warnford Court address. The HEO referred the matter to his SEO on 24 July who remarked that the advertisement made "no mention of Swiss bank accounts". He wrote thanking Mr Webb on 10 August saying that the matter was currently being looked into.

4.9 On 12 September Mr Grant of NASDIM telephoned the HEO reporting that he was hearing "alarming noises on the grapevine" about Barlow Clowes. The HEO reported this to the SEO who spoke to Mr Grant on 19 September. Mr Grant told him that Barlow Clowes had not applied to NASDIM for membership. He had heard "gossip" including a suggestion that Barlow Clowes were having to cut staff because of cash flow problems. He promised to let the Department know if he received any firmer evidence. He said also that he had heard that Barlow Clowes had applied to the Bank of England to become a licensed deposit-taker. By way of background Mr Grant explained, in evidence, that NASDIM had been aware of Barlow Clowes, who had been promoting themselves by a discreet but prestigious form of direct selling through advertisements which must have required a considerable advertising budget. He said that at the time of his conversation with the HEO there was considerable concern about the Barlow Clowes product and how such an advertising campaign could have been sustained. He said that it had turned out that Barlow Clowes had been even bigger at that time than had been suspected. Mr Grant explained that he had had to be careful in what he had said because NASDIM—a "fledgling organisation"—could not afford to become involved in litigation for defamation. Furthermore, NASDIM had no standing in the matter because Barlow Clowes had not applied to them for membership. Mr Grant said that NASDIM received Barlow Clowes's advertisements from time to time from various of their members and that the only course open to them had been either to speak to the Department or to pass on such information to them. When asked if he had ever followed up his conversation with the SEO on 19 September with more information, Mr Grant replied that he had not because NASDIM had never received any clear evidence that something was wrong with Barlow Clowes. At the conclusion of his telephone conversation of 19 September with Mr Grant the SEO telephoned his contact at the Bank of England who said that the confidentiality provisions of the Banking Act prevented his discussing Barlow Clowes's affairs in detail; but he confirmed that although the partnership had met officers of the Bank they had not applied for a licence under the Banking

Act. (Mr Clowes and Dr Naylor accompanied by Mr Anders had called at the Bank on 18 September, when the history of Barlow Clowes had been explained and the Portfolio schemes 30 and 78 had been discussed.)

4.10 On 21 September the SEO referred the file to one of the Department's prosecuting solicitors "to seek your advice on what, if anything, you think the Department can and should do about the activities of this partnership, about whom concern has been growing for some time". The SEO said that the advertisements and brochures enclosed in the file made it appear far more likely than not that licensable activities were being carried on. He added, with reference to reports received from the Stock Exchange (4.5) and NASDIM (4.9), that the possibility that regulatory offences were being committed was however less worrying to him than doubts about the viability of the operations. He said that there were believed to be some millions of pounds of funds under management, and that if the business was under the authority of a licence there would be some hope that clients' money was being protected. As things were, there could be no such assurance. He had concluded that since the business was unincorporated the option of a section 109 investigation was not open to DTI and that prosecution for regulatory offences seemed justified, but would do nothing to reassure DTI that fraud was not present. He asked whether the solicitor could suggest any course of action which would enable the Department to ascertain fairly quickly whether any misuse of clients' funds was going on. The SEO added a postscript to the effect that he had had a request for more application forms which would seem to indicate that the firm were going to apply for a licence. The solicitor had not replied to this minute by the time the partnership's application for a licence was received by the Department on 7 November. When returning the file to the Licensing Unit (at their request) the solicitor said:

"So far as concerns the last paragraph of your minute ... in the absence of a complaint from individual investors it is difficult to carry out any meaningful investigation designed to ascertain whether activities are fraudulent or not, and in the absence of powers similar to those of s.109 even more difficult to ascertain whether there is any misuse of client funds. I shall be grateful to be kept in touch."

4.11 In the meantime, on 24 October, the Bank of England had sent to the principal responsible for the Licensing Unit some promotional material (including copies of explanatory letters sent to enquirers) which Barlow Clowes and Partners had left with them (at their meeting on 18 September) concerning the Gilt Monitor, and Portfolios 30, 30B and 78. The purport of this material, which emanated from the partnership's London address, was subsequently set out in a submission by the Bank to the Treasury on 10 December—see 4.20 below. The Bank also enclosed a copy of a letter which they had received from a member of the public. The enquiry, dated 18 October, had sought reassurance from the Bank as to the credibility of Barlow Clowes and Partners and an assurance that an investment with them would be 100% safe. The Bank's reply of 24 October (which, it seems, may not have been copied to the Department) had mentioned the various ways in which a dealer might be authorised to undertake such business and had pointed out that Barlow Clowes and Partners were not currently authorised in any of the ways mentioned. The principal was next involved on 31 October when he was passed a letter which had been sent to another official in Companies Division by the Controller of Policy and Planning at the Stock Exchange. This had called the Department's attention to Barlow Clowes as having advertised regularly as gilt-edged specialists but without apparently even being licensed dealers. The letter said "No doubt we could assemble chapter and verse on this if you wish but I thought you might be looking into them already". In his reply dated 16 November the principal said "I can tell you in confidence that an application for a licence has recently been received from this firm and is being considered here. One question which I shall be taking up with the firm will be its current, past and continuing breaches of the Act. If the firm is carrying on business in dealing in securities it is doing so in an unauthorised capacity with all that that entails". Also on 16 November the principal replied to a letter dated 30 October which he had received from Mr J L McKirdy of Noble Lowndes Personal Financial Services Ltd also drawing attention to the fact that

Barlow Clowes and Partners were in breach of the Act by dealing in securities and distributing circulars regarding investments. Mr McKirdy also questioned the accuracy of statements made in Barlow Clowes's literature about their guarantee and the allocation of stock to investors. In his reply the principal said that the Department were already looking into this matter. On 20 November a member of the Bank's Court wrote to the Bank of England expressing concern that the Department appeared to be taking no action about Barlow Clowes. A senior official of the Bank, first by telephone and subsequently by a letter dated 7 December, drew these concerns to the attention of the DTI under secretary concerned (see 4.19). The Department also received on 23 November from the British Insurance Brokers' Association a copy of the partnership's brochure on Portfolio 30.

4.12 The partnership's application for a licence submitted by solicitors J R Anders & Co reached the Department on 7 November 1984. The going-concern certificates required under paragraph 2 of part VIII of Schedule 1 of the 1983 Licensing Regulations (1.13 above) was signed by Messrs Walker & Vaughan, chartered accountants, and the certificates required under paragraph 1 of part VIII of the same Schedule (1.13 above) were signed by Mr Anders. The partnership's application for a principal's licence stated that the partnership had been established in 1972, the names of the partners currently being Mr Peter Clowes and Mrs Pamela Margaret Clowes. The address of the partnership's principal place of business was shown as 66 Warnford Court, Throgmorton Street, London EC2; and another office at Glendower House, 2 London Road South, Poynton, Stockport, Cheshire was mentioned. The nature of the partnership's business was shown as being limited to British Government securities, effected only through a stockbroker. It also included the sale of statistical information relating to gilts. Clients were described as "private". Sources of the partnership's business were listed as "responses from advertising, references from accountants, solicitors, financial consultants, insurance brokers, clearing banks, insurance services department and existing clients". The partnership's annual accounting date was shown as 30 June so that, as things then stood, the first monitoring return due under regulation 8 would be due to be submitted to the Department on 31 December 1985. The partnership's principal bankers were shown as Barclays Bank plc, 17 York Street, Manchester and the clients' accounts were shown as held at Midland Bank plc, Threadneedle Street Branch. Section 5 of the form, requiring information about other individuals who had been carrying on business on behalf of the partnership during the last ten years, was not completed. Individuals' application forms for principals' licences were submitted in respect of both partners. Mr Peter Clowes's form gave as his qualifications and experience 12 years full time analysis of the gilt market and said that he had been self-employed as a partner of Barlow Clowes and Partners from 1972. Mrs Clowes's form indicated that she had had six years experience of servicing private clients and professional advisers on the gilt market. She had been employed by Barlow Clowes and Partners as an assistant manager from 1974 to 1979. Forms to support the application for a principal's licence were submitted in respect of a number of companies in which Mr and Mrs Clowes had interests, including Barlow Clowes Nominees Ltd and Barlow Clowes Unit Trust Managers Ltd. Also submitted was a letter dated 25 September 1984 from Fenchurch, the partnership's insurance brokers, giving brief details of the partnership's professional indemnity and fidelity guarantee insurance policies.

4.13 On 8 November the SEO gave instructions for the usual checks to consultants (see 2.7) to be carried out as a matter of urgency. The unit despatched standard enquiry forms to the Stock Exchange, Fraud Squad, Office of the Official Receiver, the local police, Companies Registration Office ("CRO"), and CIB—all marked "Could you please reply urgently on this matter?" The Office of the Official Receiver and CRO replied on 12 November stating that they had no comment. The local police confirmed on 15 November that they knew nothing to the detriment of either applicant; but no reply was received from the Fraud Squad (which the principal has told me was not uncommon). The Stock Exchange Surveillance Division wrote on 16 November, having first spoken to the principal drawing his attention to the partnership's links with Farrington Stead and Hedderwicks. In

their letter of 16 November the Stock Exchange said that they had been aware of Barlow Clowes for some time, particularly during the investigation into the affairs of Hedderwick Stirling Grumbar & Co in 1978. They said that Hedderwicks had acted as consultant stockbrokers to Barlow Clowes in 1978 when Mr A G de Souza, then the settlement manager in Hedderwicks gilt-edged department, had been dealing in gilts through Barlow Clowes unknown to his firm. At that time Barlow Clowes had employed Messrs Farrington and Stead. The Stock Exchange enclosed a copy of the Council Notice dated 6 February 1980 which had announced the Hedderwick penalties following the 1978 investigation. They also enclosed a number of press cuttings concerned with the Farrington Stead and Hedderwick affair of 1981. The unit checked the position with CIB, who confirmed that there had been an indirect link between Farrington Stead and Barlow Clowes Ltd [sic] during the s109 investigation into Farrington Stead. Having checked the files, the SEO reported to the principal that the name of Barlow Clowes had cropped up in the Farrington Stead investigation but that the s109 report had not criticised Barlow Clowes and that no separate investigation into Barlow Clowes had been undertaken (see 3.7). Fiches for the various companies shown on the forms submitted in support of the licence application were obtained from CRO and points of significance were noted in FSCD's file.

4.14 On 21 November an article about Barlow Clowes appeared in the (London) Evening Standard. It reported that Barlow Clowes had been operating for over a decade but had only just applied to the Department for a licence. Mr Peter Clowes was reported as saying that the partnership did not need licensing because it was exempt under section 2 of the Act. The purpose of the licence was "to keep our options open" as they were also planning to apply to NASDIM for membership. Clients' funds were believed to be about £300 million, safeguarded according to Mr Clowes by a £10 million per claim professional indemnity insurance arranged through Sun Alliance. The principal saw this article and asked the Department's press officer to explain to the Standard that their report was incorrect so far as section 2 of the Act was concerned. He then instructed the SEO to send a copy of the article to NASDIM. (The principal told me that the article provided the Department's first indication of the size of the Barlow Clowes operation.) The solicitor who had provided the Barlow Clowes literature in 1983 also noticed the article and sent a minute to the principal in which he said there was no doubt in his mind that for some months Barlow Clowes had been holding themselves out as carrying on the business of dealing in securities. He pointed out that the section 2 loophole was not available. The newspaper article was also drawn to the attention of the Department by the Insurance Brokers' Registration Council who wrote on 30 November expressing concern about the reference to section 2 of the Act and surprise that the partnership had been able to secure the insurance protection described in the article. The principal subsequently replied indicating that the reference to section 2 had not been entirely clear. He said that the Department had been in touch with the Standard and with Barlow Clowes. The article in the Standard was noticed also by the Stock Exchange, who on checking with the principal were told that the section 2 loophole did not cover Barlow Clowes. The Stock Exchange's note of the telephone conversation recorded the principal as saying that if the Department concluded that Barlow Clowes were "a fit and proper" body, they were likely to be asked to serve a period of penitence before being accepted as licensed dealers. (The principal has, however, told me that he said no such thing).

4.15 On 25 November the principal wrote to R J Anders & Co listing a number of matters which he said might cause the Secretary of State to consider refusing the application and inviting them to attend a meeting at the Department to discuss them. The matters of concern were listed as:

- (a) The partnership had for some years been acting in breach of sections 1 and 14 of the Act and might also be operating unauthorised unit trust schemes whose promotion would also breach section 14.
- (b) No application for representatives' licences had been made or information provided about employees.

- (c) No information about the former partner, E E Barlow, which would have been required by part 5 of the application form if properly completed, had been given.
- (d) Certain services which appeared to be of importance in running the business were provided to the partnership by separate companies under the control of the partners but these arrangements were not considered to provide a satisfactory business structure for a business which would be engaged in providing investment advisory and management services to the general public. Some of the companies might also require licensing.
- (e) Further information was required about the nature, scale and organisation of the business in order to ensure that the business carried on in the London and Stockport offices was being properly supervised by the partners.
- (f) The partners' future intentions regarding Barlow Clowes Unit Trust Managers Ltd would be relevant to the application.

On 28 November the SEO noted the file to the effect that Messrs Herbert Smith had been asked to advise the partnership and that the firm hoped to arrange a meeting for the following week.

4.16 On the following day the principal wrote in the following terms to the prosecuting solicitor who had replied only briefly to the SEO's minute of 21 September (4.10). He said that the SEO had "requested you to initiate a prosecution of this partnership for various offences under the Prevention of Fraud (Investments) Act 1958 but subsequently requested the return of the file as the partnership has applied for a licence". He registered concern at the comments in the second paragraph of the solicitor's minute which had indicated that, in the absence of a complaint from individual "investors" it was difficult to carry out any meaningful investigation designed to ascertain whether activities were fraudulent or not. He said his concern was that this might imply that prosecution of the clear regulatory offences would also be difficult. It seemed to him that the Department had a clear duty vigorously to investigate and prosecute if necessary for regulatory offences and he was reluctant to accept the implication that no action about regulatory offences should be taken in the absence of complaints from investors, although he accepted that in this case the firm's application for a licence provided the Department with an alternative means of dealing with the matter. He said that it was relevant in this context that Mr Fletcher (who at the time had been the Parliamentary Under Secretary of State for Corporate and Consumer Affairs) had recently indicated that he expected to see the PF(I) Act vigorously enforced. He accepted that, because of its outdatedness, vigorous enforcement of all its provisions was not practical. However, in certain fields—specifically unauthorised dealing and the promotion of unauthorised unit trust or pooling schemes—he considered that the Department should be seen to be vigorously enforcing the law as reflected in the number and types of cases which had been referred to solicitors over the last two years. He hoped that the solicitor would find this statement of his policy objectives helpful and asked to be informed if it gave rise to any difficulties. The principal told me in evidence that by late 1984 when he had written this minute to the prosecuting solicitor, the unit had largely cleared the additional licence applications which had resulted from the 1982–83 publicity and he had considered that the Department had reached the point of being able to devote more time to unlicensed dealing and could reasonably take a stricter line, bearing in mind that firms had by then had adequate time to regularise their position. His minute had therefore been an attempt to signify a change of emphasis rather than any radical change of policy. He said that his comment regarding Mr Fletcher had not been meant to indicate that there had been any change of policy. Sir Alex Fletcher, as he had then become, confirmed to me in evidence shortly before his death that this was his understanding also. Departmental policy had been to regard unlicensed dealing as "technical" and Ministers had agreed that prosecutions for technical offences alone should not be pursued (see 2.3).

4.17 On 30 November the principal prepared a brief for the meeting with Barlow Clowes which was expected to follow from his letter of 23 November. The line of questioning which he proposed covered:

- (a) Breaches of the Act and details of present and proposed business including the unit trust aspect and the need for properly maintained client accounts.
- (b) Employees and their past connections with Farrington Stead and Hedderwicks.
- (c) Relationship between the partnership and all the other companies involved.
- (d) Business structure and business plan and scale and source of business.
- (e) Possible breaches of the Banking Act 1979.

On 3 December the SEO suggested that it might be worth probing the fact that the partnership had an address in St Helier Jersey. The principal enquired where this information was from and asked to be given the file by 2pm on 17 December. The SEO wrote against his enquiry "Portfolio 28" and a note from the principal to the SEO at the top of the minute sheet and dated 17 December 1984 reads "Thanks". Following this exchange, the principal added a further note "Partnership based in Jersey? (see Portfolio 28)" at the foot of his brief for the meeting. The principal told me that what he and the assistant secretary had seen had been an off-file copy of the Portfolio 28 brochure, but the SEO told my officers that he thought it very unlikely that the brochure would not have been on the file at the time.

4.18 On 4 December 1984 the principal wrote to the Assistant Treasury Solicitor. He said that the Department were concerned both about regulatory offences and the safety of the funds under management. He summarised the grounds for uneasiness as follows:

- (a) The business was unincorporated.
- (b) It seemed to be controlled by one man, Peter Clowes.
- (c) Former employees had been Messrs Farrington and Stead, whose activities had brought about the collapse of Hedderwicks.
- (d) The Stock Exchange had expressed disbelief that the firm could pay its guaranteed return on gilts invested without eroding client capital and the Stock Exchange and NASDIM had passed on gossip from their members that Barlow Clowes was a slow payer and might have cash-flow problems.

The principal said that the situation might become a real emergency and asked the Treasury Solicitor to consider what measures might be open to the Department. He said "I am, as you see, hunting around for ways in which we might react to a hypothetical situation". The Assistant Treasury Solicitor, replying on 7 December, agreed that the Department's main difficulty was that the investigative powers available to it under the companies legislation did not extend to unincorporated bodies. He suggested that it should be put to the Department's own solicitors that the Department might consider writing to the partnership saying that in view of past breaches and the substantial funds under control, no licence would be granted unless the partnership allowed access to its books and papers and gave sufficient answers to questions thereon to enable the Secretary of State to be satisfied that the firm's conduct of business to date had been consistent with the requirements of the Licensed Dealers (Conduct of Business) Rules 1983. In the event of a refusal by the partnership he suggested that the Department should discuss with their prosecuting solicitor the possibility of applying to a magistrate for a search warrant under s14(8) of the Act so that the police could seize the firm's books and papers with a view to prosecuting any section 1 or Theft Act offences if any were discovered (but see below). He suggested that if by means of some enquiry serious defaults were discovered there was a possibility that civil as well as criminal proceedings might be appropriate. He said that it would be well worthwhile seeing if Treasury Counsel would be prepared to advise that the Attorney General should claim and attempt to exercise a power to apply to the Court for the appointment of a receiver (and later trustees) to take control of investors' funds and assets and protect them. He said "we would be trying to make

new law but ... your Department has, after all, a general function of protecting the interests of the investors". He quoted Treasury Counsel, on the other hand, as having said "The Department of Trade is not a person for whose protection the Act was passed: it is the Government Department which is entrusted with the regulation of the business of dealing in securities by means of the system of licensing which is prescribed in the first nine sections of the Act". He thought that if the Department were to adopt civil proceedings the only way would be to persuade the Attorney General to apply, either *ex officio* or in relator proceedings, for an injunction. But the Courts were only likely to agree this procedure in the most exceptional cases. He thought that in this case the Court might be persuaded if it could be shown that large funds were in serious jeopardy and sufficient urgency existed but that the Department would also have to have a fixed intention to prosecute either under the PF(I) Act or the Theft Act. Shortly after he had written this letter, the Director of Public Prosecutions' office ("DPP") advised the Assistant Treasury Solicitor that his suggestion of using documents seized by the police as the basis of civil proceedings conflicted with DPP policy.

4.19 Also on 7 December a senior official of the Bank of England wrote to the under secretary at DTI referring to two earlier telephone conversations they had had on the subject of concerns expressed by the member of the Bank's Court about Barlow Clowes (see 4.11). He mentioned also a telephone conversation which had taken place the previous week between a Bank official and the principal in which the official had expressed "serious concerns" about the position of Barlow Clowes under the Banking Act. In his note of conversations with the principal the Bank official recorded that the Bank had concluded that Barlow Clowes had been contravening section 1 of the Banking Act and that they were alerting the Treasury to their serious concerns. They were also considering inviting Peter Clowes to come to the Bank to discuss the regularisation of his business. The principal had asked the Bank to defer writing to Mr Clowes for a few days, fearing that it might make Mr Clowes less co-operative. At worst he felt that there was a danger that Mr Clowes would flee the country taking with him as much as possible of clients' funds. The Bank agreed to delay action for a short time. The Bank official recorded the principal as saying that he thought it possible that Barlow Clowes would be granted a licence notwithstanding past breaches of the Act and that it counted in the firm's favour that they had been operating successfully for ten years without complaints. The official suggested that Barlow Clowes might have been able to repay investors simply because they were always taking in new money and he drew attention to the high profile advertising policy the firm had adopted in the weekend national press. The principal agreed that no licence would be granted until the Banking Act point had been settled. The Bank official's note was endorsed by a senior official "We have already been warned of the activities of BC by a city member of Court (as gentle but clear a warning as we and DTI could hope to receive) and I would be grateful if you would write to put clearly on record to the deputy sec/under sec that we are concerned about this case and, in particular, troubled that there is any thought of granting a licence". It was this note which later had led to the senior Bank official's letter of 7 December to the under secretary referred to above in which he also passed on the comment that the Bank were much troubled by the possibility that the Department might grant Barlow Clowes a licence notwithstanding past offences and asked for reassurance on that score.

4.20 On 10 December the Bank briefed the Treasury on a number of cases of possible illegal deposit-taking including Barlow Clowes. The brief included summaries of Portfolios 30 and 78 and expressed the Bank's concerns in the following terms:

"2. In the cases of both Portfolio 30 and Portfolio 78 it seems that BC is accepting deposits as defined in section 1 of the Banking Act, because it offers, in terms, to guarantee the full repayment of the investor's original investment. It appears also that BC is using these deposits in a manner that constitutes the carrying on of a deposit-taking business because by investing money received by way of deposit in gilts it is financing its business to a material extent in terms of section 1(2)(b). Insofar as it invests in gilts in the primary market, it may also be lending deposits to others (ie HMG) in terms of section 1(2)(a).

3. Under the Portfolio 30 scheme it seems that the clients opt for a particular maturity date, and a high yielding stock, maturing in that year, is chosen. Subsequently, we understand, gilts are switched on a thrice-yearly cycle to ensure that the client takes his profit as capital gain, not income. BC can give their clients a guarantee in the sense that they know the amount of interest that will accrue, and the value of the capital at the maturity date. According to BC's brochure, the investor will be guaranteed the full return of his original investment if he waits until the relevant maturity date (of the gilt-edged stock concerned) but not otherwise; if he wishes to realise the investment before the maturity date he may suffer a loss. However, despite this risk of loss, it seems that BC is, in terms of section 1(4), accepting money on terms under which it will be repaid in circumstances agreed, the circumstances being that the investor waits until the maturity date.

4. Under the Portfolio 78 scheme, the underlying investments are also gilt-edged stocks. The precise details of the scheme remain somewhat obscure, but the terms on which the investment will be redeemed seem clear enough. In the words of BC's letters to enquirers about the Portfolio 78 scheme, "The value of your capital will be 100% guaranteed and because there is no initial charge you can withdraw at any time without loss or penalty". It appears therefore that BC, in accepting money from an investor in the Portfolio 78 scheme, is accepting, in the language of section 1(4), a sum of money paid on terms under which it will be repaid in circumstances agreed, the circumstances being in this case that the investor requests repayment.

5. The BC investment schemes came to the Bank's attention in the summer. As a result we wrote to them to point out the implications of the Banking Act with a view to seeking further information. In September we held a meeting with Mr Peter Clowes. Mr Clowes did not provide a clear or comprehensive account of BC's schemes. Furthermore it does not seem that BC have taken sufficient steps to ensure that they have adequate legal advice; despite the large scale and apparent complexity of BC's business, they apparently rely on a small firm of solicitors in Cheshire who may well be out of their depth, particularly as some of the legal issues raised are clearly complex. Since the meeting with Clowes we have taken Freshfields' advice and they have confirmed us in our original view that, although the legal position is not straightforward, the Portfolio 30 and Portfolio 78 schemes appear to involve BC in accepting deposits in contravention of section 1(1).

6. We now propose to hold an early meeting with BC to discuss how their position might be regularised. However, regularisation may not be without difficulty. First, as we have relatively little information about BC, it is not clear whether they would be able to fulfil the criteria for a licence under the Banking Act; from what we have seen so far, it seems that they might well not meet the requirements. Secondly, it is possible that a standstill on deposit-taking could lead to a liquidity crisis (although this should not occur if BC's assets are appropriately matched to their liabilities). Thirdly, if BC refuses to co-operate it might be difficult to prosecute. As you will see the legal position of the Portfolio 30 and Portfolio 78 schemes is not clear-cut and, in any event we would probably need more evidence to be able to take action in the courts. This may not be easy to obtain, given our lack of powers under the Act and our need to rely on BC's co-operation. We might also be reluctant to prosecute if this were to risk prejudicing the interests of the investors/ depositors.

7. The BC case must give the authorities serious cause for worry. BC is apparently carrying on a large-scale investment/deposit-taking activity without having to produce any accounts and without being subject to any form of supervision; it is not a licensed dealer in securities or a member of NASDIM, although I believe that it is now seeking a licence and has explored the possibility of obtaining NASDIM membership. Moreover, BC seems set on further expansion. Despite having a large number of clients already, it continues to adopt a high profile in advertising, particularly in the weekend national press. A copy of a typical advertisement is enclosed.

A recent article in 'The Standard'—copy also enclosed – indicates that BC has ambitious plans, apparently involving a 200-strong branch network. In view of the lack of supervision and accountability, fears must arise that the BC investment schemes have been imprudently run There must also be a suspicion that BC may need to attract new money to repay clients wishing to redeem their investments.

8. A major difficulty is that the authorities lack detailed information about BC. As noted above, the Bank has no powers to investigate institutions which are not authorised under the Act. Moreover, because BC is not a company, the DTI cannot use their investigation powers under the Companies Act. The DTI believe that BC may have contravened the Prevention of Fraud (Investments) Act 1958 and are aiming to hold a meeting with BC in the near future to discuss this in the context of their application for a licence to deal in securities.

9. It is clearly important that relevant Government departments and the Bank co-operate closely in this case insofar as confidentiality constraints allow. We have told the DTI of our conclusion on BC's position under the Banking Act and of our intention to hold a further meeting with BC to discuss regularisation. We, and the DTI, are conscious that we need to tread warily in case BC take any precipitate action which would be to the detriment of investors' interests".

I return to the Treasury's involvement in paragraph 4.30 below.

4.21 Meanwhile, on 12 December, the Bank told the principal in DTI of their action in reporting their concerns to the Treasury and, at the principal's request, outlined what those concerns were. The Bank's main worries were that Barlow Clowes were apparently contravening both section 1 of the Banking Act and the PF(I) Act; that they apparently had charge of a very large amount of clients' funds without being subject to any form of supervision or accountability; that the Bank had no firm information about Barlow Clowes and no powers to acquire such information; and that there was a possibility of fraud. Two days later the Bank declined a request by the principal to provide the DTI with a paper about their concerns to supplement what they had already told him over the telephone. The principal's response was that he would thus have to convey their concerns to his superiors as best he could. The principal also suggested to the Bank that any move on their part to take action independently could prejudice his attempts to secure the co-operation of Barlow Clowes and he asked them to hold back from writing to them until the outcome of his forthcoming meeting with Barlow Clowes had taken place. This the Bank agreed to do. On 17 December a recipient of the Bank's note of this conversation spoke to the DTI principal's immediate superior (the assistant secretary) to confirm the agreed approach. He reported the assistant secretary as saying that he was only concerned that the Bank should do nothing publicly to alarm anyone about their concerns over Barlow Clowes. The Bank official was happy to give this assurance.

4.22 On 17 December, the day before that on which it had been arranged to meet representatives of Barlow Clowes and their legal advisers, the principal briefed his assistant secretary who was to chair the meeting. He said that it was unclear whether the partnership was honest but ignorant of the PF(I) Act or whether it was a fraudulent operation. However, given the extent of the present business and timing factors he said the option of, in effect, not deciding and referring the matter to the tribunal for investigation was not one which he recommended. He argued that they needed to decide either to license them or to put an end to their illegal activities. He reviewed the two possible means of enquiring into the safety of the funds under management suggested by the Assistant Treasury Solicitor (4.18) and indicated a preference for the first option of persuading the partnership to give them access to its books and papers, seeing the second option—a search warrant—very much as an unsatisfactory fall-back position. He pointed out that section 14(8) allowed seizure of illegal circulars but did not extend to the firm's books and papers. He referred to the Evening Standard report (4.14) and suggested that much of the £300 million referred to might have been obtained in the last few months and

that the absence of complaints might therefore not be very relevant. The brief gave the first indication that I have seen in the Department's papers of an awareness by officials that advice given to the partnership in 1975–76 over the need for a licence "could well have been misinterpreted". In a postscript referring to the Banking Act, the principal said:

"The Bank's concern stems from BC's Portfolio 30 and 78 schemes. These appear to be unauthorised unit trusts. The Bank (rather unconvincingly in my view) claim that, because capital certainty is offered the partnership is also taking deposits in breach of the Banking Act (see section 1(5))".

(The principal has explained to me that "unconvincingly" reflected his understanding of the DTI view although he had not before then been able to consult the Department's lawyers). On the day of the meeting, the prosecuting solicitor to whom the principal had written on 29 November (4.16) replied. She pointed out that the SEO's minute had asked not for prosecution but for advice on whether she could suggest any course of action which would enable the Department to ascertain fairly quickly whether there was fraud or any misuse of clients' funds going on. After reviewing the considerable difficulties in investigating the activities of persons carrying on business otherwise than with the benefit of incorporation, the solicitor concluded that it was probably impossible to satisfy oneself whether or not there was fraud or misconduct without information from clients and others who had dealt with the individual or firm, or possibly been employed by it, though the evidence provided by the latter would have to be viewed with caution. She concluded by saying: "While I recognise your policy objective, I hope you will now appreciate the practical difficulties".

4.23 The meeting duly took place on 18 December, attended by the assistant secretary, the principal, the SEO and the assistant solicitor for the Department, Mr Clowes and Dr Naylor of Barlow Clowes and Partners and two representatives (one of whom was a partner to whom I shall refer as Mr A) of Herbert Smith. According to the Department's note of the meeting, the assistant secretary referred to the Department's concern about past breaches of the PF(I) Act but indicated that their main concern was for the present position of investors and the future conduct of business if a licence were granted. Mr A acknowledged that there had been deficiencies in the information provided at the time of the original application for a licence and guaranteed to make these good. He said the background to the circumstances which had given rise to the impression that there had been regulatory offences would be explained and he could give an assurance that there had been no malice in past events. Mr Clowes said that he had been misquoted by the Evening Standard and now that he was on notice that his business was licensable he had made an application and suspended his advertising. He said that the partnership had been formed in 1972, Mrs Barlow (who had taken care of client matters) having retired in 1978 and been replaced by a Mrs Solomons. Mrs Solomons had subsequently withdrawn when most of the business had been transferred from Stockport to London. He said that his computer packages enabled him to keep meticulous records with a small staff and at a low cost. The system provided security, controls and accountability. He catered for private clients who remained beneficial owners of their investments and there was no unitising. He said that client funds were fully segregated and kept at Midland Bank. He claimed to have himself made good the losses to his clients—which he said had amounted to some £6,500—following the collapse of Hedderwicks and he said that concern that such an occurrence should not happen again had led him to consider using Midland Bank as a custodian trustee. Furthermore, he had substantial indemnity cover and rules designed to ensure the proper conduct of business. He said that stock was currently registered in bulk in the names of Midland Bank (Threadneedle Street Nominees) Ltd or Barlow Clowes Nominees Ltd. The bank did not know the names of individual owners but this information was readily available on the partnership's computer. The bank had been given notice that the stock and cash were held for clients. Mr Clowes said that he did not accept discretionary funds. He chose a particular investment package according to the circumstances of the investor and if the investor decided to proceed he would be asked to send his cheque payable to Barlow Clowes and Partners Clients' Account. When the cheque cleared, the stock would be bought and registered in the name of

Midland Bank. Barlow Clowes regarded themselves as agents. Interest on the client account was used to meet bank charges and the balance credited *pro rata* to clients on a paid/day basis which was easily calculated by the computer. No client received more than his own accrued interest or was paid with another client's funds. Mr Clowes said that he had about £100 million of clients funds and a similar sum under the direct control of clients was being invested under the guidance of his statistical service. He said that he would obtain written confirmation from Midland Bank that clients' funds were fully safeguarded and would submit a written summary of his systems.

4.24 The Department's note goes on to record that at this point there was a break to allow each side to confer privately. After the break Mr A said that he wished to put on record that his client's misunderstanding of the Act and his need for a licence had been the product of correspondence with the Department in the 1970s which might have been misinterpreted and incorrect advice from his lawyers. The partnership were happy for the Department's officers to have informal access to their records provided that a representative of Spicer and Pegler (to whom I shall refer as Spicers) "who had recently been appointed auditors to the partnership" could be present to provide explanation and speed things up. The assistant secretary noted these remarks and said that his concern was that client money was and would remain safe. Having heard the visitors he now needed verification. He was content for it to be carried out in the way described and would put terms of reference on paper. The Midland Bank and possibly, later on, Barclays Bank would need to be told of the investigation. It was noted that advertising had been suspended and the Department made clear that they had no power to grant prior immunity from prosecution if the partnership continued to respond to enquiries from the public by sending out circulars. The principal asked for the partnership's accounts to be made available in advance of the inspectors' visit, which was to take place as early in January as possible. In the meantime Mr Clowes and his solicitors were to provide a paper on the partnership's trading plan and would make good the various deficiencies in the licence application forms which had been pointed out to them.

4.25 The Department's note of the meeting contains no mention of the Jersey business. However, in evidence on the point the principal said "I recall that we asked Mr Clowes about the Jersey operations at the December 1984 meeting and were told that Portfolio 28 was the version of the firm's investment management plan which was designed for expatriates and, for tax reasons, was located in Jersey but was, to all intents and purposes, managed from London. I believe that, at that time the Jersey plan had only just been established and was, in any event, a very minor part of the total operations". Likewise, the assistant secretary recollected in evidence that "we asked about the Jersey office at the meeting on 18 December 1984 ... Clowes said that its operations were confined to the expatriate market". My own enquiries on the point have established that none of the other officials, or indeed of the representatives of Herbert Smith, who attended the meeting on 18 December 1984 can recollect the matter of Jersey and Portfolio 28 having been discussed at the meeting in question. The SEO who had prompted the principal to raise the matter of Jersey and who prepared the Department's note of the meeting told my officers that his reason for raising it had been simply that he had felt that the meeting would provide a good opportunity to question Mr Clowes about all aspects of his business. He added that he had not thought the Jersey activities to be of particular significance in the context of a long meeting which, he said, had "concentrated on activities which were within the jurisdiction of HMG". The solicitor who attended the meeting (the same one who had received the literature about Portfolio 28 in 1983) told me that he had not realised until long after the event that the material appeared to have been sent to him from Jersey. He told me that had the point been noticed it would have been a matter of concern at the time that a Jersey partnership was sending material into the UK. When I interviewed the principal and assistant secretary concerned the principal said that he recollected that Mr Clowes had been specifically asked about the Jersey operation at the meeting of 18 December 1984 because Portfolio 28 had been one of the three portfolios known to the Department at that time. He noted that he had also been aware that the grant of a licence to the partnership would authorise the marketing

of the Jersey fund in the UK. He said that a licence authorised an individual rather than a particular scheme—including any new schemes a licence holder might wish to operate after the granting of a licence—so that the Department was not therefore obliged to consider in detail the schemes themselves when considering a licence application. The principal said that so far as the schemes themselves were concerned the Department's concern had however been whether they might have constituted unauthorised unit trusts. As to that, Herbert Smith's note of the meeting on 18 December 1984 records, among other things, that the question of whether Barlow Clowes was operating an unauthorised unit trust was left for future discussion. When I asked the assistant secretary whether they had contemplated making enquiries of the regulatory authorities in Jersey about the offshore activities of Barlow Clowes he told me that the Department routinely made enquiries of overseas regulators where an application to deal in securities was received from an overseas firm. He said that since Barlow Clowes's principals were based in the UK, consulting Jersey about Barlow Clowes and Partners' offshore activities had not been considered appropriate.

4.26 The principal telephoned the Bank of England to report the outcome of the meeting. He said that the Department were for the time being regarding Barlow Clowes as a basically honest operation and were proceeding on the assumption that they were licensable. He estimated that the proposed investigation (by which, he has told me, he meant the actual on-site investigation) would take two or three days. His preliminary conclusion from what Mr Clowes had told him was that the partnership were effectively running an unauthorised unit trust and that certain features of the scheme, such as the provision for monthly income, would have to be dropped before a licence could be granted. The Bank official recorded that in addition to the two portfolios, 30 and 78, which had been mentioned to them, DTI had been told about Portfolio 28 "which is based in Jersey". On 20 December 1984 the principal briefed the CIB chief examiner who was to carry out the investigation, explaining that the division's preliminary conclusion following the meeting on 18 December was that the firm were basically honest but that the position regarding client assets needed to be confirmed, a clear indication being needed that systems and assets were in order or that they were not. Past breaches of the Act were not a matter CIB needed to become involved with but rules 3, 4, 20–22 of the 1983 Licensed Dealers (Conduct of Business) Rules—see Chapter 1 of my report—were relevant to what CIB should expect to find. He said that a representative from Spicers would accompany the inspectors. On the same day one of CIB's principal examiners formally instructed the chief examiner who was to be assisted by a senior examiner. He said the examination was to be confined to the receipt, recording and custody of clients' money and assets, with regard also being had to the overall system being used in dealing with clients and the handling of clients' cash and assets. He suggested that they should ask the auditors designate, Spicers, for basic material before attending the premises, where the minimum of time should be spent. CIB's report should concentrate in particular on the reconciliation of clients' accounts with assets held and, so far as possible, information and explanations should be sought from Spicers and employees rather than the partners. He said the enquiry should be kept short—two weeks at most. The Solicitor's Office was kept informed of the situation and the prosecuting solicitor expressed doubts as to whether information obtained during the voluntary investigation could be used in any prosecution.

4.27 Also on 20 December, the assistant secretary sent draft terms of reference to Herbert Smith, confirming that no announcement of the investigation would be made. Herbert Smith replied on 4 January 1985 pointing out that Spicers were not the auditors of Barlow Clowes but had recently been retained as advisers in terms of management consultancy work and, in due course, accountancy work. They suggested a minor amendment to the terms of reference which the Department agreed. The agreed terms of reference were:

"Barlow Clowes and Partners agree to officers of the Department of Trade and Industry carrying out an examination of the partnership's books and papers, with particular reference to the verification of the client assets held by the partnership and the internal arrangements for dealing with, and holding client assets and the recording of client transactions.

To this end Barlow Clowes and Partners agree:

- (1) to produce forthwith to the Department's officers on request any books and papers in their custody or power;
- (2) to allow copies, or extracts, to be made;
- (3) to provide, on request, explanations of the books and papers;
- (4) to arrange for third parties to afford similar access in relation to assets held for the partnership or its clients and records kept in respect of such assets.

The terms of reference will be to consider, without reference to any statutory requirements which may or may not be relevant, whether (with the exception of any trivial errors which are put right on being drawn to the attention of the partnership without loss to the clients) all moneys and property for which the partnership, or any person holding on behalf of the partnership, is or has since the beginning of 1983 been liable to account to clients are (or as the case may be, have been) held in such manner as to offer adequate protection to the clients against the insolvency of the partnership or misfeasance on the part of the partners or any person employed by or associated with the partnership, and generally whether the management and structure of the partnership and the persons associated with it is such to command confidence as to the ability of the partnership to manage substantial sums on behalf of others".

The CIB investigation officers told me that they had seen as the starting point of their investigation—in accordance with the brief and with the principal examiner's instructions of 20 December 1984 (see 4.26 above)—a need to reconcile the total of cash and stocks held on behalf of clients with the total of client account balances. This did not mean (they said, in answer to my question on the point) that if such a reconciliation had been achieved, consideration would not have been given to the wider issue of the partnership's solvency, including contingent liabilities to clients, guaranteed by their contracts but since they had not even got to the starting point, such wider considerations had not actually arisen.

4.28 The Department's papers show that on 21 December the principal had spoken on an informal basis to a manager of Midland Bank Trustee Company Ltd, asking what he knew of Barlow Clowes. The manager said that he had met Mr Clowes two years previously when he had been negotiating for custodian arrangements which the bank had not then been able to provide although the discussions had recently been re-opened. He said that the firm had been a long-standing customer of the Midland and that Mr Derek Tree, the manager of the Threadneedle Street Branch was anxious not to lose the substantial business. He knew that securities were held for Barlow Clowes at the Threadneedle Street Branch but he did not know in whose name. He said his own view and that of the bank generally was that Mr Clowes was an honest man, the bank regarding him as a "valued customer". The principal noted the papers that the Midland's view was reassuring. He also noted that Herbert Smith had telephoned him that day to say that Spicers had confirmed with Midland Bank that the bank acknowledged that the assets they held belonged to clients. He noted the papers that that too was reassuring. Also on 21 December the principal wrote to Midland Bank notifying them of the impending investigation. He said that the Department had felt able to adopt this course only because it was satisfied, to the extent that they were in their hands, that the money and assets were safe from any eventuality. Replying for Midland Bank on 4 January Mr Tree said that the bank held significant amounts of money and government stock "to the order of Barlow Clowes and Partners". There were a number of accounts, some of which were joint accounts with intermediaries who introduced business. They were aware that (with the exception of fees) the assets held were beneficially owned by clients but they did not know the identity of individual clients. He said that the bank would be pleased to co-operate with the investigation. He concluded, "... I should say that we have had no grounds to doubt the integrity of our customers and it appears that they have gone to some lengths to arrange their business so that investors are protected from any failure of

the partnership or fraudulent action by Barlow Clowes staff. Having said that, we must point out that all the money and stocks we hold are at the disposal either of the partnership solely, or jointly with the intermediaries mentioned above, and this clearly limits our ability to exercise any real control over events". The principal acknowledged Midland's letter on 14 January. He told me in evidence that one of the purposes in writing to Midland had been to bring to their notice the Department's regulatory concerns. As regards the statement that all the money and stocks the bank held were at the disposal of the partnership, the principal commented to me that this was no different from other kinds of client account for example those operated by solicitors. He said that the kind of custodian arrangement referred to by the other Midland Bank manager would have afforded investors with Barlow Clowes a higher standard of security than was actually given to them under the Licensed Dealer Rules but he added that Barlow Clowes's existing arrangements went beyond the requirements of the Licensed Dealer Rules and so provided a higher standard of assurance.

4.29 Meanwhile on 10 January the agreed terms of reference had been forwarded to CIB. The CIB officers immediately requested certain preliminary documents from Spicers and they visited their offices on 14 January when they were given the audited partnership accounts for the year to 30 June 1983 and the partnership's consents to approach third parties. Spicers estimated that the preliminary documents would be available by about 23 January. On 17 January, reporting to the assistant secretary on progress to date, the principal examiner said "... it has already become apparent that no overall reconciliations of clients' balances with securities etc have taken place for several years, if at all, and that the audit of the partnership did not include its dealings with clients". The CIB officers told me in evidence that they had been surprised to learn that there had never been an audit of the client accounts. On 16 January the chief examiner wrote to Spicers asking for a large number of documents as a starting point for CIB's examination. He said that he understood that no reconciliations of client balances had been carried out in the past but that such a reconciliation as at 28 December 1984 was in the course of preparation and should be available the following week. Spicers replied initially on 21 January, saying that some of the documents requested would require very large volumes of paperwork. They proposed, therefore, to provide full details only in respect of "Account 105" (an account in the joint names of Barlow Clowes and Partners and Fenchurch Life and Pensions Consultants Ltd). They thought that this would demonstrate the principles upon which the system for all clients was based and that the inspectors could look further into this (and the other funds) from the partnership's own records. Spicers wrote again on 24 January enclosing some of the requested papers which, they said, they had not audited. These included reconciliations of clients' balances for Account 105 but, as the chief examiner told me, this in isolation meant nothing because all of the accounts needed to be reconciled on the same date. In a further report to the assistant secretary on 29 January, the principal examiner said that only a small part of the documents requested had been supplied. He said that during the course of discussions it had been admitted that no overall reconciliation of clients' balances with securities/cash had ever taken place and that it had not yet been possible for Spicers to prepare any such reconciliation. They had, he said, recently reconciled the securities register with the stocks held on behalf of clients; but no cash reconciliations of individual accounts apart from Account 105 had been accomplished due to the failure of the partnership recording system to allocate residual cash balances amongst clients' accounts (a factor which the CIB investigators told me they had found very surprising). The principal examiner said that Spicers had indicated that it might be necessary to go back to the commencement of the partnership business in order accurately to allocate the cash. He said that the partnership's auditors, Walker and Vaughan, had explained that the partnership's accounts for the year to 30 June 1983 had only been audited as to expenditure and that the verification of the fee and commission income had been based on a random test check of some 90 client files. The principal examiner said that CIB had received no documents on three joint accounts or two discretionary accounts. It had not therefore been possible to commence a detailed examination nor to satisfy themselves as to the overall accuracy of the dealing records—the

main point of the exercise—nor had the CIB officers attended the business premises. He concluded by drawing attention to an article which had appeared in the Sunday Times on 27 January 1985 predicting that bond-washing would be outlawed in the next budget with adverse effects for Barlow Clowes's investors. The article said that funds under management were estimated at £400 million and referred to Portfolio 28.

4.30 During January the Bank of England and the Department agreed to keep in touch with developments. The Treasury also considered the earlier Bank of England submission (4.20) in January. On 7 January, in the context of a submission to the Economic Secretary on the subject of companies thought to be contravening section 1 of the Banking Act—including Barlow Clowes—an official said “I ... find the Barlow Clowes case very worrying, and I think it is a sleeping dog that cannot be allowed to lie”. He said that he proposed telling the Bank that while they recognised that immediate action lay with the DTI they were extremely unhappy with the position. Whilst fully recognising the risks to clients should a prosecution prove unsuccessful, his view was that extreme pressure should be put on Barlow Clowes to regularise their position under the Banking Act and that, if they were unwilling or unable to do so, the Bank together with the DPP should give consideration to prosecution since allowing Barlow Clowes to expand even further without supervision increased the risks. The submission was seen by the Chancellor and the Economic Secretary subsequently discussed it with its author, whose conclusion was agreed. In their letter of reply to the Bank on 18 January the Treasury said that they would be seeking an opinion from the Treasury Solicitor as to whether Barlow Clowes's activities constituted deposit-taking. They asked to be kept informed of developments particularly if there were delays on the DTI front and added that they would not regard it as acceptable for BC to continue unsupervised, or to continue to do what the authorities regard as unlawful business. In evidence the Treasury official has said that the Bank's purpose in notifying the Treasury had been to maintain pressure on the Department to resolve the question of Barlow Clowes, either by licensing them after satisfying themselves that the firm would be run on prudent and honest lines or by refusing a licence. He said that the Bank had been proceeding slowly on establishing whether or not a case existed for prosecution for illegal deposit-taking so as not to cut across the negotiations DTI were having with Barlow Clowes. Despite the worries expressed in the Bank's initial letter, neither the DTI nor the Bank had believed there was *prima facie* evidence of fraud.

4.31 Towards the end of January Mr Peter Hayes Chairman of Plan Invest Group plc wrote to his Member of Parliament who forwarded the letter to Mr Alex Fletcher (the then Parliamentary Under Secretary of State (the “PUSS”) at the DTI). In his letter Mr Hayes referred to a “very large firm” doing substantial business and advertising regularly, while being neither licensed by the Department nor a member of NASDIM. He said that there were “many rumours circulating regarding that firm”, and that he was concerned “that many existing investors of that firm and would-be investors may be put at risk”. He also expressed concern that a firm of such size should have been allowed to do so much business for such a long time without anybody in authority having made enquiries and having made sure that it was not acting outside the law. Although Mr Hayes did not identify the firm in his letter, the assistant secretary said in his covering submission to Mr Fletcher dated 18 February 1985 that the “very large firm” mentioned was “almost certainly Barlow Clowes and Partners”. The submission continued: “It is actually very small, but handles a large volume of funds. It has been a source of concern for some while, but the security of the assets is the prime consideration. There are difficulties, because the firm is a partnership and therefore outwith both the s 109 and s 35 powers (petition for winding-up). The firm agreed to a “voluntary 109”, the (inconclusive) results of which we are considering. A separate submission is likely to be forthcoming. This is not, of course, for external disclosure. But the case serves to make the point that the law cannot be enforced against persons unknown.”

4.32 On 13 February, when reporting the receipt of some further information from Spicers relating to the reconciliation of the stock of securities, the principal

examiner told the assistant secretary that while he (the assistant secretary) was considering the position outlined in his report of 29 January (4.29) he would be assigning his two CIB officers to work on other cases. On the same day a Bank official told the assistant secretary that Mr Clowes had contacted the Bank wishing to discuss his position under the Banking Act. He recorded the assistant secretary as saying that the CIB enquiries had now been halted but that there was no evidence of fraud and that Mr Clowes remained willing to co-operate. The Bank's record contains the statement: "As we already knew from informal discussions with CIB, Barlow Clowes's records were so incomplete that only a complete reconstruction of their records would enable an outsider to satisfy himself that assets and liabilities balanced. This will be a lengthy process". The assistant secretary disclosed to the Bank that the Department were considering with the Treasury Solicitor whether to ask the Attorney General to bring a relator action removing control of the business from the partnership to a trustee. Meanwhile, Mr Clowes had agreed not to advertise so that any flow of new money should be much reduced. On 20 February the Bank official wrote to the assistant secretary letting him know that the partnership had accepted that they were in contravention of section 1 of the Banking Act and that, although they had ceased advertising, monies were still being received from the public. The Bank had suggested that a restructuring of the business might avoid the need for Banking Act authorisation. In the meantime the Bank, in order not to prejudice the Department's course of action, had not required that illegal deposit-taking should cease forthwith. The Bank had obtained Mr Clowes's permission to discuss his affairs with the Department as clearly a co-ordinated response was sensible. On 23 February a member of the Solicitor's Office told the assistant secretary that early that day there had been a programme about Barlow Clowes on LBC radio. He said it seemed possible that the item was inspired by Barlow Clowes, which was "worrying".

4.33 I reproduce below the full text of two minutes which were written by the principal to his assistant secretary on 26 February 1985. The first of these minutes read:

"I spoke to [Mr A] of Herbert Smith & Co concerning the present stage of the enquiries. [Mr A] had spoken to you earlier in the morning and had indicated that Mr Clowes was about to go on two weeks holiday. We had therefore agreed that we should ensure that Herbert Smith had whatever authority they needed to push the enquiries along in Mr Clowes's absence. Hence the reason for my calling [Mr A].

2. I indicated to [Mr A] that, on the basis of present information, the most worrying aspect of the partnership's affairs was the absence of any audit of the client accounts. He took the hint and indicated that [Spicers] would be requested to do the necessary and that this work would not be held up pending Mr Clowes's return. In that respect the proposal I make in my other minute has now been accepted and the work set in hand. However I did not feel that it was appropriate to lay down any time-table at this stage and so the ball is in their court and, if they do not work quickly enough we may need to put some additional pressure on them.

3. [Mr A] wanted to know, in effect, whether a clean audit report would mean the grant of a licence. He re-affirmed that the partnership wanted a licence and would do whatever was necessary in order to obtain one. He accepted that I could not give an answer but I did give as broad a hint as I could that the position of the client accounts was the main outstanding point which we were still unhappy about.

4. I suggested to [Mr A] that, on Mr Clowes's return, we should have a further meeting to take stock of the position. [Mr A] readily agreed. He also mentioned that Herbert Smith and [Spicers] had made a number of suggestions to the partnership concerning the future organisation of the business and the accounting records. When asked whether this would be relevant in determining the licence application I confirmed that it would be a point we would bear in mind.

5. I was not able to get hold of either [the principal examiner or the chief examiner] before speaking to [Mr A] but it seemed important to get things primed up before Mr Clowes went on holiday. As it turned out the priming became action which, I am sure, is the right course to take at this stage.”

(Mr B of Spicers told me that he did not specifically recall having been told of the conversation on 26 February between the principal and Mr A but he said that the above note appeared to record in general terms the work which Spicers had at that time been engaged to perform.)

4.34 The second minute read:

“[The principal examiner’s] minutes of 29 January and 13 February 1985 refer. The “spot check” which we had asked CIB to carry out into this partnership has proved to be impossible to do, at least for the moment. The reason is that the client accounts kept by the partnership have never been audited. Thus the results of any spot check could not be accepted with confidence since there would be no way of knowing whether the records being checked have been prepared correctly in the first place. As I read [the principal examiner’s] minutes the only way in which we could satisfy ourselves as to the accuracy of the client accounts and the present position of client assets held by the partnership on trust would be for:

- a [Spicers] to carry out a complete audit of the client accounts—this may possibly need to go right back to day 1 although I rather suspect that in practice it would need to cover “only” the last two or three years; and
- b for [Spicers] to report to us the outcome of their audit which includes the verification of assets held on behalf of clients at a recent date (possibly the end of 1984).

2. In these circumstances there would seem to be little point in CIB doing any further work, at least for the moment, and [the principal examiner] has confirmed this conclusion. It is no part of CIB’s function to carry out free audits and the time which would be involved would be considerable. [Spicers] would be able to carry out such an audit that much more quickly because they have the back-up staff available.

3. Accordingly I suggest that we see the partnership again and indicate to them that we wish to see the outcome of the full audit of the client accounts by the end of, say, March by which time we will come to a decision in relation to the licence application. The implication will be quite clear. If [Spicers] can confirm the accuracy of the client records a licence will be granted, subject to the other minor points we have already raised with the partnership. If no satisfactory audit report is forthcoming then the partnership should not be surprised if a notice of intention to refuse their application is forthcoming.

4. I attach a draft submission [see below] setting out the details of this case which you may wish to consider putting further up the line or to Ministers. This suggests that, whilst we would give no promises in respect of prosecutions, we would expect the partnership not to actively seek any further business pending the resolution of this matter. The continued illegality of their continuing business is of course the concern but it is difficult to see how, short of putting them out of business, we can resolve that problem. They know they are acting illegally and that should put some pressure on them to comply with our demands. Having said that it is of considerable concern that the position concerning client accounts is in such a terrible mess and that no indication of the true position was given when Mr Clowes came in to see us before Christmas. It appears that [Spicers] are now trying to put things to rights. If they succeed then all well and good. If they don’t the partnership will face the consequences.

5. I would welcome (a) confirmation from [the principal examiner] that I have correctly reflected the results of CIB’s enquiries to date; and (b) any comments from copy addressees on the proposals made in this minute and the attached draft submission.”

The recommendation in paragraph 2 of the draft submission was in the following terms:

“It is recommended that no decision should be taken on this licence application until the partnership produce to the Secretary of State confirmation by [Spicers], the partnership’s accountants, that the client records have been properly maintained and that the clients’ assets have been properly handled. It is also recommended that no action be taken, for the time being, in respect of the partnership’s continued breach of the PF(I) Act.”

4.35 When I discussed these two minutes with the principal he said that it had never been the original intention that the CIB officers should conduct a full audit (that not being their function), nor had there been any question of their having been required to carry out an enquiry into the financial viability of the firm. He would of course have expected CIB to report on anything else of relevance that they had come across during their enquiry. What had been envisaged had been an exercise to demonstrate that the sums invested by clients were properly held and accounted for. The crucial point here, the principal said, was that Barlow Clowes had not carried the investment risk: they had merely managed investments on behalf of clients—there being no mingling of funds under the scheme and each investor owning his own investment. The principal explained to me that it had been because the CIB officers had not been able even to complete their limited brief (because of the deficiencies of the records themselves) that he had considered for the reasons given in his minute (4.34) that only a full audit would provide the degree of assurance that the Department now required.

4.36 On 4 March the assistant solicitor and CIB’s principal examiner both commented on the draft submission enclosed with the second of the above-quoted minutes. The solicitor said “We think that there is a serious danger that if the matter is allowed to drag on the Department will be held to be negligent if it turns out that something is wrong, particularly in relation to new business taken on since we became aware of the possible difficulties”. He said that his agreement to not being fiercer with Barlow Clowes on this point at the meeting in December had been on the basis that the voluntary investigation was supposed to have resolved the matter one way or another within a few days early in January. He said that although he had made enquiries several times, he had heard nothing formally until the principal’s minute of 26 February. He drew attention to the Revenue’s recent announcement about bond-washing and said that it was significant that Barlow Clowes had been mentioned on Radio 4’s Moneybox programme on 2 March and in an article (a copy of which he attached) in the Financial Times on the same date. He said that the uncertainty created by the Revenue’s announcement could well lead to a number of clients questioning their position, and if the result was that they were to enter into different arrangements then again “there is a serious danger that we will be held to be negligent if this activity is being carried on unlawfully (and there seems no doubt that it is) and we know about it and do nothing to stop it. My advice, therefore, is that the submission to Ministers should be cast in much stronger terms. It should seek authority for telling Barlow Clowes that either they stop taking on any new business, even through existing contacts and take steps to protect the existing assets or that we will take immediate action”. He concluded by saying that the Assistant Treasury Solicitor’s suggestion of a receiver might be a possible line of action to take in the event that this became necessary. The principal examiner in charge of the CIB investigation reported as follows:

“1. I refer to your two minutes to [the assistant secretary] of 26 February and note that an approach has been made to Herbert Smith & Co regarding the present state of play.

2. I have asked the chief examiner to prepare a report of his enquiries which will be forwarded to you; in the meantime he will not pursue those enquiries any further.

3. In general, you have reflected in your longer minute the results of our enquiries, ie there has never been, and is not now, any reconciliation of clients’ cash balances and securities held for clients. On one point of detail it

should be borne in mind that the partnership's auditors are still Walker and Vaughan; [Spicers] are management consultants brought in to advise on systems, as a result of which they have become involved in a major reconciliation exercise re clients' accounts—it is [Spicers'] own assessment that they may have to "re-work" the entries over some 8 years.

4. I would make the following comments on the draft submission:

Paragraph 2 — The clients' records quite clearly have *not* been properly maintained and the only assurance that could be given is that they have *now* been put in order.

Paragraph 6 — I feel that the first sentence is something of an oversimplification of the terms of reference part of which stressed the consideration of whether the holding of clients' money was organised in such a way as to offer adequate protection to clients against insolvency and misfeasance. May I suggest the quotation of the whole of the last paragraph of the agreed terms of reference.

[Spicers] are not, of course, carrying out an audit but a reconciliation exercise. The auditors say that they have not been instructed to carry out the 1984 audit.

Paragraph 8 — CIB cannot confirm that there has been a cessation of advertising and we cannot comment on the nature of the business at present being undertaken.

Paragraph 9 — CIB cannot subscribe in a submission to Ministers to the impression that those concerned are not fraudsters. Our officers have not met those concerned nor have they attended on the company's business premises and therefore cannot comment. More importantly to us there is everything to suggest that the *clients'* records have *not* been properly maintained! Those accounts have never been reconciled with cash in hand and securities held and [Spicers] have not succeeded in reconciling the accounts even after 3/4 months of work.

5. Overall my view is that while it may turn out to have been an accounting muddle a great deal of clients' money is at stake and a muddle in itself in the circumstances is deplorable. Our understanding from [Spicers] is that it could be some time before the clients' accounts can be fully reconciled and it would seem that the Department is fully justified in insisting on being fully satisfied as to the company's conduct before consideration is given to the granting of a licence; I recognise, however, that that decision is entirely for your side of the house.

6. CIB will, of course, be willing to give further assistance in examining records if and when [Spicers] succeed in getting anywhere near a resolution of the present problems."

The two CIB officers who carried out the investigation told me that they were in complete agreement with the principal examiner's comments.

4.37 On 5 March the Treasury official to whom I have referred in 4.30 wrote to the DTI under secretary advising him that the case of Barlow Clowes and Partners had been brought to the attention of Treasury Ministers, who were "most concerned that immediate action should be taken to regularise the position at Barlow Clowes". He said that he was writing to urge the Department to pursue their investigations into Barlow Clowes's application for a licence with all possible speed, so that their activities could "either be brought under proper regulation—either under the PF(I) Act or under the Banking Act—or, alternatively, stopped".

His letter was copied to the assistant secretary and to the appropriate official in the Bank of England. The under secretary asked the assistant secretary to keep him informed of progress on the case. He commented "The question is not a simple and straightforward one and ... in your reply to [the Treasury official] you should ask him whether there is any information he has which we should have on Barlow Clowes to enable us to come to a decision. If he has no such information then I am rather surprised at his letter which simply asks us to come to a decision quickly". The next day the Treasury sought advice from the Treasury Solicitor's Department as to whether the partnership were deposit-taking for the purposes of the Banking Act 1979.

4.38 When forwarding to the principal a copy of the investigators' report dated 7 March 1985, the principal examiner said that the control totals of stock held on the computer-maintained Securities Register showed stocks held for clients as at 28 December 1984 totalling £81,145,114 (presumed at acquisition price). The investigators' report read as follows:

"1. Barlow Clowes and Partners (hereinafter referred to as 'the partnership') the partners of which are said to be Mr Peter Clowes and his wife Mrs Pamela Margaret Clowes, carries on business as dealers in gilt-edged securities from 66 Warnford Court, Throgmorton Street, London EC2, from Glendower House, 2 London Road South, Poynton, Stockport, Cheshire and also from 39 Don Street, St Helier, Jersey. [see below] A copy of the partnership agreement has not been produced. The business of the partnership comprises the management of a number of portfolios for both direct clients and those introduced by third parties mainly engaged in a procedure known as 'bond washing' and an investment advisory service for clients styled 'Gilt Monitor'.

2. Following discussions between the partnership, Herbert Smith & Co, its solicitors, [Spicers], Chartered Accountants, its management consultants and the Department concerning an application by the partnership for a licence to deal in securities pursuant to the Prevention of Fraud (Investments) Act 1958, the partnership agreed on 4 January 1985 to an examination of its books and records in the following terms:

[See paragraph 4.27 for the terms of reference which were here stated.]

We, [the investigators] were assigned to carry out the examination.

3. By telephone on 10 January 1985 we requested, [the relevant partner of Spicer's to whom I shall refer as Mr B], to arrange for the production of various books and records necessary for us to commence our examination and on 14 January 1985 we attended by appointment at the offices of [Spicers] and collected various consents to approach third parties, including the partnership's auditors, and a copy of the partnership's audited accounts for the year to 30 June 1983 only. During the course of general discussions with [Mr B], when we questioned the feasibility of paying sums withdrawn by clients within two working days from receipt of notice of withdrawal as provided for in Portfolio 78, [Mr B] said he understood it was the practice of the partnership to make these payments from funds held in respect of other clients pending receipt of the funds from the realisation of the clients' securities. This would, of course, give rise to a deficiency of attributable funds in the relevant bank account in the interim period. [Mr B] told us that this practice was presently under review.

By letter dated 16 January 1985 to [Spicers], we confirmed the list of books and records previously specified which [Spicers] had indicated they expected to be available by 23 January 1985 and that we understood no reconciliation of clients' balances had been carried out in the past but that such a reconciliation as at 28 December 1984 was in the course of preparation. In a letter dated 21 January 1985 [Spicers] informed us that certain of the items requested would require very large volumes of paperwork and proposed initially to provide information in respect of Account 105 only (a joint account with Fenchurch Life and Pensions Consultants Limited), which would demonstrate the principles upon which the system for all clients is based.

By appointment we attended again at the offices of [Spicers] on 24 January 1985 and were given, under cover of a letter dated 24 January 1985 a small part of the documents requested:

- (a) Securities register as at 28 December 1984 for all accounts
- (b) List of clients' balances at 28 December 1984 and a list of securities/cash held on behalf of each individual account at 28 December 1984 for Account 105 only
- (c) Reconciliation of clients' balances for Account 105
- (d) Records of day-to-day dealings in securities for 1984 on all accounts
- (e) Bank statements for 1984 for the partnership and Account 105
- (f) Partnership cash book to 13 December 1984 and Account 105 cash book to 17 January 1985
- (g) Sample copies of partnership circulars and forms for completion by clients
- (h) Details of indemnity insurance
- (i) Details of fees charged to clients
- (j) Details of partners and staff and their duties
- (k) Identification codes.

During the course of discussions with [Mr B] it became apparent that Account 105 was the only account on which clients' balances had currently been fully reconciled in respect of both securities and cash and that no overall reconciliation of clients' balances with securities/cash held had been prepared. Indeed we were given to understand that no such reconciliation had ever taken place although this was now being attempted. However, due to the failure of the partnership recording system to allocate automatically residual cash balances amongst clients' accounts, it might be necessary to reconstruct the cash records from the commencement of the partnership business, a period of some eight years, in order to achieve this reconciliation.

It was made clear to [Mr B] that the remaining items on the list of documents were still required before our examination could commence and he agreed that these would be supplied as and when they became available.

4. Pursuant to the consent mentioned in paragraph 3, we attended by appointment at the offices of the partnership's auditors, Messrs Walker & Vaughan on 28 January 1985 and interviewed the relevant partner, [Mr C].

In relation to the audit of the accounts for the year ended 30 June 1983, [Mr C] told us that verification of the fee and commission income was based on a print-out produced by the partnership's computer of amounts transferred from the clients' accounts to the partnership which was test checked with a random sample of clients' accounts and that the loan account to the partnership of £250,000 (which is shown at the bottom of the balance sheet after the partnership capital account) was obtained on 23 June 1983 and is repayable within two years. [Mr C] continued that the audit did not include any audit of the clients' dealings which gave rise to his report, which is described as an 'Accountant's Report', being qualified in the following terms 'The Clients' Account and Clients' Bank account are not regarded as being part of Barlow Clowes and Partners and our audit has been confined to transactions within the firm's own accounting records'.

No nominal ledger as such is maintained by the partnership although its computer can produce a cash book analysis of nominal ledger items. [Mr C] told us that some time ago he gave to the partnership a specification for the nominal ledger to be included in the partnership's computerised recording system but that no action had been taken to implement this and the nominal ledger remains within his working papers. [Mr C] said, further, that in November 1983 he had advised the partnership that the whole of the clients'

transactions should be the subject of an annual audit but that he had received no instructions to carry out this work nor, indeed, had he received any instructions to carry out an audit for the year to 30 June 1984.

5. On 31 January 1985, under cover of a letter we received by hand from [Spicers], stock reconciliations only of the remaining clients' accounts and a reconciliation of the partnership bank account as at 28 December 1984.

6. We have obtained details of the partnership's indemnity insurance cover which we have been informed has recently been renewed but at present we are unable to comment on the adequacy of this insurance cover.

7. We have been given details of the fees charged to clients on various portfolios and in relation to Portfolio 30 it appears from the documents supplied to us that neither the initial fee of 3.5% charged on investment nor the annual fee of 1.5% are mentioned at an early stage to potential clients. In fact the sample documents in respect of Portfolio 30 supplied do not make any mention of fees charged whatsoever.

8. We attach sample documentation given to us in respect of Account 105, the balances of which have been reconciled by [Spicers] with securities and cash held. It will be noticed that the reconciliation shows in the joint cleared cash listing at 21 January 1985 an item in respect of a receipt of £10,000 from [Mr D] on 8 June 1984 (Reference ...) which is not recorded in the Account 105 bank statements. Further, there is no trace in the printout of Account 105 clients of an account in the name of [Mr D] although the list of securities held on Portfolio 30 shows a holding of 13.5% Exchequer 1992 stock to the value of £9239.30 on behalf of Ref ... This situation has existed uncorrected, if not unknown, since June 1984.

9. The present position is that we have not reached a point in our enquiries where a visit to the partnership's premises would serve any useful purpose nor have we interviewed the partners or staff. From our examination of documents supplied, there appear to be a number of portfolios (Nos 33, 45, 48, 75 and 87) for which we have not been given sample circulars. Circulars in respect of portfolios 30, 30S, 78 and Gilt Monitor were supplied by [Spicers] under cover of their letter dated 24 January 1985 which states 'We understand that there is no other published information in connection with the other portfolios.' We do not have a full list of all portfolios.

No overall reconciliation of clients' balances with securities and cash held has been produced. A reconciliation of Account 105 clients' balances with securities and cash has been supplied but apart from securities reconciliations on the other accounts there are no individual cash reconciliations.

No further documents have been received since those enclosed with [Spicers'] letter of 31 January 1985 nor has there been any further communication from them and we still have not received all of the documents specified in our original letter of 16 January 1985 as necessary to enable us to commence our examination."

When I asked the officers if they could remember the source of the Jersey address, after much thought, they concluded that it had almost certainly come from the Portfolio 28 leaflet on FSCD's file. There was no such leaflet on their own file although they had similar brochures relating to other portfolios, which led them to conclude that they had not been given a Portfolio 28 brochure by Spicers.

4.39 On 18 March a member of the Treasury Solicitor's Office advised the Treasury that, on their analysis of the claims made in respect of Portfolios 30 and 78, Barlow Clowes were prima facie carrying on a deposit-taking business for the purposes of section 1(2) of the Banking Act and by accepting deposits in the course of so doing without recognition or a licence were acting in breach of the prohibition on deposit-taking in section 1(1). Meanwhile, in DTI the assistant secretary, after some consultation with the assistant solicitor, put up a submission to the PUSS on 19 March in the following terms:

"The problem

An unlicensed partnership, immune from s109 investigation and s35 winding-up, which has attracted very substantial funds. The indications are that the business is not fraudulent, but this must be verified. The Minister should be aware of the circumstances; and I need the Minister's agreement to the particular course proposed in paragraph 12 below.

Background

2. Barlow Clowes is the unlicensed firm behind the naggings of Mr Hayes of Plan-Invest. They specialise in gilts, notably 'bond-washing' schemes of the sort the Chancellor has just announced measures against. The firm came to the Department's attention through press advertisements which suggested that it might be carrying on the business of dealing in securities without being licensed or otherwise legally entitled to do so. The normal follow-up action was taken. (Also by the Bank of England, in regard to possible unauthorised deposit-taking.) After some exchanges of correspondence (which brought to light some regrettably equivocal views imparted by officials ten years ago) Barlow Clowes applied for a PF(I) Act licence.

Problems with prosecution

3. The Department's publicising of its view of the PF(I) Act licensing provisions has prompted scores of new applications for licences over the past two and a half years. There is no doubt that many new applicants had already been 'carrying on the business'—usually by retailing unit trusts—and were accordingly prosecutable for unlicensed dealing. In practice, as the Minister is aware, a blind eye has been turned. Legal advice has always been that a prosecution for unlicensed dealing requires evidence obtainable only by s109 enquiries; and investigative resources are unfortunately too scarce to divert to technical offences where there is no suspicion of actual malpractice.

4. Letting Barlow Clowes off did not appeal. They have dealt in a big way and for a long time, albeit without provoking complaints from anybody except competitors. But there was the regrettable letter of 1975 mentioned above; and the firm, as a partnership, was not accessible under s109.

Problems with refusing a licence

5. Rejecting the licence application (for which there were at the time no known 'conduct of business' grounds) would have been at least irrelevant, since the firm already ran a large volume of investments; and at worst counter-productive, since it could have provoked a run and put investors in greater jeopardy than they actually were.

Problems with granting a licence

6. At the same time granting a licence—aside from any 'letting off' objections—was unthinkable without any assurance that the many £million alleged invested with the firm were secure and properly held. Such knowledge is normally obtained via s109; but this, as already mentioned, was unavailable. The same result might be achieved voluntarily; but probably at the risk of destroying the already slender chances of a prosecution under the PF(I) Act.

Getting at the facts

7. The categorical imperative was to discover whether investors' funds were in jeopardy. Barlow Clowes were accordingly seen. They gave a tolerably reassuring account of themselves, but accepted that it could not provide a basis for determining their case without independent verification. They agreed to this verification being provided via a joint investigation, on a 'without prejudice' basis, by CIB officials and Messrs Spicer and Pegler. They also agreed to cease all further advertising.

First attempt inconclusive

8. The verification has been conducted and proved inconclusive. The partnership's client records have never been audited. Accordingly even if the physical assets were reconciled with the accounting records, it would be impossible to say with any confidence whether or not the situation was in order. The only way to establish this (or the reverse) is to get the clients' records audited and then verify them against the assets. This is a job for commercial accountants, not CIB.

What now?

9. My judgment is that Barlow Clowes can be got to have [Spicers] do this with the requisite urgency, although this still needs to be ratified with Mr Clowes, who has been away on holiday.

The problem of continuing business

10. The more difficult question is what to do about this while the further verification is in train. Although advertising has ceased, Barlow Clowes are still taking on new business. Solicitor's advice is that unless this is stopped or legitimised whilst the client records are being audited there is a serious danger of the Department being held liable in negligence if funds turn out to be missing. Both courses are unattractive. The legal possibilities we might invoke to prevail upon a recalcitrant Barlow Clowes to turn away new business—indeed those open to us if funds turn out to be missing—involve breaking new ground. (The power to petition for compulsory winding-up (s 35 of the Companies Act 1967) does not apply to partnerships.) The court would have to be persuaded, an action somewhat akin to episodes of the pit dispute, to put in a trustee or receiver. This might work, but it would be novel and would thus involve a considerable amount of bluff. In any event turning away business risks provoking a run.

11. A legitimising licence would secure us from liability, but comes uncomfortably close to anticipating a satisfactory audit, and would intensify criticism if funds turned out to be missing. On the other hand we should be able, in negotiation, to get sufficient assurance, with the verification exercise itself, to grant one.

12. So my advice is that legitimisation is a lesser evil than either letting Barlow Clowes continue to take on new business unlawfully or attempting to get them to turn it away. I should be grateful to know whether the Minister concurs.

13. For what instincts are worth, mine is that Barlow Clowes are above board. The merchandise (gilts) is itself sound, and the depository bank remains unperturbed. I rate Mr Clowes as an addict of doing things with gilts, not a crook; the size of the operation, the time it has existed, and the absence of any investor complaint all point this way. But other—and very worrying—possibilities cannot yet be dismissed."

Spicers have told me (in relation to what was said in paragraph 7 of the above submission) that their understanding was that their role had been limited to accompanying the CIB investigators as representatives of Barlow Clowes. They told me that in practice there never had been a joint investigation; CIB had conducted their own investigation and the CIB investigators had not been accompanied by Spicers.

4.40 On 21 March the assistant secretary made a further submission to the PUSS as follows:

“BARLOW CLOWES AND PARTNERS

After sending forward my submission of 19 March I learnt that Treasury Solicitors had advised the Treasury that, as mentioned in the 'Background' paragraph, it did appear that what Barlow Clowes were doing was unlicensed deposit taking. Clearly if Treasury were about to take action we could not sensibly legitimise Barlow Clowes. However my understanding is that, although they too are concerned about possible negligence they are not

clear what to do. (Their position is slightly easier and their exposure less than ours because they have not had an application nor formal contacts.) Legal advice following consultation with the Solicitor at home in bed with flu, is that if the Minister accepts the recommendation to legitimise we can properly put the ball into Treasury's court by writing to them along the lines of the attached draft [see below]. If they decide against action on the Banking Act front the way will be clear for us to proceed with the course recommended. If they are minded to act, however, it will be necessary to consider making a joint 'pit dispute' approach to the court without having any further truck with Barlow Clowes. Although there are different regulations and statutes involved, they are concerned with one and the same business and for the same basic reasons. I doubt if we could continue to treat with Barlow Clowes if others were already resolved on more drastic action.

2. The White Paper of course proposes (paragraph 15.14) that 'the Department should be empowered to inspect the books and papers of ... any person (company *partnership* or sole trader) whom it had any reason to suspect might be carrying on investment business without being authorised'. In short, to plug the gap in s 109."

On the same day the Treasury official sent the DTI under secretary a copy of Treasury Solicitor's advice and suggested that an early meeting of all concerned should be convened to decide what to do to resolve the matter urgently. The under secretary replied the following day saying that they had now had a steer from the Minister who was writing to the Economic Secretary. Accordingly, on 22 March, the PUSS wrote to the Economic Secretary at the Treasury in the terms of the draft letter which had been submitted by the assistant secretary on 21 March, saying, among other things, "Officials of our Departments and the Bank have been concerned for some time over the activities of this firm of gilts specialists which, by extensive advertising, has collected some £80m of clients' funds for investment in gilts. The business appears to have been trading illegally, in that it does not have a licence to deal in securities. It applied for a licence some time ago, but before granting it I wished to be certain that the funds were there. The investigations carried out have been inconclusive, and I am now advised that if I allow the firm to continue trading illegally and it is in fact unsound, I may be held negligent. I have therefore provisionally decided that the better course is to legitimise them, and thus subject them to monitoring and conduct of business rules provided that adequate reassurances are given. One of the main considerations in my mind has been the effect of not doing so in circumstances where we may not have adequate mechanisms to protect the investors from a collapse. (The power to petition for compulsory winding up cannot be used on a partnership.) I understand, however, that your officials have just concluded that the business may also constitute illegal deposit-taking. It would clearly be wrong for me to proceed as above if you or the Bank were about to take action. I would be grateful therefore if you could let me know urgently what you are proposing to do."

4.41 When I put it to the assistant solicitor, who had had some involvement in the process of preparing the submission to the PUSS, that the submission envisaged the grant of a licence at an early date, before audit or verification had been completed, and that his suggestion that the Department might be held liable for negligence appeared to have been the motivating force for this, he said that his strong minute (4.36) had been intended to bring matters to a head—resulting either in a licence or a closure of the business. His own view at the time had been that Barlow Clowes would not have been able to meet what was being required of them but that, if they had, then the proper course would have been for them to be licensed. He agreed that the submission (and the PUSS's letter of 22 March to the Economic Secretary) was open to the interpretation that possible liability for negligence on the part of the Department had been seen as a reason for granting a licence but this had not been the thought behind his minute, the purpose of which had been to stimulate action. The solicitor further agreed that if the opening statement in paragraph 11 of the submission—that "a legitimising licence would secure us from liability"—had been construed as exonerating the Department in all circumstances, that would not have been correct. He agreed that if, as had then been thought to be the case, there could have been a liability in negligence for

allowing the partnership to continue operating without a licence, there could equally have been a similar liability for granting a licence without due enquiry. The assistant secretary told me that he had not envisaged licensing as an expedient to deal with the liability problem, but rather as the least unsatisfactory answer to dealing with the whole Barlow Clowes problem, the other options—as he saw them—being those of acquiescing in the unlawful continuation of unlicensed activity or of precipitating a messy collapse. In this last regard, the principal told me that experience showed that stopping a firm taking on new (or reinvestment) business effectively brought it to an end: it could not in practice stop taking on new business and remain viable because of the damage to its reputation in the market place; and he commented that that could be an extremely unjust outcome in the case of a firm which was perfectly honest and above board. When I discussed this aspect of the matter with the solicitor, he said that there had been—as he thought was clear from what he had said on 4 March (4.36 above) and from the submission of 19 March (4.39)—a hierarchy of considerations to be taken into account. He set these out as follows:

- “(a) the prime one was the protection of new investors. If ‘old’ money was missing that was obviously extremely serious, but there was nothing that could be done about it immediately. However we could do something to ensure that no new money was at risk. If the only way to do that was to close the firm down then that would have to be attempted, even at some risk to ‘old’ money and at the risk of injustice to the firm if it was in fact honest. However, if it could be done some other way and the subordinate considerations mentioned below could be achieved then that could legitimately be done. The way proposed was that new funds should be accounted for separately from existing funds, under independent supervision. There was no need for a requirement for them to be held in trust in a client account since the Licensed Dealers Rules would cover that. The point was to ensure that they were not affected by any deficiency as regards ‘old’ money.
- (b) Second to that, the objective was to protect whatever old funds there were as well as possible. Again it was not the principal concern that those funds were all the funds that should have been there. If some was missing, it would have to be followed up. But that was less immediately important than ensuring that what was there was protected. That result could be achieved by requiring the funds to be subjected to the safeguards in the Licensed Dealers Rules.
- (c) The third objective in order of priority was not needlessly to destroy an existing business if there was a reasonable basis for believing that it was basically honest and above-board. There were two reasons for this. The first was that there was a risk of causing damage to investors, either by a disorderly collapse or at the very least by causing them to have to make alternative, perhaps less advantageous, arrangements. The other reason was that it would be unjust to destroy the goodwill of a business which had been honestly if not lawfully acquired. The way to achieve this objective was to ‘legitimise’ them. That could be done if, but only if, the assessment was that they were reasonably above board. An important part of that assessment was the going concern certificate. A firm which has to pay back large amounts to clients or meet large claims for damages, beyond its resources, cannot reasonably be expected to continue as a going concern. To sum up, the priorities were, first, to protect new investors, second, to ensure that the position of old investors did not become worse, third to preserve the business if possible. If a way could be found to accommodate all three then it was reasonable to pursue it. If not, then the action must be such as to reflect these priorities. Compared with these considerations the auditing and verification of past accounts was less important. If they turned out to be unsatisfactory then action could be taken. The important thing was to act one way or the other, above all in relation to new money.”

The solicitor added that it had not of course been for him to judge the degree of assurance required, so long as the assessment was a reasonable one. On that basis, his legal view had been (and remained) that the Department could legitimately

conclude that granting a licence was the better route to take. (I should add here that in an earlier discussion which I had with Sir Alex Fletcher (the PUSS at the time) about the choices open to the Department, Sir Alex said that it would be wrong to conclude that the option of legitimising had been taken simply because there had been a possibility of the Department being held negligent.)

4.42 An internal Bank of England minute of 22 March referring to a conversation which the writer had had with the DTI assistant secretary expressed concern that the Department had not kept in close contact with Spicers and were thus unable to say what progress had been made in preparing reconciliations of Barlow Clowes's clients' accounts. They regarded satisfaction on this point as crucial to the issue of any licence by any regulatory authority. The Bank recommended a joint approach by the authorities and a meeting was arranged. On 25 March, in briefing the principal about the proposed meeting, the assistant secretary minuted that the security of client assets was a more immediate and important concern than the legal irregularity of the business. In his view therefore the most sensible outcome would be a revised single remit for Spicers, which would cover both a statutory investigation for the Bank and an informal one for the Department. He concluded "I understand that Mr Fletcher has agreed that Barlow Clowes could be licensed. However, I would strongly prefer not to determine their application for the time being unless there is no other solution to the liability problem". The meeting took place at the Treasury on 26 March attended by Bank of England, Treasury and DTI officials. The Bank's formal note of the meeting recorded that DTI's inclination was to grant the licence before a full investigation had been completed, in order to ensure that future business complied with the Department's rules. A Treasury official was very opposed to a licence being granted before the Department had satisfied themselves that everything was above board. His view also was that the partnership should be told to stop illegal deposit taking and that, if they did not, they should be prosecuted. The Bank had come to the same view and had only delayed action because they thought that the Department were pursuing the relator action proposal. After some further discussion about how Barlow Clowes's position under the Banking Act might be regularised, it was agreed that, subject to "comments from Ministers (who would be urgently briefed about the matter)", the Department should write to Barlow Clowes's saying that they would grant a licence if within two weeks, the partnership:

- “(i) provided an auditor's certificate (from [Spicers]) that they would be a going concern for at least one year (this is the standard PF(I) Act requirement);
- (ii) commissioned [Spicers] to complete urgently a full audit of BC's business;
- (iii) made arrangements for Midland Bank and/or [Spicers] to monitor movements on clients' accounts;
- (iv) ceased accepting deposits in contravention of the Banking Act.”

In addition the Department would consider asking the partnership to establish a company to carry on the business. The Bank would at the same time write to Barlow Clowes requiring them to cease accepting new deposits and suggesting that they consider means of altering their business so that their investment schemes would no longer involve the acceptance of deposits. They would make clear that no licence under the Banking Act would be granted unless a full investigation had revealed that there were no difficulties and all the criteria were fulfilled. After the meeting a Bank official telephoned the principal stressing the importance of ensuring that the terms on which Spicers were commissioned to audit Barlow Clowes were fully satisfactory. He said that in his view it was most important that the DTI were wholly content with the terms of reference of the audit and that they (DTI) were shown a copy of the terms in their draft form. The urgency of the matter was to be stressed to Spicers who should be authorised in writing by Barlow Clowes to contact DTI during the course of the audit and give interim reports. The note indicates that while the principal agreed about the importance of having adequate terms of reference and of urging speedy action, he felt that there was a risk that the other suggestion might undermine confidence between Spicers and Barlow Clowes and prejudice their willingness to co-operate. After the meeting a

conference with counsel was held to consider what legal action could be taken if Barlow Clowes did not meet the DTI's requirements or refused to cease deposit taking. The SEO who attended the conference between solicitors and counsel summarised the instructions given to counsel—"In view of the possible vulnerability of Ministers if client money was lost he was asked to advise on what measures were available to Ministers which had at least a sporting chance of success. Counsel was asked to include in his consideration the appointment of a receiver and an injunction to stop them breaching the law". Counsel promised to give his advice to Treasury Solicitor the following day.

4.43 On 29 March a Treasury official made a submission to the Economic Secretary annexing the text of an agreed joint note (resulting from the meeting on 26 March) and Treasury Solicitor's summary of counsel's opinion (copies of which had been supplied to the Department). The joint note outlined the background, recent events and possible courses of future action. As to the Department's decision (because of the very large sums of money invested with the firm) to seek assurances that those funds were secure and properly held, and to the "inconclusive outcome" of the preliminary investigation by officials from CIB the note said:

"The preliminary results of the investigation, received at the end of January, proved inconclusive. It was established that some £80 million is held on behalf of clients. However, the client records have never been audited and it was not possible for the investigators to satisfy themselves that this figure is in fact the limit of Barlow Clowes's obligations to clients. The Department has concluded that the only way to establish whether or not the situation is in order is for the clients' records to be fully audited and verified against assets. It is understood that [Spicers] are in process of carrying out this task, but the results may not be known for weeks. The limited investigation found no evidence of fraud."

After reviewing the situation as it then stood the note continued:

"Next Steps

12. There are a number of inter-related courses of action which could be adopted. They are described below under four headings:

(a) *Licensing and authorisation*

On the basis of present information, and in view of the Banking Act breach, the DTI would not be prepared to grant a licence to Barlow Clowes. However, a licence might be granted if further assurances were forthcoming and the firm's business regularised. The refusal of a licence on its own would not be an adequate response to the problem without parallel steps to bring the business to an end and to protect the assets presently in the hands of the firm. (The firm has after all been operating without a licence for some time.) In the case of the Banking Act, the Bank consider it unlikely that the firm would be able to meet the authorisation requirements, even if it applied (which it has not done). In any event it would not be possible for them to reach a decision quickly as it would be necessary to be fully satisfied that clients' funds were wholly accounted for and that appropriate systems and management were in place for the future. In view of the doubts presently surrounding the firm, the Bank consider that Barlow Clowes would have to discontinue deposit-taking until the application had been determined.

(b) *Further investigations*

There is clearly a need for further information about Barlow Clowes. But further enquiries would involve delay in reaching decisions, the risk of a collapse before their completion, and consequent charges of negligence for failing to take prompt action. However, further enquiries might produce the assurances the DTI need in order to proceed with the grant of a licence, or alternatively make clear the need for other official action.

(c) *Prosecution*

There is a case for the prosecution of Barlow Clowes, under either or both of the PF (I) Act and the Banking Act, for operating without a licence/authorisation. But any prosecution would be time-consuming and would not of itself do anything to protect existing clients' funds. At the same time, the publicity involved in a prosecution could provoke a run on the firm, with losses by some investors, and accusations of sabotage on the part of the authorities if the action were based solely on technical offences and not substantial evidence of malpractice.

(d) *Other Legal Action*

A separate note is attached. (Annex B). Apart from the relatively straightforward procedures of granting or refusing licences and of prosecuting, there are no obvious legal remedies available for dealing with situations of this kind. The Bank have no investigatory powers under the Banking Act. The power to petition for a compulsory winding-up under section 35 of the Companies Act 1967 does not apply to partnerships. Counsel's opinion has been sought on other possibilities (designed to prevent Barlow Clowes from taking on new business or to protect existing clients' funds in the event of a collapse or a run provoked by official action) which are described in the attached note. Action which might be taken is without any clear precedent and we cannot predict with certainty the attitude of the court. Such action is also open to the risk of provoking a run and would almost certainly involve a moratorium on payments of interest/income.

Conclusions

13. The present situation cannot be allowed to continue, but there is neither a clear-cut case, nor any established legal power for dealing with the problem. Further official enquiries are desirable but would involve a further delay. The choice lies between (i) taking immediate action (most probably refusal of a licence and prosecution) to bring the firm's activities to a close whilst taking whatever steps were possible to safeguard clients' assets; and (ii) giving the firm a final chance to provide assurances about the security of the funds it holds and to regularise its affairs. Whilst the first option would have the advantage of demonstrating that the authorities had taken firm action it would itself put investors at risk both through a run and because the costs of subsequently sorting out the firm's affairs might have to be paid for by investors. On balance, officials do not believe that there is sufficient evidence to justify this action. But given the existence of technical offences and the possibility of more serious ones, and since preliminary enquiries have proved inconclusive, the firm must be told that they now have little time to satisfy the authorities that its affairs are in order.

14. It is therefore recommended that:

- (i) the DTI should write to Barlow Clowes informing them that they were minded to issue notice of intention to refuse a licence under the PF (I) Act; but if within two weeks the partnership gave the following assurances these would be taken into consideration:
- that the accountants recently engaged by the firm [Spicers] provide a fresh certificate under the licensing regulations that the firm can reasonably be expected to be able to carry on business as a going concern for at least a year;
 - that [Spicers] also complete as soon as possible a full audit of the client accounts, the results of which will be made available to the Department;
 - that arrangements are made for the protection of existing clients' funds which are equivalent to the protection that will be afforded to funds accepted under the rules attached to a licence;
 - that, until further notice, any new funds accepted are separately and independently accounted for;
 - that whatever steps may be necessary are taken in order to comply with the requirements of the Banking Act.

- (ii) that the Bank should at the same time notify the firm that its activities are in breach of the Banking Act and should cease or be modified in such a way that they no longer constitute illegal deposit-taking. (The Bank would not take active steps during the two week period to ascertain whether Barlow Clowes were complying with its instructions in order to allow the DTI's conditions described above to be met.)
- (iii) that the Bank and DTI should make whatever contingency plans are possible for action to protect clients' funds in the event that Barlow Clowes fails to comply with these conditions."

4.44 The note of counsel's opinion, also annexed to the submission, indicated that counsel had advised that none of

- (a) an application for an injunction to restrain continued acceptance of client money by Barlow Clowes
- (b) an application for the appointment of a receiver or
- (c) a winding-up petition

were possible options. Counsel had outlined what could be done as follows:

(d) *Licences*

The Department could and should refuse a licence if Barlow Clowes were in breach of the Banking Act. Barlow Clowes should be told of their need to be licensed under the Banking Act if they wished to carry on deposit-taking for the purposes of that Act.

(e) *Midland Bank*

Counsel had suggested that the most fruitful way forward would be to put pressure on Midland Bank by suggesting that, by continuing to act for Barlow Clowes after being put on notice that Barlow Clowes were acting illegally (by operating their business without licences), the bank might itself be assisting Barlow Clowes in the commission of criminal offences and thereby be incurring some kind of liability. The fact of being put on notice in this way would constitute the legal basis on which the bank could freeze the Barlow Clowes assets it held and retain them as constructive trustees. Midland Bank, as constructive trustees, would then be legally entitled to apply to the court for directions as to how they could or should deal with depositors' property held by them.

(f) *Prosecution*

Although Parliament had provided the sanction of prosecution as a method of enforcement for both Acts, and the authorities had a discretion whether to prosecute in any case, counsel had advised that it would be misconceived and irresponsible to instigate a prosecution if this were to precipitate the collapse of the business and there were insufficient funds to repay investors all that was owing to them. Prosecution in the context of a situation as delicate as this should be viewed very much as a weapon of last resort.

A postscript was added to the note by way of a rider to the advice summarised at (a) above. This was to the effect that counsel had advised that only in very exceptional circumstances was the Attorney General entitled to apply for an injunction to prevent a breach of statutory duty even where the statute had only provided the remedy of a criminal sanction. The note continued:

"Such exceptional cases would be where the continuing breach of the law would cause irreparable harm and/or where the application of the criminal sanction has proved to be totally ineffective... Such a power might well be exercisable in a situation where there was evidence that a financial institution that was operating its business illegally, was eg, on the verge of collapse and that its collapse would expose a substantial sector of the public to the risk of irreparable loss."

4.45 The Treasury official's submission to the Economic Secretary set out the recent history and explained that the Treasury had become involved because the Bank of England had informed them in the interests of depositors under section 19 of the Banking Act 1979 (which frees the Bank from the obligation of confidentiality in such circumstances). He explained that their response had been to co-ordinate the authorities' response; to put heavy pressure on DTI to take urgent action; and to seek to ensure that the firm should not be allowed to carry on doing business on an illegal basis. The official said that DTI's view of Barlow Clowes was that they were incompetent rather than corrupt or fraudulent but that his own view was that the incompetence bordered on the irresponsible. He said "I cannot conceive of a firm handling customers' funds of at least £80m. without having conducted an audit of clients' accounts." Furthermore, he saw a danger that Barlow Clowes would claim that the authorities' lack of action constituted acquiescence in their activities. The official recommended the course of action proposed by the agreed joint note allowing the partnership (because of the Easter break) 10 working days to comply. He commented briefly on counsel's advice noting that the most promising way forward was to get Midland Bank to freeze the assets. He questioned the advice that "it would be both misconceived and irresponsible to instigate a prosecution if by so doing, one were to precipitate the collapse of the business and there were insufficient assets out of which to repay investors/depositors all that was owing to them" saying that the advice appeared wholly to ignore the interests of new depositors. The official said that provided the Minister was willing to accept the risk of the further short delay, the real decision would be required in two weeks as to whether to refuse a licence and prosecute or allow a further delay while Spicers completed a full audit and the business was reorganised to take it outside the scope of the Banking Act. The first option might provoke a run by "the many pensioners mainly on the South coast who depend on the scheme for income and capital appreciation"; the second might expose the authorities to severe criticism of negligence if it turned out Barlow Clowes was fraudulent, corrupt or unable to meet its liabilities. Recognising that the regulatory decisions were for the Bank and the DTI, he nevertheless said that unless the risks attached to option 2 could be shown conclusively to be minimal, "our advice tends strongly to option 1". If the firm was neither corrupt nor insolvent there was no reason why investors should not get their money back; but if there were problems then losses would be limited and new depositors protected by stopping the firm straightaway. Option 2 effectively meant that the supervisory authorities would be allowing Barlow Clowes to continue to take deposits, in the full knowledge that they were unable to vouch for the soundness of the firm. He thought the choice for Treasury Ministers appeared clear. He submitted a draft letter which was to be sent to the Secretary of State for Trade and Industry (Mr Tebbit) in the absence of the PUSS.

4.46 On 1 April the Economic Secretary agreed the submission and on the same day he wrote to Mr Tebbit, in the terms proposed, agreeing the action jointly proposed by Treasury and DTI officials subject to the proviso that Barlow Clowes be given 10 working days to respond. The letter concluded "My own view is that if Barlow Clowes's response to the proposed letters from DTI and the Bank are not fully satisfactory, the unpleasantness following an enforced cessation of business would be preferable to allowing the present state of affairs to continue with the risk of exposure or default at any time." The matter was referred to the Chancellor who asked to be kept closely informed of developments. The Bank official and the DTI principal agreed that the Bank's and DTI's respective letters should be sent by hand the following day. In the event of Barlow Clowes being unable to meet the deadline DTI would send a letter of intent to refuse a licence, possibly on 19 April, with a copy going to Midland Bank who would be expected to apply to the court for directions.

4.47 Officials of the Department and the Bank then put their joint plan into action, each writing separately to Herbert Smith and the partnership on 2 April. (I refer to the Bank's letter at 4.49 below.) Both of DTI's letters were delivered by hand. DTI's letter to Herbert Smith (signed by the principal) began by summarising the situation following the meeting on 18 December 1984. The letter said that it appeared that Barlow Clowes and Partners had for some time been, and

were continuing to be, in breach of section 1 of the PF(I) Act. While not condoning such a breach, the Department's view had hitherto been that the interests of investors would best be served by avoiding any action which might lead to a collapse of the firm—a view which had been reinforced by assurances from the partners that the business was well run and client assets safeguarded and by the fact that Herbert Smith were now acting for the partnership. However, it now appeared that the assurances given by the partnership could not safely be relied upon and that, in addition, the partnership might also be in breach of section 1 of the Banking Act. The letter went on to say that the agreed voluntary investigation of the partnership's books and papers had not been completed because, "contrary to the description of the record keeping system given at the December meeting, the partnership records were not in a state which could readily show that client assets are being properly held and accounted for". The main deficiency noted had been that there had never been any independent audit of the clients' accounts so that the accuracy of the client records could not be assured. Moreover, client balances had, generally, not been fully reconciled with securities and cash held and a considerable amount of work would be required to put this right. This state of affairs, the letter said, was a matter of concern and, in view of the impression given at the December meeting, surprising. It was clear that the existing record keeping did not come up to the standards required by the statutory rules. The letter explained that the principal understood that Spicers were currently engaged on an exercise to reconcile the client accounts and generally to bring the records up to standard. It was felt that a decision about the granting of a licence could be deferred no longer. Accordingly (in paragraph 8) the letter said that the Secretary of State was minded to serve notice of his intention to refuse a licence but would defer reaching a final view until 18 April 1985 to give the partnership an opportunity to make further representations. As to that, the Department's minimum requirements were:

- “(a) An accountant's report, in respect of the information required by paragraph 2 of part I of Schedule I of the Dealers in Securities (Licensing) Regulations 1983, [see 1.13] provided by [Spicers]. The existing report, given by Walker & Vaughan, is now out of date and does not take account either of developments since November 1984 (notably the Government's decision to end the practice of 'bondwashing') nor the work presently being undertaken by [Spicers] in relation to the client accounts.
- (b) Information, confirmed by Midland Bank plc and [Spicers], concerning the arrangements (1) which exist to protect the assets of existing clients of the partnership and (2) which ensure that all payments made to existing clients are properly due.
- (c) Confirmation that, until satisfactory information in (d) below has been received, any new funds, from whatever source, received by the partnership are separately and independently accounted for in a separate trust account.
- (d) Information, confirmed by [Spicers], that that firm has been instructed to produce a full reconciliation of the client accounts, and a complete verification of those accounts with client cash and securities. In addition an undertaking from the partnership that this work will be completed at an early date (to be specified) and a full report of the results thereof provided to the Department.
- (e) Information concerning the future operation of all the portfolio and other schemes operated by the partnership together with confirmation by your firm that the partnership's continuing operations are being conducted in full compliance with the Banking Act 1979.”

The letter continued that in the event of the Secretary of State issuing a notice of intention to refuse a licence the partnership could require their case to go before the statutory tribunal who would investigate and recommend accordingly. The Secretary of State would be obliged to follow the tribunal's recommendation. The letter went on to suggest that, in view of the foregoing requirements and the large amount of client money and securities under the control of the applicant, the partnership's business might more appropriately be handled by a limited

company; a substitute application by the company formed to continue the partnership's business would be given prompt attention and might facilitate compliance with the foregoing requirements.

4.48 Spicers told me, in their evidence, that it seemed to them unclear what DTI's letter had meant by the expression bringing the records "up to standard" in relation to the work that they had at that time undertaken on behalf of the partnership. They said that it seemed possible that the Department had not appreciated that their work at that time had been "limited to assisting in the reconciliations being prepared as at 28 December 1984 and to considering the desirability of changes to Barlow Clowes's systems". The principal, for his part, told me that the source of the remark had been his conversation with Herbert Smith on 26 February (4.33). In relation to "assurances given by the partnership" Herbert Smith have told me that any such assurances had not been given by them (Herbert Smith) and that, in their view, the reassurance which the Department could legitimately have drawn from the fact that Herbert Smith were acting for the partnership was that the client had been receiving competent legal advice, that Herbert Smith would be straightforward and frank with the Department, would not act fraudulently and would not accept instructions which they knew would involve the communication of untrue or misleading information to the Department. Herbert Smith also told me that if they had been given cause to doubt their clients' integrity they would have taken appropriate steps. I asked the principal why, particularly in regard to requirement (d) in his letter of 2 April, he had not followed exactly the wording of the joint note which had envisaged seeking from Spicers "a full audit of the client accounts" (see 4.43) since it seemed to me that the terms "reconciliation and verification" might have been more restrictive than the term "audit" would have been. The principal replied that he had seen this simply as a matter of terminology. He did not himself consider that use of the phrase "full audit of the client account" would necessarily have indicated the standard to which the accounts were required to be audited. He said that there had been no general statutory requirement for client account audits and he had seen it therefore as important to set out as fully as possible in the terms of reference the standard of audit which the Department expected Spicers to work to. He accepted that the terms which he had used—and indeed his own expectations—had not extended to establishing that the partnership were in a position to do other than fully meet current net liabilities to clients. Nor had his reference to "continued viability of the business" in his later submission to the Minister on 11 April (see 4.50 below) sought to go beyond this definition. The principal recognised a certain ambiguity in the wording of (c) but confirmed that it had been envisaged that new monies should be separately accounted for until the results of (d) were to hand. He also confirmed that it had been expected that the separate accounting should commence immediately.

4.49 On 3 April the principal sent a copy of his letter to the Bank commenting that "this situation will need to be resolved, one way or the other, following the 18 April 1985 deadline". On the same day the Bank sent the principal a copy of their letter to the partnership which had also been despatched on 2 April. The Bank's letter said that the Bank had concluded that in operating Portfolios 30 and 78 the partnership were accepting deposits in contravention of section 1(1) of the Banking Act 1979. It asked the partnership immediately to cease accepting deposits, whether by taking new monies, or by renewing existing deposits or enlarging them by crediting interest or premiums, and to confirm in writing that they had done so. It reminded the partnership that the maximum penalty for contravention of section 1(1) was two years' imprisonment and an unlimited fine. The letter pointed out that if the firm wished to continue accepting new money they might consider restructuring the schemes or appointing a licensed or recognised institution as custodian trustee to accept deposits, leaving the firm simply to act as manager. If the partnership decided to apply for a licence under the Banking Act, the Bank would need to be satisfied that the firm was fulfilling all the relevant Banking Act criteria. The Bank would need full evidence from reputable and independent accountants about the conduct of business of the firm including evidence of its solvency, its handling of clients' monies and its internal control and accounting systems. According to the Bank's record of a telephone conversation

with Herbert Smith on 9 April the latter told the Bank that Midland Bank Trust Co Ltd had been approached about acting as a custodian trustee and were prepared to co-operate. They said that a company was being formed to manage new monies and that it was in relation to these new monies that the Midland would act. The Bank official said that the Bank would wish to be advised of the new arrangements for skirting the Banking Act before they were finalised so that the Bank could ensure that they achieved this objective. He then enquired about Spicers' progress with their audit. The Bank official recorded Herbert Smith as saying that the audit was not yet complete. Spicers had, he recorded, "achieved an adequate global reconciliation and were satisfied that the stock and cash said to be held was indeed held; but they were still working to reconcile individual clients' accounts ... Herbert Smith said that Spicers had found nothing to reflect on the integrity and honesty of the operation". According to the Bank official's note, the relevant Spicers' partner had been present (at Herbert Smith's) at the time and had apparently been nodding assent. Herbert Smith told the Bank on 11 April that Midland had formally agreed to act as custodian trustee.

4.50 Also on 11 April the principal made a submission, through his assistant secretary, to the PUSS. This was as follows:

"Barlow Clowes and Partners

1. The Economic Secretary's letter of 1st April 1985 in effect confirms the agreement reached at official level on how to deal with this firm which is carrying on an unlicensed business of dealing in securities as well as operating in breach of the Banking Act. [The assistant secretary's] submissions of 19 and 21 March refer.

2. The letter calls for only a brief reply and a draft is attached. However the Minister should be aware of the steps which have been taken since [the assistant secretary's] submissions and following consultations with Treasury and Bank of England officials. Treasury Counsel has also been consulted.

Action Taken

3. The agreed action referred to in the Economic Secretary's letter has been initiated. On 2 April the Bank wrote to the firm telling them to cease their illegal deposit-taking activities or to modify their operations so that they do not breach the Banking Act. On the same day we wrote to the firm's solicitors, in the context of their PF(I) Act licence application, seeking assurances from them about the continued viability of the business, the adequacy of the arrangements for the protection of clients' assets, and that their continuing business will be conducted in full compliance with the Banking Act. We have also sought assurances that the audit of the client records will be completed quickly, with a full report made to the Department, and, pending this, all new clients' money will be placed in a separate and independently monitored trust account. We have asked for these assurances by 18 April 1985.

4. On receipt of satisfactory assurances along these lines the Treasury and the Bank would be content for this Department to license Barlow Clowes, despite the past breaches of the legislation. This accords with the recommendations made in [the assistant secretary's] submissions. Both the Bank and the Treasury have expressed misgivings about us licensing Barlow Clowes in any circumstances in view of the past breaches, but accept our view that too much should not be made of these "technical" offences, provided that we can be assured that the business is being properly run and that clients' assets are not at risk.

Contingency plans

5. If Barlow Clowes fail to produce these assurances we and the Bank will take all possible steps to bring the business to an end, and to make whatever arrangements are possible to protect investors. However neither the Bank nor the Department have powers to require Barlow Clowes to cease business. Prosecution would not make an immediate impact, and neither would (directly) action to refuse the PF(I) Act licence. The Act gives us no powers to obtain court injunctions against those breaching the Act's

provisions. Legal advice is that there is a possibility (but no more) that the Attorney General could, in certain circumstances, secure an injunction; but there would need to be exceptional grounds as evidence of fraud. We have no such evidence.

6. The most promising course of action seems likely to be that open to Midland Bank plc who hold, on trust, the money and securities of Barlow Clowes's clients. We are advised that they could apply to the court for directions as to how to deal with the clients' money they hold. Such proceedings would freeze the assets. It seems likely that Midland Bank could be persuaded to take action on being made aware of our intention to refuse a licence. This, together with the present illegal activities and the potential civil consequences of such dealing, should be enough to convince Midland Bank that they needed to take action. Such steps would protect clients' assets held by Midland Bank (but not elsewhere). Action of this nature would soon become known and would bring the business to a rapid halt. It would also be very messy and the costs of sorting out the muddle could be considerable—and would be met by investors.

Conclusion

7. If Barlow Clowes provide us with the requested assurances their activities can be legitimised and the business will continue. Investors will continue to receive, more or less, the services they paid for (there may need to be some adjustment to meet the Banking Act point). However, if Barlow Clowes fail to deliver by 18 April we, and the Bank, will be faced with a difficult and messy "liquidation". The alternative course, of deferring a decision, which the Economic Secretary rejects, is not really feasible in any event. We would risk being held negligent if we did not act."

On 16 April the PUSS wrote to the Economic Secretary in the terms of the draft enclosed with the submission. He said that the line of action agreed by officials had been put into effect and that the firm had been given until 18 April to provide assurances that their business was being conducted honestly and in compliance with the Banking Act. He said that they had also been told to furnish, at an early date, an independent accountant's report on the completeness and accuracy of the clients' accounts. He added that if these reassurances were forthcoming, he expected the firm to be licensed under the PF(I) Act, thus becoming subject to the detailed conduct of business rules and monitoring requirements placed on all licensed dealers. But, if not, the Bank and the Department would need to take steps to protect the interests of investors. In his evidence to me Sir Alex Fletcher told me that although the submission by officials had apprised him of counsel's suggestion that Midland Bank might be able to take action, he had no recollection of having actually seen counsel's opinion.

4.51 Also on 16 April the under secretary, having seen the submission to the Minister, asked the principal for confirmation, first, that the separate and independent account for new moneys applied to new money from existing clients as well as money from new clients and, secondly, that the reference in paragraph 6 to clients' assets held other than by Midland not being protected referred essentially to those assets which were simply "in transit" to or from Midland Bank for the purpose of buying or selling securities. The principal replied the same day confirming both points but adding that the Department believed, but did not know for sure, that Midland Bank held most, if not all, of clients' money. Also on the same day, Herbert Smith telephoned the principal to say that the Department would be receiving on the due date the information requested in their letter of 2 April. The principal listed the assurances as:

- (a) an accountant's report by Spicers;
- (b) confirmation by Midland Bank;
- (c) confirmation about a new segregated client account;
- (d) confirmation that Spicers had been instructed;
- (e) confirmation that the business had been reorganised to avoid section 1 Banking Act breach.

He also noted that he had been told that a new company had been formed and would be applying for a new licence in place of the partnership; Midland had agreed to act as custodian trustee and one of their people had been recruited as an executive director of the new company. He was told that the intention would be for the licensed company to act for the partnership and their clients until such time as the clients became clients of the company in order to avoid the abrupt termination of existing arrangements “with potential tax disadvantages for the 11,000 or so clients involved”, and Midland would become custodian trustee of these assets on completion of the client account audit. This information was passed on to the Bank of England who recorded the principal as having told them that provided the Banking Act problem could be satisfactorily resolved the Department might be able to reach a decision on the licence application, possibly within 24 hours. Herbert Smith reported to the Bank on 17 April that a new company was to be set up for which Midland Bank would be custodian trustee. The Bank said that the proposed safeguards appeared satisfactory noting that the crediting of dividends remained a transitional Banking Act problem. (In the meantime the Department had received what the SEO referred to as their first complaint about Barlow Clowes. The complaint—which came from an address in Mallorca—was in the form of a copy letter to The Daily Telegraph and had reached the Department via the Office of Fair Trading. The complainant was dissatisfied with the handling of his affairs by the Barlow Clowes Gilt Monitor Service. A copy letter dated 29 October 1984 from Barlow Clowes’s London address referring the complainant to their “Jersey Office” had been enclosed. The SEO replied on 17 April, saying that Barlow Clowes were not licensed by the Department and that the matter would best be dealt with by corresponding direct with the firm.) On 17 April the principal indicated to his successor that, for the time being, it was proposed that he should retain responsibility for the case himself. Two days later he minuted that he had accepted Herbert Smith’s explanation for the material not having arrived by 18 April and their assurance that it would be received on 22 April. The same day the Bank briefed the Treasury and the DTI on discussions they had had with Herbert Smith. The principal made clear that the Department expected the Bank to give a firm view on the position under the Banking Act the following week. He said he could not rule out the possibility that a licence might be granted in advance of the custodian trusteeship arrangements being in place. The Bank official said that the Bank would examine the terms of the custodian arrangements before taking a view on the Banking Act position.

4.52 Herbert Smith’s letter to the Department dated 18 April was received on 22 April. With their letter they enclosed one from Spicers, also dated 18 April, which read as follows:

“We refer to paragraph 8(d) of your letter dated 2 April 1985 and confirm that we have been instructed by the partnership to provide assistance in reconciling their client accounts as at 28 December 1984 and, in addition, to carry out an audit of these accounts as at that date.

The present position with regard to this work is as follows:

- (i) We refer to paragraphs 8b and c of your letter dated 2 April 1985. Subject to the satisfactory completion of the work we are carrying out in respect of the reconciliation and audit of the partnership’s client accounts, we confirm that we are not aware of any funds received from clients which have not been accounted for through the client accounts of the partnership maintained with Midland Bank Threadneedle Street branch, nor have we any reason to doubt that payments made to clients are properly due.
- (ii) Client securities held by Midland Bank Threadneedle Street branch have been reconciled to the partnership’s individual client records. These securities have an aggregate nominal value of some £86.6m. We have been involved in the preparation of this reconciliation which has been carried out to our satisfaction.
- (iii) Bank reconciliations have been prepared for all client bank accounts held at Midland Bank Threadneedle Street and whose aggregate balances shown by

the relevant bank statements amount to some £1.1m. We are at present engaged in checking these reconciliations which have been prepared by the partnership.

- (iv) While the reconciliation procedures above constitute a major part of our audit work we shall also wish to circularise a sample of the partnership's clients to obtain direct confirmation of the validity of the accounting records. We shall commence this work in the near future and, for the purposes of our audit, we propose to seek from those clients selected, confirmation of the sums invested and the cash payments received by them up to 28 December 1984.
- (v) We shall also review the system of internal control operated by the partnership with a view to recommending improvements in procedures.

During the work we have so far carried out we have not become aware of any matter which would indicate that client securities or cash have been misappropriated. The length of time taken to reconcile the client accounts is due principally to the large number of clients, the lack of earlier detailed reconciliations and the small number of individuals with the depth of knowledge necessary to resolve specific queries.

We shall be pleased to discuss this matter with you or to provide any further information that you may require."

4.53 Herbert Smith's covering letter dated 18 April said that they had been instructed to reply to the points raised in DTI's letter of 2 April "in the terms set out in this letter and to provide such further assistance as you consider appropriate". Their reply was by reference to the lettered sub-paragraphs contained under paragraph 8 of DTI's letter (see 4.47) and

- (a) enclosed a going-concern certificate signed by Spicers in respect of the licence application already submitted for the year commencing 1 July 1984. The certificate was addressed to the partnership and was qualified, "We have not carried out an audit for Barlow Clowes and Partners and this report is based on the information you have given us and upon discussions with you regarding the assumptions underlying the financing requirements for the year ending 30 June 1985 for which you are solely responsible and which inevitably contain uncertainties inherent in any projection of future events for an extended period".

The certificate went on to say "We have enquired into the state of affairs of Barlow Clowes and Partners with particular reference to the ongoing level of fixed costs, likely variations in the level of fee income and available cash resources. We are not aware of anything to indicate that the opinion expressed by yourselves in the declaration in paragraph 3 of section 3 of Form 1 of the said application is unreasonable in all the circumstances".

- (b) enclosed the letter from Spicers to which I have already referred (4.52), confirming, Herbert Smith said, that the assets of existing clients were dealt with as client monies and that Spicers were aware of no reason to doubt that payments made to existing clients were properly due. Herbert Smith also enclosed a letter dated 19 April from Midland Bank plc Threadneedle Street which, they said, confirmed that the bank understood that the partnership accounts which they were operating at Threadneedle Street were client accounts and that monies sent to the partnership by investors were credited to those accounts. The bank's letter was addressed to Peter Clowes Esq, and listed six accounts (described as either "client account" or "client trust account") of which four were shown as operated jointly with intermediaries. The letter continued: "I understand these accounts are credited with clients' monies and trust this information is sufficient for your purposes".
- (c) said that "monies received from customers, whether received prior to the date of your letter or thereafter, are being accounted for in accounts designated as clients' accounts".
- (d) enclosed a copy of a letter dated 18 April from Barlow Clowes and Partners—on paper headed with their address 66 Warnford Court,

Throgmorton Street, London EC2—to Spicers in which they instructed Spicers to carry out the following work in respect of all their client accounts at Midland Bank plc Threadneedle Street:

- “(i) to provide us with any clerical assistance necessary to produce a full reconciliation of these accounts as at 28 December 1984 and
- (ii) to carry out an audit of these accounts as at that date”.

The partnership’s letter went on to confirm that there were no other client accounts other than those described above and that the partnership would produce to Spicers all the relevant books and records relating to client transactions. Herbert Smith commented that the work that Spicers had been instructed to carry out included the work detailed in sub-paragraph (d). They also enclosed a further letter to the Department from the partnership dated 18 April saying that the work Spicers had been instructed to do would be completed by 30 June 1985 and that full details of the results of the work would be provided to the Department thereafter.

- (e) in relation to the Banking Act Herbert Smith said that their clients had instructed them to form a limited company to carry on future business of investment management to be known as Barlow Clowes and Partners Ltd. The directors would be Mr and Mrs Clowes, Dr Peter Naylor and Mr D Tree (formerly manager of the securities department of Midland Bank plc, Threadneedle Street and with more than 20 years experience in banking, including securities). They said that Mr Clowes, on behalf of the new company, had asked Midland Bank Trust Company Ltd for custodian services and they enclosed a copy letter dated 11 April in which Midland set out preliminary arrangements for such a service (see 4.54 below). Herbert Smith’s view, which they said they had discussed with the Bank of England’s Banking Supervision Division, was that if such an arrangement were to be put into operation, the company’s business would not infringe the Banking Act. Turning to the partnership, Herbert Smith said that the Banking Act remained a problem in relation to its continuing activities. Accordingly they had informed the Bank of England that the partnership did not intend to accept any further new deposits from customers once the company had received a licence from DTI. Herbert Smith’s proposal for dealing with the continuation of the management of funds deposited with the partnership prior to that date was that a management agreement should be entered into between the partnership and the new limited company, the effect of which would be that the company would manage the funds and that the new procedures to be operated by Midland Bank Trust Company Ltd would operate in respect of the partnership funds as well as the new company’s funds. The clients’ relationship would remain with the partnership solely rather than with Midland. Herbert Smith said they had discussed this proposal with the Bank of England who were considering the matter. Subject to the Bank’s agreement Herbert Smith said that point (e) of the Department’s letter had been dealt with. The solicitors said that a licence application in respect of the new company would be submitted, supported by the necessary certificate from Spicers. They asked the Department if their clients could proceed accordingly.

4.54 The Midland Bank Trust Company’s letter of 11 April enclosed with Herbert Smith’s letter summarised the custodian services on offer. They said that they understood that the new company would offer two services, Portfolios 30 and 37 and that it was anticipated that a large number of existing clients would transfer to the new products. Their services would apply only to funds invested through the new company. All new assets would be held in the name of Midland Bank Trust Company Ltd and new investments purchased would be registered in their name. The Trust Company would deal direct with brokers and clients, leaving the company’s role as manager only. The investments would be in block holdings, Barlow Clowes maintaining the individual client records. The Trust Company would satisfy itself that the bulk purchases and sales of stock were correctly allocated to the individual investors by setting up a series of checks on Barlow Clowes’s records.

4.55 In commenting to me on their letter of 18 April Herbert Smith said that in that letter they had said that they had been instructed to write in those terms, indicating that the statements of fact and intention were made by Herbert Smith on behalf of their clients. In their written comments to me regarding their letter of 18 April to the Department (4.52), Spicers said that their letter had drawn attention to the fact that their work had not then been satisfactorily completed. They also said in relation to 8(b) of the letter dated 18 April that they had issued no subsequent report on this particular matter. When I put it to the relevant Spicers partner (Mr B) that the implication of this statement appeared to be that the Department had not been entitled to be satisfied on point 8(b) of their letter of 2 April, because Spicers had never given full assurances on this point, he said that Spicers' view was that the Department had not been entitled to assume that they had received any further assurances on point 8(b) of the letter of 2 April than appeared from Spicers' letter of 18 April 1985. Spicers had also commented to me, in writing, that they (meaning Spicers UK) had never audited the accounts of Barlow Clowes International, of the Geneva company called Barlow Clowes and Partners SA, or of the Jersey partnership named "Barlow Clowes and Partners". Nor, they said, had they ever been instructed to conduct such an audit. When I pointed out to the partner the difference in wording between what had been asked for under item (d) of the Department's letter of 2 April and the instructions recorded in the opening paragraph of Spicers' letter of 18 April, he said that he had not drafted the letter of instructions from the partnership. He said however that Spicers could not on their own have carried out the reconciliations which were referred to, since that required the knowledge of the partnership personnel. Spicers could therefore only audit reconciliations prepared by the partnership but that work would, as indicated in item (iv) of Spicers' letter of 18 April, constitute a major part of the audit work which Spicers had accepted instructions to carry out.

4.56 On 23 April the principal referred Herbert Smith's letter to the assistant secretary, commenting that the assurances provided by Herbert Smith went a long way towards demonstrating that the firm were putting their house in order but that, as the main assurances related to arrangements still to be finalised the Department needed to keep up the pressure. He suggested that a further meeting should be arranged "to clarify their intentions and to resolve a couple of uncertainties". He commented that it was encouraging that the firm had taken up the suggestion of forming a limited company. As to the assurances given in respect of the points raised in his letter of 2 April he expressed the following views:

- (a) Spicers' certificate was of little use because of its early expiry date (30 June 1985) but the Department could be content with this for the time being because a new certificate was expected to be submitted with the licence application in respect of the company; the certificate was clear evidence of Spicers' confidence in the firm.
- (b) and (c) These assurances did not go very far at all but were acceptable as an interim statement and as justification for allowing Barlow Clowes more time.
- (d) The assurance here was "satisfactory".
- (e) The proposed custodian arrangement would deal with the Banking Act point and the partnership's unwinding of the present arrangements would come within Midland's arrangement once the audit of clients' accounts had been completed. However, the Bank of England wished to check the arrangements with Midland Bank Trust Company Ltd.

The principal said that the following questions and points arose: (a) when would the custodian arrangements become operative? (b) would the new arrangements constitute an unauthorised unit trust? (c) how long would it take to wind down the partnership and what should the Department do about it in the intervening time? (d) much depended on (a) and the receipt of a new licence application; and (e) it was reassuring that the firm had recruited Mr Tree of Midland Bank. In giving evidence to me the principal acknowledged that the Department's requirement for

new client money to be kept separate from the existing accounts had not been fully dealt with in Herbert Smith's letter of 18 April. He thought that the Department had, however, been asking a good deal in the letter of 2 April and it had become a question of judgement as to how far it was appropriate to accept the assurances that were forthcoming.

4.57 In a letter dated 19 April reporting the outcome of their discussions with Herbert Smith and Midland Bank's willingness to act as custodian trustee provided it could be demonstrated that the accounts were satisfactory, a Bank of England official told the Treasury that he had learnt from Herbert Smith that Spicers had already reconciled clients' liabilities and total assets and that all that was left was the task of checking that the accounts accurately reflected the detailed movements in amounts due to clients. This was expected to be completed by 30 June. He said that the Bank of England and their solicitors were satisfied that provided the custodian arrangements operated in respect of the new company as they had been told, then section 1 of the Banking Act would no longer be breached. The position regarding the old partnership was more difficult. The proposal to safeguard investors' assets by involving Midland appeared very satisfactory, although it seemed that this would only be in place from the beginning of July. The Bank official said that there remained a Banking Act problem in that the crediting of dividends (or other monies) to a client's account could involve the acceptance of a deposit. Herbert Smith had thought that paying the money away to clients could cause them confusion, undermine confidence and perhaps damage the business irreparably. They had also considered that the administrative task in contacting the 15,000 clients about the new arrangements would be heavy enough without the burden of writing to clients separately about the crediting of dividends. Herbert Smith had urged the Bank to adopt an accommodating attitude towards the crediting of dividends which they saw as essentially a minor technical problem. The Bank accordingly proposed to say to DTI—subject to receiving satisfactory assurances from Midland—that although there could be minor contraventions by the partnership, they did not consider that Banking Act or prudential considerations should lead DTI not to grant a PF(I) Act licence to the new company. In taking this line, they recognised that it was possible that, in the event, Midland might not be able to take on the "checking" role currently envisaged. Also on 19 April the Treasury agreed this approach by the Bank and proposed to make a submission accordingly to the Economic Secretary (see 4.59 below). Bank records show that on 26 April the Bank had a meeting with officials from Midland Bank Trust Company Ltd at which Midland had expressed some doubts about taking on the role of custodian trustee for Barlow Clowes. The Bank's records also show that before the meeting a Bank official had spoken to the assistant secretary and expressed concern that the Department appeared to have made little progress since hearing from Herbert Smith. The assistant secretary had said in reply that the principal had been away that week. The Bank official spoke again to the assistant secretary after his meeting with the Midland Bank officials saying that he was most concerned that all steps should be taken to regularise the position as soon as possible. On this occasion the assistant secretary is reported as having said that a worry had been raised that Barlow Clowes were operating an unauthorised unit trust and the Department had not yet resolved how to deal with this problem. Midland Bank plc in commenting to me on their involvement with Barlow Clowes said that it had appeared to them at the meeting with the Bank of England on 26 April that its subsidiary Midland Bank Trust Company Limited would not be able to undertake the role of custodian trustee as envisaged because it would in their view require separate ledgers for each of Barlow Clowes's customers and that subsidiary did not then have a system to undertake this. Midland said that it had been suggested during the meeting that they had already been acting in a quasi-custodian capacity and had a responsibility to protect the interests of depositors. This Midland had specifically denied and they told me that the Bank of England could have been left in no doubt that Midland were not able or willing to take on a monitoring role for the benefit of investors.

4.58 On 29 April the assistant solicitor sent the principal a minute concerning an item which had recently appeared in the Sunday Times. This had referred (incorrectly) to a certain investment intermediary as a licensed dealer in securities

“ which is selling investments in return for a commission”. The two plans offered were Barlow Clowes’s products, Portfolio 28 being described as managed in Geneva and Portfolio 78 as managed in London. The assistant solicitor expressed concern that Barlow Clowes seemed to have been acting as manager for someone else. As the intermediary, though not a licensed dealer, was a member of NASDIM, the principal spoke to Mr Grant of NASDIM about the press article. Mr Grant subsequently wrote to the principal, on 1 May, enclosing with his letter a brochure in the name of the intermediary concerned which had apparently been based on Portfolios 28 and 78 and which guaranteed a minimum rate of return, to be notified monthly, and, if required, return of the full investment on demand at any time within six days of receiving the client’s written instructions. The brochure offered the choice of having the investment managed either in Switzerland or the United Kingdom, the former enjoying slightly higher rates of return. The scheme was shown as “ administered by Barlow Clowes and Partners, Warnford Court, Throgmorton Street, London EC2” and clients were invited to make their cheques payable to “ Barlow Clowes and Partners Clients’ Account”. Also enclosed with Mr Grant’s letter was a fact sheet issued by the intermediary for the “ Monthly Income Service” giving examples of what would have been paid on a range of capital sums invested on 1 April 1985. Management in Switzerland was said to produce a higher yield “ as no VAT is incurred”. Mr Grant said that the manager of the intermediary business concerned had been required to explain himself to NASDIM’s Complaints and Disciplinary Committee. In reporting back to the assistant solicitor the principal said that NASDIM had already taken up with the intermediary the criticisms featured in the article. As to Barlow Clowes he added, “ as we all know a major proportion of this firm’s business has come from referrals from accountants, solicitors, licensed dealers, NASDIM members and others. It is difficult to know how to put a stop to those referrals (although NASDIM has recently written to all its members drawing attention to the inadvisability of dealing with unlicensed people, although without mentioning Barlow Clowes by name) unless, of course, we wish to pull the plug on this affair. For the moment we do not wish to do so and prefer instead to protect investors’ interests by regularising the present arrangements as speedily as possible”. The solicitor told me that he did not recall the mention of Geneva in the article as having been seen at the time as of any significance. His concern had been that the intermediary might have been acting as a front organisation to cover unlicensed dealing and he had been further concerned because Barlow Clowes had at the meeting on 18 December 1984 undertaken to stop advertising.

4.59 On 1 May a Midland Bank Trust Company Ltd official attended a meeting at the Department to discuss the proposed custodian trusteeship arrangements. The Department’s note of the meeting records the principal as describing these arrangements as a key feature in the investor protection provided to clients and the assistant secretary as saying that the Department’s view of Barlow Clowes was that they were not fraudulent but were in a bit of a regulatory mess, operating in breach of both the PF(I) Act and the Banking Act. For his part the Midland Bank official was recorded as having explained that Midland had a couple of years previously been unable to provide custodian facilities for Barlow Clowes because the requirements had been found to be too complex: and he said that although Barlow Clowes had re-opened discussions some months previously, they had made no reference to the concerns of the regulators. The Trust Company had put a proposal to Barlow Clowes to provide custodian arrangements whereby the Trust Company would have control of the total monies but would not operate separate client accounts because they did not have adequate computer facilities. They would undertake to carry out certain test checks but their responsibility would be to supervise the accounts overall. The Bank of England had, he said, indicated that they would be content with the Trust Company’s proposals but Midland felt that this put too much responsibility on them because they would have overall responsibility for the deposits while the detailed accounts were in fact being maintained by Barlow Clowes. Midland would need to be convinced that bond-washing was a legal activity and in this connection, the official mentioned that Barlow Clowes intended to continue bond-washing but would limit the amount of investment to £5,000. He said that he would let the Department know the Trust Company’s decision. A postscript was added to the Department’s note of the

meeting, saying that the Trust Company had backed out on 3 May. However, the Treasury official had in the meantime, on 2 May, made a submission to the Economic Secretary bringing him up to date with the situation as he understood it. He said that, according to Barlow Clowes's solicitors, "Spicers have succeeded in balancing the books, although they have not yet managed to disaggregate Barlow Clowes's individual liabilities". (In giving me his comments on the latter quotation Mr A of Herbert Smith has said that the statement it attributes to him is confusing and is not language that he would have used. He said that his recollection of his conversation with the Bank official—to which I referred earlier at paragraph 4.57—was that he had emphasised that Spicers had completed the reconciliation of the total liabilities and assets of Barlow Clowes and Partners but that the detailed checking of the amounts due to individual clients was a lengthy exercise which would not be completed for some time—possibly not until 30 June 1985.) The submission continued that the Department had reported "a most satisfactory response from BC to their earlier request for information: so worries about a major scandal or default have considerably abated". He outlined the arrangements which were then being made with Midland Bank Trust Company Ltd saying that the current investment schemes would be wound down either by repayment on maturity or by transferring them to the new company and subjecting them to the control of Midland Bank Trust Company Ltd. He went on to say that the Bank were not 100 per cent clear whether the new plans would conform with the Banking Act but were persuaded that it would be sensible to take a liberal view, despite the possibility of minor contraventions by the continuing partnership. He said that the Bank proposed telling DTI that Banking Act or prudential considerations should not prevent them from granting a PF(I) Act licence. He said that a new complication which had arisen was that Barlow Clowes might be operating an unauthorised unit trust. He concluded that while "still messy" the case was "no longer alarming", although both the Treasury and the Bank would maintain pressure on the Department. The Economic Secretary's response was that the situation still needed to be monitored closely.

4.60 On 3 May Midland Bank Trust Company told the Bank of England that it could not take on the custodian trusteeship role. The Bank alerted the Treasury immediately and a Bank official then spoke to both the assistant secretary and the principal. According to his note of these latter conversations, the Bank official established that "in order to comply with the licensed dealer rules it was necessary for the DTI only to be satisfied in relation to the safe custody arrangements for clients' monies and securities. This meant no more than Midland Bank already provided by way of service to Barlow Clowes ie, that the money was held with a bank, and that the securities were in either a bank or trust nominee company, or in a Barlow Clowes dedicated nominee name. The DTI would clearly have liked the full Midland Bank Trust Company scheme to have gone ahead as offered since it provided them with considerable comfort. But if necessary they would be prepared to accept very little provided that we could say that the Banking Act was not being breached". (The principal has explained to me that the point he was making here was that the Department could not insist on more than the minimum requirements of the Licensed Dealer Rules.) The Bank official also recorded that he had asked the principal whether there were any PF(I) rules concerning the advertising or distribution of the Geneva-based Barlow Clowes product (which would have to comply with the Banking Act advertising regulations if the product were a 'deposit'). The principal had replied that their only requirement was that it be handled through an authorised dealer. The principal had also said that there was room for argument as to whether Barlow Clowes were operating an unauthorised unit trust, but that the Department were inclined to accept the views of Midland and Herbert Smith "which were presumably that it was not". (The principal has told me in this connection that a view could only be taken on that issue after the details of the proposed custodian arrangements were known.) The principal had said that an early decision would have to be made and the official had promised that the Bank would urgently consider whether there was any other way that Barlow Clowes could be put outside the Banking Act. As I have seen from the Department's papers, the principal asked the assistant solicitor on the same day

(3 May) to prepare, on a contingency basis, a notice of intention to refuse a licence. This he did, the grounds given for the issue of the notice being:

“ 1. The partnership has carried on business in breach of section 1 of the Act and otherwise than in accordance with the rules made by the Secretary of State under the Act for regulating the conduct of business by holders of licences in such a manner as to put its clients at risk, in particular as regards the handling of clients' money and the keeping of records in relation thereto;

2. The partnership has conducted its business in breach of section 1 of the Banking Act 1979 and is unable to find means whereby it can cease to do so; and

3. There are grounds for suspecting that the partnership has continued actively to solicit business knowing of the facts at (1) and (2) above, and in doing so may have committed a breach of section 13 of the Act by dishonestly concealing the material fact that it was carrying on business without authorisation and when it was not in a position to establish that (even if its contracts with its previous clients were not void for illegality so as to entitle the clients to the return of sums paid) all sums for which it was liable to account to previous clients had been properly accounted for, to the consequent risk of any new clients.”

In a minute (of 7 May) to the principal the assistant solicitor said that there had been an item about Barlow Clowes on the Radio 4 programme Moneybox on 6 May. He said that it had appeared to him that the products being offered through the intermediary firm (see 4.58) were new products and that the relationship between Barlow Clowes and the firm was a “good deal closer than simply that of professional intermediary and producer”. He said that he suspected that Barlow Clowes were doing more than just accepting referrals from intermediaries, which was all that he thought had been permitted at the meeting on 18 December 1984. He said that his misgivings remained.

4.61 Meanwhile, on 3 May the assistant secretary had made a submission to the PUSS (who acknowledged its receipt on 8 May) as follows:

“ *BARLOW CLOWES*

This is to let the Minister know how matters now stand. In a nutshell the situation has ceased to be alarming but it is further from being sorted out than I had hoped.

2. 18 April (the prescribed deadline) produced a long—and distinctly reassuring—reply to our “ultimatum”. In particular [Spicers], who have now got a significant way into the books and records, have stated in writing that no indication of misappropriation has come to light. Their contribution is, overall, couched in terms which accountants of their standing would never use if they did not feel at ease with the situation.

3. There remain various matters to be sorted out with Barlow Clowes and their professional advisers—effectively getting firm commitments and deadlines for those operations which have still to be carried through. This process has been delayed somewhat (a) by Barlow Clowes's solicitor being away on other business (b) by complications with Midland Bank.

4. The reply to the “ultimatum” proposes arrangements aimed at getting those activities which constitute deposit-taking carried out by the Midland Bank Trust Company—a licensed deposit taker. The Bank of England (who were consulted about these arrangements “in draft”) opined that they would in principle regularise the position under the Banking Act. But it has since become clear that they were put forward as a technical solution, and that neither the arrangements nor the circumstances in which they were being proposed had been discussed fully or at a sufficiently senior level with the Midland. The Midland has (understandably) been a bit reluctant to play the part in which it has been cast.

5. The Chairman of the Trust Company has been to see both the Bank of England and myself. I gave as much assurance about the mildness of the nettle to be grasped as I reasonably could. There is, however, a purely

logistical concern. Barlow Clowes's potential clientele could be ten times larger than the Trust Company's. This would make the controls they judge necessary for investor protection inordinately expensive. But the basis of this judgement is individual accounts for every Barlow Clowes client—in effect that Barlow Clowes does not exist.

6. The Midland have just told me that they “reluctantly cannot” take part in the proposed arrangements.

7. There are three possible exits from this situation

(i) twisting the Midland's arm

(ii) getting another bank (or banks) in

(iii) finding alternative arrangements satisfactory to DTI, the Bank of England and the Midland.

8. Which to go for depends upon further discussions with the Bank of England which are already under way. As things look now.

(i) There is leverage. Opting out of the proposed arrangements does not alter the fact that the money is already in the Midland. Knowing what they know and not having done anything about it puts them in a vulnerable position...

(ii) I cannot see this being feasible, but the Bank of England have faint hopes.

(iii) Requires greater flexibility in construing and applying the Banking Act than the Bank of England have shown thus far. The best bet otherwise.

9. I will of course report further as circumstances require.”

4.62 On 7 May, by prior arrangement, the principal sent a copy of Herbert Smith's letter of 18 April to the Bank of England. He said in his covering letter that DTI were “discussing certain aspects of the letter with Herbert Smith & Co, particularly in relation to point (e) of their letter”. The Bank's records show that on 8 May the principal telephoned for an up-date in the Bank's thinking. A Bank official told him that there was no device they could suggest properly or otherwise to Barlow Clowes which would obviate the need for a licence under the Banking Act or custodian facilities *a la* Midland Bank Trust; and as to the former, the official said that he remained convinced that the absence of audited accounts was a complete bar to the Bank granting any authorisation. The principal had commented that although the Department's lawyers were pressing for action, the administrators were resisting this while the possibility of regularising the firm remained and there was nothing to suggest that the operation was other than bona fide. Herbert Smith also telephoned the Bank on 8 May to ask whether the Bank would license Barlow Clowes under the Banking Act. The Bank's file records their official as saying in response that the absence of audited accounts was crucial and that the Bank would need a full report on internal systems as part of satisfying themselves that Barlow Clowes were “fit and proper”. Furthermore the Bank could not allow the firm to continue deposit-taking while a licence application was being considered. The official drew Herbert Smith's attention to the application of “the advertising regulations” to Barlow Clowes's Geneva based operations and also to what had been said in “the Moneybox programme”. The next day the Bank official telephoned the principal and they discussed ways of bringing Barlow Clowes's schemes outside the Banking Act. The principal (who has told me that he was here rehearsing the views of DTI lawyers) was still of the view that Barlow Clowes were not deposit-taking. The Bank official reminded him that not all of Barlow Clowes's clients' securities were held by Midland and he suggested that the principal should confirm with Spicers that these securities had been audited. The Bank official then sought confirmation, which Herbert Smith later gave him, that Barlow Clowes Nominees Ltd had been included in Spicers' investigations. Herbert Smith told him that the auditors had not thought it necessary to specify it by name because it operated as a “washing” account. The official noted that he

found this explanation odd because Barlow Clowes Nominees Ltd had £7.5 million (nominal) of stock registered in its name at the end of 1984 which seemed hardly consistent with its being a washing account.

4.63 On 14 May an official from Lloyds Bank City Trust telephoned the Bank to say that they had been approached by Barlow Clowes. The same day the Treasury Solicitor advised the Treasury in general terms about the interpretation of s.1 of the Banking Act (see 1.17) in particular that it embraced a conditional, as well as an absolute, obligation to repay the sum received. They sent copies to the Bank and DTI. The following day a meeting was held attended by representatives of the Bank of England, Treasury, Treasury Solicitor and the Department. The Department's note of the meeting recorded (in relation to section 1(2)(b)) that "it was generally agreed that the Barlow Clowes business is not a deposit-taking business since the activity/business is not financed out of capital/interest received by way of deposit". The Bank's note of the meeting recorded that "there now seemed to be general agreement that Barlow Clowes accepted deposits as defined in section 1(4)(a)". The note said that DTI had, however, questioned whether Barlow Clowes was carrying on a deposit-taking business in terms of section 1(2)(b): this depended upon how Barlow Clowes financed its business and the Treasury official had expressed surprise and annoyance at DTI's not having a better understanding at that stage of Barlow Clowes's financing arrangements. The Treasury's account of the meeting was recorded in a letter to the Bank dated 16 May. Both it and the Bank's account said that DTI had indicated that if there were a substantial degree of doubt as to whether Barlow Clowes were in breach of the Banking Act, DTI themselves would be prepared to grant a licence. Some aspects of the present operation would need to be modified but DTI did not see these as fundamental. Counsel was to be asked to advise on the technicalities of the Banking Act. (A conference with counsel took place on 16 May, when counsel advised *inter alia* that the critical test of a deposit was whether under the terms of the agreement the recipient undertakes an obligation to repay the sum received from the payer.)

4.64 Herbert Smith submitted Barlow Clowes and Partners Ltd's first application for a licence on 16 May 1985, the accompanying going-concern certificate having been signed by Spicers and dated 10 May 1985. Spicers' letter (addressed to the company) qualified the certificate in the following terms: "We have not carried out an audit of Barlow Clowes and Partners Limited and this report is based on the information you have given us and upon discussions with you regarding the assumptions underlying the financing requirements for the year ending 30 April 1986 for which you are solely responsible and which inevitably contain uncertainties inherent in any projection of future events for an extended period". The certificate continued on similar lines to those set out in 4.53(a). The company's application for a principal's licence stated that the company had been established on 8 February 1985. Names of the directors and controllers were listed as:

Mrs P M Clowes	Director
Mr D R Tree	Managing Director
P Clowes	Director
Dr P J Naylor	Director

The stated sources, or expected sources, of the company's business included Barlow Clowes and Partners, in respect of the business already undertaken by that partnership. The company's annual accounting date was shown as 30 June so that, as things then stood, the first monitoring return was due to be submitted to the Department by 31 December 1985. Applications for representatives' licences to deal in securities were submitted in respect of six individuals including Mr Clowes and Dr Naylor. In their covering letter of 16 May Herbert Smith referred to previous correspondence, in particular their letter of 18 April 1985, about the relationship intended to exist between the company and the business previously carried on by Barlow Clowes and Partners. The letter went on to say that DTI had agreed that the present application would need to be read in conjunction with that submitted on 5 November 1984 in respect of the partnership's application for a licence and that any information submitted on that occasion would be treated as

having been submitted on this occasion. They added that it was envisaged that a further two directors, one of whom would be financial director, would be appointed. Details of insurance cover arranged for the new company were also submitted.

4.65 On 23 May the principal told the assistant secretary that the licence application from the new limited company disclosed nothing unusual (except for a possibly suspect manager—see 4.73 below). He said that Spicers had provided an accountant's report, which although qualified could be regarded as "clean". He reported that Herbert Smith were working on two possible solutions to the Banking Act problem—either by involving Lloyds or by re-structuring the business. He reported that he had told Herbert Smith that the Department were now concerned "only with the resolution of the Banking Act point and how that was achieved was immaterial to us". He had asked Herbert Smith to let him and the Bank of England have something in writing on the possibility of the business being re-structured, with a view to an early discussion. He reported also that the Bank of England had expressed some concern about the lack of information about Barlow Clowes Nominees Ltd in Herbert Smith's letter of 18 April. But he said it seemed to him immaterial whether stock was registered in the name of a nominee company controlled by Barlow Clowes or by Midland Bank. (The principal has told me by way of explanation of his comment here that it was a reflection of the minimum requirements of the Licensed Dealer Rules, which was all the Department could insist upon.) He said that the Department had received assurances that the stock and stock records had been reconciled to the satisfaction of the auditors (and no doubt the Bank) and that because stock was registered in the name of Barlow Clowes Nominees Ltd it did not necessarily mean that it was physically held by the partnership. He believed that such stock was in fact held by Midland Bank along with the rest of the scrip. On the same day another official added a postscript to the principal's note to the effect that Herbert Smith had telephoned to say that Lloyds appeared willing to proceed provided that the Bank of England approved the arrangements. There was to be a meeting the following week between Barlow Clowes, Herbert Smith, Lloyds and their solicitors Linklaters, following which Herbert Smith would again be in touch with the Department.

4.66 Meanwhile, on 16 May Herbert Smith had sent to the Bank of England for comment a paper summarising the arrangements which Barlow Clowes and Partners Ltd hoped to make with an authorised deposit taker—possibly Lloyds Bank (City Trust Branch). The proposed arrangements were that a prospective Barlow Clowes client should complete a proposal form and return this together with his cheque. The cheque would then be sent to the Trust Company, accompanied by a mandate authorising the Trust Company to (i) credit the cheque to an account designated "clients of Barlow Clowes and Partners": (ii) deal with the client's money in accordance with instructions from the company, (iii) pay monies to the client either on a specified periodic basis or at the termination of the portfolio; and (iv) pay prescribed fees to the company. In addition the client would complete a mandate for the company (i) specifying the objectives which would govern the investment policy and (ii) authorising the company to administer the funds by purchasing gilt-edged securities which were to be held by the Trust Company. In their reply of 17 May the Bank said that provided the clients' cheques were to be made payable to the Trust Company, which would be authorised under the Banking Act to accept deposits, the Bank of England would have no objection to the proposed method of operation. Herbert Smith told the Bank on 21 May that it was the intention that cheques would be made payable to the Trust Company by reference to a designated account. This correspondence was copied to DTI on 30 May.

4.67 A few days earlier on 24 May, the principal had written to Mr Peter Hayes in reply to a letter he had written to the PUSS on 28 February. In his letter Mr Hayes had referred to the Inland Revenue's recent announcement on bond-washing and had commented that it might "well have a considerable bearing on the company about which I have expressed concern". In his response of 28 May (to the principal's letter of 24 May) Mr Hayes said "I have made it very clear in

previous correspondence that a very large firm which advertises very regularly is neither licensed nor a member of NASDIM and Alex Fletcher, in his replies to me, had made it equally clear that he knows perfectly well the firm to which I have referred, but so far as I know, that firm is still trading and taking monies from the public It seems to me that either that firm should be forced to discontinue its activities until a licence has been granted to it or a licence should be immediately issued". Mr Hayes had also been in correspondence with Mr Grant of NASDIM, who had written to him on 20 May letting him know that Barlow Clowes had applied to the Department for a licence.

4.68 On 28 May the Bank of England told Herbert Smith that should the hoped for arrangements with Lloyds fall through, they would need alternative proposals straightaway. When checking with the principal on 3 June whether he was aware that Herbert Smith had arranged a meeting with Lloyds Bank on 6 June, a Bank official enquired about Spicers' audit. The principal said that he expected Spicers to provide a report by the end of June which would give Barlow Clowes a clean bill of health, but that he expected there to be some loose ends not fully resolved on which Spicers would continue to work. The principal wrote to Herbert Smith on 5 June, referring to his letter of 2 April in which he had requested certain information in connection with the original licence application by the partnership. He said that he was still awaiting final confirmation that the future operation of the business would be in full compliance with the Banking Act. He said that he wanted to be sure that Barlow Clowes had alternative plans for bringing their business within the confines of the Banking Act in the event of Lloyds backing out. On 10 June Herbert Smith reported to the Bank that Lloyds had indicated their willingness to offer the kind of custodian trusteeship arrangement that Midland had been proposing and that they (Herbert Smith) were drafting an agreement to be entered into by Lloyds and Barlow Clowes. They said that the only problem remaining was whether the arrangements might constitute an unauthorised unit trust. Also on 10 June the principal rang the Bank reporting that he had arranged a meeting on 18 June to be attended by DTI, Herbert Smith and Peter Clowes to discuss the licence application. He said that DTI intended to impress upon Mr Clowes himself the need for urgency and that they proposed to set a new deadline—the end of June—by which time they wished to be able either to grant the licence or to refuse it. The Bank official noted that the principal had told him that the Department were anxious to reach a decision before the situation became too widely known. The principal had said that, so far as the unit trust question was concerned, the Department could rely, for the purpose of the licence application, on a legal opinion from Herbert Smith (though this would not prevent their reaching a different conclusion of their own at a later date).

4.69 The proposed meeting took place on 18 June 1985. I have seen that, according to the Department's note of the meeting, Lloyds Bank's solicitors' concern was to ensure that the proposed arrangements for a single account for Barlow Clowes's customers would not constitute an unauthorised unit trust (their wish being to avoid any relationship with individual clients beyond being a bank in respect of deposits and custodian of the securities). The note records the assistant solicitor and Herbert Smith's representative (Mr A) as having discussed the technicalities of a "unit trust scheme", Mr A concluding that he thought there were various devices available for ensuring that the final arrangements brought the schemes outside the statutory definition. For his part, the principal said that most of the assurances sought in his letter of 2 April had been received by 18 April. Now that a licence application had been received from the company, the only outstanding matter was agreement by the Bank of England that the arrangements between Barlow Clowes and Lloyds would not breach the Banking Act. Mr A said that he thought that the Bank of England would be satisfied with the new arrangements but he doubted that these would be in place before Spicers' final report on the detailed client account reconciliations, which was still expected by the end of June. He offered the end of the first week in July as a target for resolving the Banking Act problem. Mr A said that the Bank of England had approved the outline agreement which, the DTI solicitor agreed, appeared to put the firm outside the Banking Act. Mr A added that Spicers' survey of clients had had a 90% response and he indicated that the reconciling of all of the clients' funds would not

be a problem. Such problems as had emerged were mainly concerned with dates of records. He reported that the management had been strengthened and Derek Tree was now well settled. Mr A said they would be beginning the process of re-negotiating all of the client contracts for transfer to the corporation but this would be a lengthy process and some clients might not agree. He added that the residual business activities of the old partnership would therefore require licensing in order to continue to run the existing business to the extent that it was not transferred. The assistant solicitor asked for a letter amending the description of the partnership's business to state that it existed to manage the "run-off" of its dealing obligations under prior contracts. (In evidence to me, the assistant solicitor explained, in regard to his request here, that the Act gave the Department no power to set conditions when granting licences. However, an applicant was required to submit a business plan. As a matter of law, this did not prevent him subsequently from departing from the plan, although the next year he would have had to submit a different one. But if the applicant said he was going to do X and then did Y that would raise questions as to whether he had always intended to do Y. If he had always so intended then his statement that he was going to do X would have been incorrect and a ground for revocation of his licence under section 5(1) of the PF(1) Act. That was, he said, why it had been important legally to get the assurance as part of the application.) Mr A agreed to meet the request and undertook to send a letter amending the partnership's business description, to send the Department copies of the final agreement with Lloyds, to send Spicers' final report by 1 July and to write confirming that the new arrangements did not constitute an unauthorised unit trust. The DTI solicitor said that it must be for Herbert Smith to satisfy themselves on all the aspects of the new arrangements.

4.70 Following the meeting the principal reported to the Bank that the discussion had been satisfactory; that the agreement with Lloyds was being drawn up; and that if it proved satisfactory to the Bank, the Department would be prepared to issue two licences—one to the company and one to the partnership. Herbert Smith's note of the meeting on 18 June 1985 recorded that "although the Department could not certify a negative they would wish Herbert Smith to confirm that it was our view that the arrangements did not constitute a unit trust". In their evidence to me, Herbert Smith told me that they had been asked at the meeting to confirm this point and also to confirm that in their view the new arrangements with Lloyds did not give rise to breaches of the Banking Act. They said that they had subsequently confirmed both points and were not aware that their views had been rejected or called into question at any time. They further told me that in expressing their legal opinion they had had reason to assume that the Department would seek advice from its own legal advisers. Herbert Smith have also told me that, in regard to their role in verifying the company's licence application forms as required by paragraph 1 of Part VIII of Schedule 1 of the Dealers in Securities (Licensing) Regulations 1983 (see 1.13), they had discussed the information required with each of the individuals concerned and had been satisfied that each of them had fully understood the questions.

4.71 Meanwhile, Mr Peter Hayes's correspondence with the Department (see 4.67) had been continuing, the principal having replied to Mr Hayes's letter of 28 May on 5 June. The letter of 5 June included the following: "However, I should point out that the Department's ability to pursue those who carry on the business of dealing in securities without authorisation depends on us identifying the miscreant in the first place. The Department's powers—as well as our resources—are limited and whilst we do seek to identify those concerned we value any assistance given in identifying offenders. As a practitioner in the field you are well placed to pass on to us information suggesting that someone may be trading whilst unauthorised and I would mention that we do receive this kind of information from time to time, particularly from NASDIM. Having been provided with a name we do follow up each allegation with the object of ensuring that all those who need to be authorised under the legislation and that appropriate action is taken against those who operate outside the regulatory net." Mr Hayes told me that following receipt of this letter, he had telephoned the principal in order to make quite sure that he had adequately identified Barlow Clowes. He said that he had a long conversation—some 20 minutes—with the principal. Mr Hayes told me that

during this conversation (of which there is no record in the Department's file), which had included discussion about the viability of Barlow Clowes's products and the financial security of their clients, the principal had explained at length the Department's dilemma. Mr Hayes said that at the end of the conversation, he had himself felt convinced that Barlow Clowes would not be granted a licence, particularly as bond-washing had just been legislated against. He had believed the principal to be "on top of the problem" and it was for this reason that he had not pursued the matter further. (I have seen that Mr Hayes wrote to the principal on 17 June thanking him for the conversation, which he said had done much to reassure him.) For his part, the principal has told me that he would dispute the suggestion by Mr Hayes that he provided any relevant information about Barlow Clowes beyond the fact that they were unlicensed dealers. He has said that he recalls no discussion about "viability" and "financial security". Given that the correspondence with Mr Hayes had started at Ministerial level, he would have been particularly careful of what he had said to him and would have noted anything of relevance Mr Hayes had said to him. As it was, the conversation had taken place against the background of Mr Hayes's concern about the Department's general approach to enforcement of the Act. Nothing he had said could possibly have given Mr Hayes his alleged "conviction".

4.72 The principal wrote to Herbert Smith on 20 June, reviewing what had transpired at the meeting on 18 June. His letter said "My letter to you of 2 April 1985 set out a number of matters which I considered relevant to the consideration of the then licence application. You subsequently provided information on all these points (including a further application by a new company—Barlow Clowes and Partners Limited) except final confirmation of the position under the Banking Act 1979. I am aware that it has taken you longer than you anticipated to produce the requested confirmation and I appreciate the reasons for this delay. You explained at the meeting that Lloyds Bank plc has agreed, in principle, to act as custodian trustee in a way which would enable you to give the requested confirmation that the future conduct of business will be carried out in full compliance with the Banking Act 1979." He said that, following their discussion, the Department looked to Herbert Smith for confirmation that the new arrangements did not constitute an unauthorised unit trust and he asked Herbert Smith to let him have a revised description of the partnership's business so that in the future the partnership would be restricted to running off its existing commitments. He asked for this information to be provided within the next few days, confirming that it should not be delayed pending the receipt of the Spicers report and commenting that he was in the meantime "relying on the assurances and undertakings which have already been provided". I have seen that on 21 June he reported to his assistant secretary "we are almost there". He said that he expected the necessary clearances in respect of the banking arrangements and the unit trust point to be obtained within two weeks, whereupon "we can proceed to issue a licence". He continued: "In fact we will need to issue licences to both the partnership and the limited company so that the former can run off the old business in an orderly manner. Further and better particulars will be provided by Herbert Smith & Co in support of the existing licence applications. We might have Spicers' report within this time scale although I made it clear to [Herbert Smith] that they should not delay matters pending receipt of that report. We have assurances that it will be provided to us on completion and that, for the moment, is sufficient." The principal said that their difficulty was getting the arrangements finalised. He said that although he had stressed the urgency of the matter, he thought Herbert Smith were aware that there was no set deadline; and he added that the length of time that had already elapsed did not help the Department's cause. He said that if everything had not been settled by 3 July he would propose to issue formal notices of intention to refuse the two applications, which would give Barlow Clowes a further two weeks to sort things out. If the assistant secretary agreed his proposed line he suggested that a letter should go to the Bank and the Treasury and he submitted a draft letter for approval. He added that he had reported the outcome of the meeting on 18 June to officials of the Bank and the Treasury. He said that he had also told Mr Grant of NASDIM because "on 19 June the NASDIM council was due to decide the fate of [the intermediary] who has had a significant involvement with Barlow Clowes...". On 24 June the assistant

secretary wrote to the Bank and the Treasury. He outlined recent developments, indicating that if the points discussed at the meeting on 18 June were resolved as expected within the next ten days or so, and "if the Bank can confirm to us that they are content" the Department would license Barlow Clowes. However, he saw the need to have contingency plans, in the event of Lloyds pulling out, involving the urgent closing down of the firm. He said that if everything had not been sorted out by 3 July the Department would issue notices of intention to refuse the applications and would follow this up with steps to close down the business through action to appoint a receiver via Midland Bank. He went on to explain that the Department needed to issue a licence to the old partnership which would be gradually transferring its contracts to the new company, a slow process because of the need to get clients' consents. He said that there was an advantage in this arrangement, in that the Department would be able to monitor progress. He said that they expected Spicers' report by the end of the month but that "if we are in a position to grant a licence before then we will do so". He said that the report was not expected to disclose any matters of significance.

4.73 In the meantime the Department were proceeding with their usual checks in respect of the company's application for a licence. On 20 May the principal had asked the SEO what was known about one of the managers of the company. The SEO told him that the manager concerned was not known to the Department. The SEO gave instructions for the usual checks to be made, which revealed nothing detrimental. On 1 July the Department were sent a copy of a minute from the Chancellor of the Exchequer's private office to the Inland Revenue asking for a draft reply to a letter dated 26 June which the Chancellor had received from a constituent. The assistant secretary said that it called for no action by the Department. I have seen that the constituent's letter was concerned with Portfolio 30—which the constituent said (as a financial adviser) he had found a useful form of investment. He was concerned that the Revenue's proposals regarding bond-washing would adversely affect the portfolio. In their submission putting up a suggested draft reply, the Revenue summarised the activities of Barlow Clowes, and said that "we understand that the firm had about £400m. under management when the accrued income scheme was announced". An annex to the submission (prepared by the Treasury) summarised the recent history and concluded that "whilst there are still some details to be finalised, neither the Bank nor the DTI now believe there is anything seriously amiss at Barlow Clowes". The Chancellor's reply of 26 July to his constituent's letter confined itself to the proposed changes in tax legislation and the reasons for them. Also on 1 July a Treasury official wrote to the assistant secretary in response to his letter of 24 June, saying that he took some cheer from developments but that he was "sufficiently wary of this case not to start counting chickens yet". He continued "I agree with your perception of the position and proposed action".

4.74 On 8 July Herbert Smith wrote to the Department asking for their letter to be considered as a formal request for the partnership's licence application to be amended to show that the business to be undertaken was to be limited solely to the running off of the existing partnership portfolios managed by the partnership. (In evidence, Herbert Smith told me—in relation to their letter of 8 July—that they themselves had given no confirmation that the business was to be transferred from the partnership to the new company.) Herbert Smith sent another letter to the Department on the same day. They said that Lloyds Bank had agreed, subject to formal documentation, to provide a custodian facility. They enclosed a copy of a letter dated 1 July from Lloyds setting out the proposed arrangements. This letter said that their offer did not apply to the partnership's presently existing clients but only to new clients taken on after 1 July 1985. Herbert Smith enclosed with their letter copies of a draft Trust Deed, a draft mandate in favour of Lloyds Bank plc and a draft Portfolio Management Agreement to be entered into by clients. They explained that the Portfolio Management Agreement would vary in accordance with the different facilities provided. Herbert Smith said that the documents would enable DTI to see the structure of the relationship and the way in which it was intended to operate. They said that in their view the arrangements did not result in any breach of the Banking Act and enabled Barlow Clowes and Partners Ltd to

comply with the requirements of the Licensed Dealers Regulations. They said that the draft documents had to be approved by Lloyds' solicitors but that they did not envisage any substantial changes.

Under the terms of the draft Trust Deed Lloyds Bank plc ("the Custodian") undertook to:

- (a) receive investment monies from persons wishing to establish a portfolio with the company
- (b) hold such investment monies in a bank account opened and maintained by Lloyds on behalf of the company
- (c) deduct therefrom and pay to the company its new contract fee and its administration fee payable half yearly in advance
- (d) invest the balance in fixed-date UK Government stocks, bonds or other securities (Government Obligations) as directed by the company to enable it to comply with the terms of its Portfolio Management Agreement
- (e) hold the UK Government Obligations, cash or any other assets representing the same as custodian trustee.

For its part, the company undertook to send to the Custodian a duly authenticated copy of each Portfolio Management Agreement; so far as practical to ensure that each client's investment monies were paid direct to the Custodian; to the extent that this was not done to forward to the Custodian funds received by the company or any of its agents without any deductions whatsoever; and to instruct the Custodian to hold on behalf of the clients such UK Obligations as had been purchased by the company in the name of the Custodian to enable it to comply with the terms of the Portfolio Management Agreement. The Custodian was to maintain a bank account under a specific number, to be referred to by the parties as "The Barlow Clowes Clients' Account". The Deed which contained other stipulations besides those mentioned above, was to operate for one year and thereafter either side could terminate it giving six months notice. I referred the principal to the fact that the new arrangement did not include Herbert Smith's management agreement proposal for dealing with the continuation of the management of funds deposited with the partnership (paragraph (e) in their letter to the DTI of 18 April 1985—4.53 above) and asked him whether he had regarded the position as satisfactory. He said that they had been hoping that the formation of a limited company would have enabled Barlow Clowes to make a fresh start by transferring all their current investment agreements to the new company but said that they had concluded that (as they had found in other circumstances) getting that kind of clean break was difficult to achieve.

4.75 A Bank official telephoned the principal on 8 July to enquire about progress. The principal told him what he had received from Herbert Smith and also said that Spicers' report was not yet available. In his note of the conversation the official recorded his impression that, from what the principal had said, that would not of itself prevent the granting of a licence. The principal had, he said, made clear that the Lloyds Bank material established that the new arrangements related only to clients' agreements entered into after 1 July 1985 and that there was "no commitment with regard to the transfer of existing agreements out of the partnership". On 15 July the Bank wrote to Herbert Smith raising two technical points on the wording of the draft documents and saying that subject to clarification of these two points, the Bank's view was that the proposed arrangements did not breach the Banking Act. The letter said that although it was noted that the new arrangements were to be in respect of new clients only, the Bank would expect new deposits by existing clients to be included in the new system. The principal also wrote to Herbert Smith on 15 July, acknowledging both of their letters dated 8 July. He said that the Bank of England would be deciding whether the new arrangements breached the Banking Act. He went on, "It is, of course, for Barlow Clowes and Partners Ltd, Lloyds Bank plc and their respective advisers to satisfy themselves that the proposed arrangements comply with relevant regulatory requirements. Accordingly I have not considered the documents enclosed with your letter in detail and, in particular, I have not referred them to the

Department's legal advisers". He went on to ask for written confirmation that in the solicitors' view the new arrangements did not constitute an unauthorised unit trust. He said that the Department expected licensed dealers to conduct their business properly and he referred Herbert Smith specifically to rules 7, 13, 14 (as regards investment management contracts and the form which such contracts should take) and rule 27 (as concerned compliance with generally accepted standards of good market practice) of the 1983 rules. He said that he had not considered whether the various documents met with the detailed requirements of these rules. He said that he awaited Spicers' report, which he understood would be available shortly and that the licence would in all probability be granted subject to the following points being satisfactorily resolved within the next few days:

- (a) Bank of England agreement that the Banking Act was not breached
- (b) confirmation that an unauthorised unit trust was not operating
- (c) the Department received a copy of Spicers' final report
- (d) the report was satisfactory
- (e) no other relevant matters came to light

4.76 A Bank official telephoned the principal on 31 July for a progress report. The principal told him that he had heard from Herbert Smith the previous week that Spicers' report was being typed but that he had not yet received a copy. Nor had Lloyds yet formally agreed to undertake custodian arrangements. The principal said that he was about to go on leave and was minded to suggest that notices of intention to refuse the licences be issued. Herbert Smith wrote to the Department the same day. They said that subject to two points requiring clarification, the Bank of England had agreed that the proposed arrangements would not breach section 1 of the Banking Act 1979. They said also that their view was that the proposed arrangements did not constitute an unauthorised unit trust. They said that such provisions as permitted the company to mingle monies and/or invest on a collective or individual basis were designed solely to permit flexible and efficient management of the funds. There was no intent that there should be any benefit to the individual investors as a result of such collective action. They enclosed a copy of Spicers' "report on the audit of the partnership client account". And they confirmed that Lloyds' solicitors did not require any amendments to the draft documentation which would affect the general structure of the arrangements. The document they enclosed consisted of three pages as follows:

Page 1

**"BARLOW CLOWES AND PARTNERS CLIENTS ACCOUNTS
REPORT OF THE AUDITOR TO BARLOW CLOWES AND
PARTNERS**

We have audited the financial statements set out on pages 2 and 3 in accordance with approved Auditing Standards and have obtained verification of the clients' investments and cash. In our opinion the statement is properly drawn up in accordance with the books and records and gives a true and fair view of the composition of the clients' funds at 28 December 1984.

London EC3
1st August 1985

Spicer and Pegler
Chartered Accountants

Page 2

BARLOW CLOWES AND PARTNERS CLIENT ACCOUNTS

28 December 1984

ASSETS	Note	000's
Cash at Bank		379
Investments	1	88,962
Sundry debtors		<u>224</u>
		<u>89,565</u>

LIABILITIES

Amounts due to Barlow Clowes and Partners	112
Sundry creditors	<u>25</u>
	137

APPROVED BY BARLOW CLOWES AND PARTNERS

P Clowes

1st August 1985

REPRESENTING

Clients Accounts	<u>89,428</u>
------------------	---------------

Page 3

BARLOW CLOWES AND PARTNERS CLIENT ACCOUNTS

NOTES TO THE STATEMENT OF ASSETS AND LIABILITIES

28 DECEMBER 1984

1. Investments held by the Fund

[There then followed a list of gilt-edged stocks showing both nominal and market values per security held. The total market value of all securities held was shown as £88,961,961]"

On 2 August, a departmental accountant (who has since died) returned the report to a junior official training under the principal saying—and I quote his minute in full—“You asked me to look at the report prepared by [Spicers] on the clients’ accounts held by this firm. I have not previously seen any auditors’ reports on client accounts so I do not know if this conforms to the norm. However it does appear to be a comprehensive statement which, while it cannot *guarantee* that no client money is missing (and no audit report will ever provide a guarantee) gives as reasonable an assurance that all is well as one can expect”. The principal told me that in approaching a departmental accountant in his absence his junior had been carrying out his (the principal’s) instructions. When I asked (there being no other evidence on the file relating to the point) what, if any, description of what had happened—or other related documents – would have accompanied the report when it was referred to the accountant, the principal said that he thought that only the report itself, with no other papers or information, would have been sent. He further told me that, especially in the light of the departmental accountant’s advice, the report, which he had seen on his return from leave, had seemed to him satisfactory and had been the kind of document he had been expecting to see. (In representations which the principal later made to me about my account of his evidence here, he wrote: “We did not send Spicers’ report to the departmental accountants without any introduction. We knew that we would need advice on the report when we received it. I made arrangements for this to be obtained as speedily as possible and spoke to the departmental accountant in advance of receiving the report. I am sure the departmental accountant would not have given the advice he gave without this background information”.)

4.77 When I asked the relevant partner in Spicers (Mr B) about the statement and report dated 1 August (see previous paragraph), he described what Spicers had produced as an audited balance sheet of the client funds of the UK partnership as at 28 December 1984 with an opinion attached. The statement had, he said, balanced the total assets with the amounts due to clients. When I referred Mr B to the apparent narrowness of the reference, in Spicers’ report, to the statement as giving “a true and fair view of the composition of the clients’ funds at 28 December 1984”, and asked whether he was saying that the Department were entitled to treat the statement as going further than simply verifying what existed at 28 December 1984, he responded that the statement and report could be regarded as conforming to the requirement set out in paragraph 8(d) of the letter of 2 April 1985, as well as representing the audit of the client accounts which the partnership, as a result of

the letter of 2 April, had instructed Spicers to carry out by their letter to Spicers of 18 April 1985. When I asked him whether Spicers had regarded their instructions to audit the clients' accounts as requiring them to concern themselves with whether the funds standing to the credit of clients would prove sufficient to enable the partnership to meet future contractual liabilities to clients, he said that they had not regarded that as part of the work of auditing the client accounts. When I put it to Mr B that an audit of, for example, a solicitor's client account involved the auditor reporting on compliance with the Solicitors' Accounts Rules and asked him whether he considered that Spicers' report should have covered the subject of compliance with the licensed dealers rules, his response was that it had been clear to all concerned that in the past the partnership had not been complying with those rules (which had not, he pointed out, been applicable to the partnership at a time when it had not been licensed).

4.78 On 1 August Herbert Smith wrote to the Bank to say that revised draft terms of the custodian trusteeship arrangements would follow when the drafts had been agreed by both parties. On 14 August the assistant secretary wrote to Herbert Smith acknowledging receipt of their letter of 31 July and seeking confirmation that the two points raised by the Bank of England had been settled to their satisfaction and that the arrangements between Lloyds and their client had been completed. Herbert Smith replying on 16 August promised to let the Department know immediately everything had been sorted out. On 23 August Herbert Smith sent the Bank details of the proposed amendments to the documents and asked for confirmation that these would satisfy the two technical points the Bank had raised. They also said that the Bank's requirements that new monies from existing partnership clients should be dealt with under the new arrangement had been "noted and passed on to their client". The Bank confirmed on 4 September that the proposed amendments were satisfactory. On 11 September the principal wrote a file note stating that he had on 3 September spoken to Herbert Smith to enquire about progress. He said that they had told him that they were awaiting final agreement of the draft documents from Lloyds' solicitors and confirmation from the Bank of England that the two points that they had raised had been dealt with satisfactorily. They expected everything to be settled within a few days. He then spoke to a Bank official who confirmed that the Bank had heard from Herbert Smith. The principal noted that before making these enquiries he had discussed the case with the assistant secretary who had agreed that all that could be done was to chase up Barlow Clowes's solicitors. The principal noted however, that "if the matter drags on for very much longer, it will be necessary to reconsider the course of action adopted in this case". On 3 October Herbert Smith sent the Department certified copies of the Trust Deed and the mandate form. They said that the new arrangements had been in operation since 1 July and asked if the licence applications could now be dealt with. The principal telephoned the Bank on 7 October, saying that it was expected that licences would now be issued.

4.79 On 17 October the principal made a submission to Mr Howard (who had succeeded Mr Fletcher as PUSS on 2 September) through his assistant secretary, who added a postscript to it. The submission was as follows:

"LICENSED DEALER APPLICATION: BARLOW CLOWES & PARTNERS

THE PROBLEM

1. Should we grant a licence to deal in securities to the above firm which presently, and for some time, has been operating in breach of the Prevention of Fraud (Investments) Act 1958.

RECOMMENDATION

2. For the reasons given below (and further explained in earlier submissions) officials propose to grant the requested licence.

TIMING

3. In view of the delays in getting to this position, an early decision would be helpful.

BACKGROUND

4. The background to this problem is set out fully in the submissions made to Mr Fletcher in March and April 1985 (copies attached). Briefly the problem is this. We discovered that Barlow Clowes and Partners (a partnership) had been dealing in securities in breach of the Prevention of Fraud (Investments) Act 1958 for a number of years. The partnership duly applied for a licence. If we rejected the licence application the business would have to be closed which, given that this is a partnership, would have been a very messy affair and the costs of sorting out the muddle would be considerable and would probably be borne by investors. Before granting a licence, however, we would wish to be satisfied that the present operations appear "clean" and that the partnership was properly looking after investors' money. A further complication was the discovery that the partnership was accepting deposits in breach of the Banking Act 1979. Mr Fletcher accepted the recommendation (paragraph 7 of my submission of 11 April 1985) that efforts should be made by us and the Bank of England to obtain such assurances as we could about the existing business, to ensure that the partnership ceased to act in breach of the Banking Act and then to grant licences under the Prevention of Fraud (Investments) Act 1958 to legitimise its dealing in securities.

5. It has taken much longer than we anticipated to resolve the situation. This arose because Midland Bank, which acted as custodian for the partnership, decided that it would not be prepared to take on added responsibilities, which it needed to do as a way of resolving the Banking Act problem. The partnership was forced to look for an alternative custodian. Lloyds Bank agreed in principle to so act in July but the documentation has only recently been finalised. The position now is that the business is no longer being conducted in breach of the Banking Act 1979; we have obtained the report of accountants (Spicer and Pegler) which indicates that client monies have been properly accounted; we have successfully persuaded the partnership to set up a limited company which will conduct all future business (this would allow the Department to use its Companies Act investigation powers if need be in the future; such powers do not extend to partnerships of course); and all that now remains is for the Department to reach a decision on the licence application.

6. In fact there are two licence applications. The original partnership application and a new one by the limited company which bears the name Barlow Clowes and Partners Ltd. Both entities will require licences—the partnership to run off past business; and the company to conduct new business.

7. It was not practical to require the partnership to suspend its operations over the last few months. The partnership manages some £100m of investments on behalf of clients and advises other clients. Nevertheless the partnership has complied with our request to stop advertising and thus the amount of new business taken over the last few months will have been much reduced. The business had now engaged reputable City firms of solicitors and accountants to advise them on their activities. It appears probable that the lack of expert advice was partly to blame for the partnership finding itself carrying out unlicensed dealing.

RECOMMENDATION

8. The partnership has co-operated fully with the Department (and the Bank of England) in seeking to put its house in order. The efforts made by the business should not be underestimated and have probably cost it significant sums of money in fees for its professional advisers. From all that we have seen the business is now properly run and properly advised and accordingly I recommend that the licences should be granted without further delay.

The assistant secretary's postscript read:

"I agree with this recommendation. In view of much Bank and some Treasury involvement (at Ministerial level) in this extraordinarily difficult case, it would be appropriate to send a 'signing off' letter to the Economic Secretary. Draft submitted."

On 21 October the PUSS agreed the recommendation and he wrote to the Economic Secretary copying his letter to the Deputy Governor. He said that "we have at last been able to dispose of this very awkward case.... The firm has provided the answers requested and its accounts have been certified as complete and accurate by an independent accountant". The letter said that the Bank of England being now satisfied with the arrangements with Lloyds Bank, Barlow Clowes were to be legitimised under the Act.

4.80 On 23 October the SEO, submitting to the assistant secretary a draft letter which was to go to Herbert Smith with the licences, said that at the principal's suggestion he had indicated in the letter that the Department had relied heavily on Herbert Smith's assurances. He said "this may give them an incentive to let us know quickly if they find in the future that they have been hood winked". He said that the letter kept open the option of prosecution for past offences until a considered decision had been reached on that point. The SEO wrote to Herbert Smith on 25 October enclosing principal's licences in respect of the partnership and the company. He said that representative's licences had been sent direct to six persons (including Mr Clowes and Dr Naylor). The letter went on "the decision to grant these licences has been taken in the light of the information currently in the Secretary of State's possession, and has been heavily influenced by the assurances received from or through yourselves". The letter concluded that the Department reserved the right to take into account past activities of Barlow Clowes should future events bring them into question. The partnership's licence was signed by the assistant secretary on 22 October to take effect from 28 October 1985. It authorised Peter Clowes and Pamela Margaret Clowes trading as Barlow Clowes and Partners to carry on the business of dealing in securities. The company's licence was signed by the assistant secretary on 24 October to take effect on 28 October 1985. The six representatives' licences were signed by the SEO on 25 October and sent direct to the individuals concerned.

4.81 In commenting to me Herbert Smith told me that when they had written to the Department on 3 October 1985 confirming that the arrangements with Lloyds Bank had been in operation since 1 July they had done this only after establishing the position with their clients and had therefore been representing the position on behalf of their clients. Herbert Smith told me that in their view, they had given no assurances to the Department on their own behalf, and they asked me to give careful consideration to the statement in the Department's letter of 25 October that "the decision to grant these licences ... has been heavily influenced by the assurances received from or through yourselves". Spicers have commented to me on paragraph 5 of the Department's submission of 17 October 1985 to the PUSS which said "we have obtained the report of accountants ... which indicates that client monies have been properly accounted". Spicers told me that their report of 1 August 1985 had dealt with the truth and fairness of a balance sheet of client funds as at 28 December 1984. They said that their report had not dealt with the conduct of the partnership's business and in particular had not addressed the extent of compliance with the Conduct of Business Rules to which the partnership would have been subject had they been licensed. Nor had it dealt with events in the seven months which had elapsed since 28 December 1984. Spicers commented to me that the Department might not have appreciated the limits of their work and might have placed greater reliance on it than was justified. In written comments to me Spicers drew a distinction between acting, as they had, for the partnership—primarily in an accounting/auditing role—and being employed by the Department as investigating accountants. If their role had been the latter, communication between themselves and the Department would have been uninhibited. They pointed out, in that connection that it appeared from Sir Godfray Le Quesne's report, that the Department had been aware of a number of indications that all was not well (they referred in particular to paragraphs 4.4, 4.6, 4.8, 4.9, 4.12, 4.14, 4.22,

9.2 to 9.8, 9.15 to 9.17 and 9.19). Understandably, they said, given Spicers' actual role the Department had not felt able to relay all these to Spicers. However the effect had been that Spicers were not directed to those areas which appeared to have been causing the Department specific concern. Had they been told what the Department knew, they would perhaps have acted differently. Had the Department employed investigating accountants it was likely that more extensive terms of reference, such as those outlined in paragraph 14 of the submission to Mr Maude of 13 October 1987 (6.49 below) would have resulted. As it was, although they had of course agreed to provide the Department with certain information, they had done so on the instructions of the partnership. While they had naturally believed their reports to the Department to be accurate, the subject matter of those reports had been determined by the partnership rather than the Department. Subject to what had been agreed between the partnership and the Department and to any applicable professional and legal obligations, Spicers had owed the partnership a duty of confidentiality and, indeed, a general duty of care. (Subsequently Spicers, through their solicitors, referred me to the very limited circumstances in which, under the guidance given at the time by the Institute of Chartered Accountants in England and Wales, members of the Institute were relieved of their personal duty not to disclose information about their clients' affairs to other persons.)

4.82 The assistant secretary told me that he felt that the comment in the draft letter submitted to the PUSS on 17 October that Barlow Clowes's accounts had been certified as complete and accurate by an independent accountant had been justified. I discussed with the principal the work being done by Spicers and the Department's reliance on their work. He said that Spicers had been quite clear as to what they were being asked to do and why. Had they found deficiencies in the client accounts during the course of their work, he said, they would clearly have been under an obligation to inform the authorities. I asked the principal if he thought that the fact that Spicers had been employed by Barlow Clowes rather than by the Department and that he had not adopted the Bank of England's suggestion that Spicers should be authorised in writing by Barlow Clowes to contact DTI during the course of the audit (4.42) might have limited what the Department could have expected to receive from them. He said that Spicers had been well aware of the circumstances in which they had been engaged and would not have risked their reputation by not reporting to the Department anything untoward that came to light. I asked him if he thought it reasonable to have expected Spicers to have reported to the Department on anything other than what the Department had specifically asked of them. He said that Spicers had known that their work was not solely a formal audit; the question of whether or not a licence was to be granted had depended on their work. He had thought the going-concern certificate provided by Spicers also to have been of significance. He said that he had regarded these certificates in a serious light because the accountants signing the certificate would have had to have made enquiries about the firm, and he had felt that the certificates signed by Spicers—qualified as they were—had confirmed that the firm was sufficiently financed to carry on the business they were proposing to do and had been an indication of Spicers' confidence in Barlow Clowes. The principal has also said that he had found it reassuring also that Herbert Smith had felt it appropriate to act for Mr Clowes. When I saw Sir Alex Fletcher I asked him whether he had felt that it was right for the Department to have regarded Spicers' report as having been made to the Department, and whether the Department could reasonably have expected Spicers to volunteer information which had not actually been asked for. Sir Alex said that Spicers' first duty had been to their client but that he saw no reason why they should not—with their client's agreement—have reported also to the Department. As to volunteering information to the Department, he said that a firm of Spicers' standing could have been expected to stick to their professional ethics and their terms of reference. I put it to Sir Alex that there were indications in the papers that the Department were prepared to issue a licence to Barlow Clowes in advance of the audit report from Spicers, provided that they could be satisfied that the firm were no longer contravening the Banking Act. Sir Alex indicated that Ministers might not have given approval to such a course of action, which in the event had not been put to them because of the very long delay in the Banking Act point being

settled. The assistant secretary, making the same point when I saw him, told me that, as matters turned out, they had never actually found themselves in a position of having to decide whether or not to issue a licence before receipt of Spicers' report, because the Banking Act problem had first to be resolved.

4.83 Towards the end of my investigation I received (through Alexander Tatham, acting for investors) a written submission from a financial journalist, Miss Lorna Bourke, regarding contacts which she said she had had with the press office of DTI (usually with a particular officer, whom I shall call officer X) between the summer of 1984 and the end of 1986. In the course of these contacts, Miss Bourke had, she said, sent the Department a number of letters of complaints from readers. She had also told the press office of the serious doubts which she (and a number of other financial journalists) had had about the high returns promised by Barlow Clowes and had urged the Department to put a stop to the firm's activity before a lot of innocent victims lost their money; indeed, she had been convinced that Barlow Clowes had been using new investors' money to pay existing clients. When I put Miss Bourke's submission to the Department, they said that a thorough search of the press office files had yielded no evidence of documents being sent by Miss Bourke. Nor—as I would know from my own examination of the Financial Services Division files—did the latter contain any such evidence. Furthermore, none of the staff concerned including officer X, had any recollection of calls from Miss Bourke relating specifically to Barlow Clowes, nor of receiving papers from her.

4.84 In subsequent evidence (which I took jointly from Miss Bourke and officer X) Miss Bourke maintained that she had spoken to the Department's press office (or other officials to whom they had referred her) about Barlow Clowes on numerous occasions in 1984 and 1985. She said that she had spoken—she believed to officer X—about Barlow Clowes's advertising and had been told that, while the advertising had contravened the PF(I) Act, bond-washing had been stopped and that the advertising had also ceased—this would have been, Miss Bourke thought, some months after the change in the law affecting bond-washing (which was made by the Finance Act 1985, with general effect from the end of February 1986). Miss Bourke maintained that, on at least three occasions, she had sent to the press office copies of letters of warning or complaint which readers had sent her. She had not received any reply from DTI but had not been expecting to do so as she had simply sent them photocopies of the letters (one of which—written anonymously and dated 17 July 1984—she said she had been able to find, and showed me), on which she would have scribbled a brief note. The letter which was shown to me expressed concern and misgivings on the part of "City contacts" about Barlow Clowes on a number of accounts: unlicensed dealing in securities, failure to allow for charges in the rates of return quoted, conducting schemes which would have required a Deposit Taker's Licence, failure to issue contract notes to clients or to enter into a management agreement with them, doubts about the tax effectiveness of the schemes and uncertainty as to the clients' entitlement to profits made and liability for losses sustained. The writer commented that, whilst his contacts said that they had no reason to doubt the integrity of Barlow Clowes, the firm's willingness to flout legislation had to pose a question mark in the minds of anybody considering their scheme. In her written statement, Miss Bourke said that she had received another anonymous letter, which had suggested that she should ask Mr Clowes about his offshore companies into which, the document alleged, UK investors' funds were being channelled. Miss Bourke said that she had subsequently interviewed Mr Clowes who, she said, had readily admitted that he had a number of offshore companies, many more than the anonymous document had indicated. Miss Bourke told me in evidence that she had sent a copy of this document also to the DTI press office.

4.85 Miss Bourke said that she recalled two particular telephone conversations with officer X: in the first, which would have been shortly before the issue of the first licence (in October 1985—see 4.80), she had been told that DTI could not investigate Barlow Clowes because it was a partnership and, in the second, which would have been some time after the issue of the first licence, she had been told

that the Department were reluctant to take action because it might precipitate the collapse of the firm. Officer X, on the other hand, had no recollection either of having had any contact with Miss Bourke about Barlow Clowes or of receiving any documents from her and, indeed, recalled having received only one enquiry about Barlow Clowes from a journalist. This had been shortly before the issue of the first licence, on which occasion (having spoken to the Licensing Unit) officer X was told that a licence was to be issued shortly, that there was no need for concern about Barlow Clowes which was a well-run concern and that their operating without a licence was "a technical discrepancy". In addition to the latter evidence, which was given to me orally by officer X in Miss Bourke's presence, it was represented to me later (by solicitors acting for officer X who had also been present at the oral evidence-taking) that the evidence of Miss Bourke was contradicted in every relevant particular by that of their client. Officer X had, they said, handled press comments and complaints about licensed dealers during most of the period concerned and had confirmed that where there had been telephoned or written complaints a press office file would be opened. None had been opened at that time for Barlow Clowes and officer X disputed having had any material approach from Miss Bourke about Barlow Clowes or having received any documents from her.

Findings
October 1983—November
1984

4.86 It had been suggested to me, on behalf of investors, that closer monitoring of the press from 1975 onwards would have brought the activities of Barlow Clowes to the Department's attention well before 1983. I found no evidence to suggest that this would have been so. As indicated earlier (paragraph 9 of the Introduction), advertising in the national press began only in the later part of 1983, and by October 1983 the Department were aware of the firm, as a result of informal monitoring of advertisements in the weekend press by one of their officials (4.1), although evidence of Barlow Clowes's dealing in securities did not come forward until early December (*ibid*). It was not, however, until some four more months had passed—during which time additional evidence of Barlow Clowes's holding themselves out as dealers in securities in Great Britain had been brought to the notice of the Licensing Unit (4.2 and 4.3)—that the official concerned gave instructions that Barlow Clowes should be written to, after which a further month elapsed before the letter was sent (4.4). The reason given by the official for having delayed taking action on Barlow Clowes was his belief that the partnership had either applied to NASDIM for membership or had been making enquiries of them about doing so. It seems clear that no application had in fact been made, but the possibility that there had been enquiries cannot be excluded. As I see it, action should in any case have been taken to clarify the position. The failure to take such action led to an unnecessary delay, which merits my criticism.

4.87 Once contact had been made with Mr Clowes by telephone on 19 June, following the Department's reminder four days earlier (4.7) the delay in obtaining a licence application from the partnership was, largely, not attributable to the Department. But bearing in mind the disturbing reports which had been reaching the Licensing Unit from 30 May onwards (4.5 to 4.9) the Department are, in my view, deserving of criticism for failing to press for more urgent action between the dispatch of application forms on 31 July (4.7) and their receipt on 7 November 1984 (4.12). Following receipt of the application forms a meeting was arranged, and took place on 18 December.

December 1984

4.88 As is shown in paragraph 4.12 above, the licence application had been made by Mr and Mrs Clowes as the partners in Barlow Clowes and Partners, with addresses in London and Cheshire. At this point it is necessary to look at the question of the Jersey partnership. Here I should begin by recording that the Principal Officer, when giving me his comments on the complaints on 28 November 1988, had made the point, in response to certain aspects of the case advanced on behalf of investors in the offshore Barlow Clowes funds, that since Barlow Clowes was a partnership the partners' licences would cover the licensable activities of the partnership as a whole—wherever individual portfolios were being managed or administered from. It was thus misleading, he said, to refer separately

to the “offshore partnership”: the operation was—for licensing purposes—indivisible, and thus was licensed when the partnership was licensed in October 1985. On 22 December 1988, however, the Principal Officer wrote to me to say that contact with the inspectors appointed to look into the affairs of James Ferguson Holdings plc had brought information to light which meant that his initial reply might have inadvertently been misleading as regards the “Jersey partnership”, for which he apologised. He stressed however that the new information had not been available to the Department at the relevant time (in 1985). It had turned out, he said, that there had been a separate Jersey partnership, of the same name, consisting of Mr Peter Clowes and a company owned by his Jersey solicitors called Conwin Services Limited. The question of a principal’s licence for Conwin Services Limited (the PF(1) Act having meant that each partner of a partnership dealing in securities in this country needed a principal’s licence) had not arisen in 1984–85 because the Department had not known that the Jersey firm did not comprise the same partners as the GB Barlow Clowes and Partners. The facts had been further obscured, the Principal Officer said, because the Department had been told in December 1984 that the Jersey Portfolio 28 was designed for expatriates but to all intents and purposes managed from London. Thus it seemed, he said, that the separate identity of the Jersey partnership had not been disclosed or explained. The Department had still not known, he added, that the Jersey partnership had had different partners from the GB partnership when, in July 1986, Mr Clowes had explained that his offshore operations were thenceforward to be handled from Geneva or Gibraltar. (The Department’s note of a meeting with Mr Clowes on 30 July 1986 records that he had told officers that “he had set up a partnership in Jersey in 1976 to service expatriates”—see 5.4 below.)

4.89 I believe that such discussion as there was of the Jersey business at the meeting on 18 December 1984 (4.23 to 4.25) cannot have included any mention of the fact that the Jersey business was carried on by a separate partnership. The recollections of the principal and the assistant secretary of that discussion do not include any mention of that, and if it had been mentioned I believe it would have been noted as a point of some significance. Nor is there any indication of officials having been told of the point on any other occasion during the 1984–85 licensing process. On the other hand, there was material in the Department’s files which provided positive evidence of the existence of a separate Jersey partnership in the form of the letter of 7 December 1983 to the departmental solicitor enclosing information about Portfolio 28 (4.1). And that material cannot be said to have been buried in the Department’s files. It had been brought specifically to attention shortly before the meeting of 18 December 1984 (4.17), and indeed had been the cause of officials’ enquiries about the Jersey operations at that meeting. Additionally, it seems to me that Mr Clowes’s reference at the meeting to Portfolio 28 having been located in Jersey “for tax reasons” (4.25) provided a pointer to the probability of there being a separate Jersey entity. More generally, the background to the meeting on 18 December was not just concern about unlicensed dealing by Barlow Clowes. Other doubts and concerns, going to the fitness of the firm, had been raised and were regarded as coming from sufficiently trustworthy sources to require further enquiries before any question of a licence could be considered. In these circumstances it seems to me that officials should have been careful to check the information which Mr Clowes had given them with the information already in their possession. If that had been done as regards the Jersey operations, it would have been seen that Mr Clowes’s assertion that Portfolio 28 was designed for, or confined to, expatriates (4.25) was difficult to square with the terms of the Portfolio 28 brochure and the receipt by the departmental solicitor of promotional material from a Jersey address (4.1). And such a checking process would, of course, have provided yet another opportunity to observe the indication of a separate Jersey partnership. All in all, I can only conclude that the Department ought to have been aware, in December 1984, that there was a separate Jersey partnership, from which it follows that they ought also to have been aware, *inter alia*, of the limitations—in terms of what was then, and thereafter continued to be, under consideration by Herbert Smith and Spicers—which flowed from the fact that it had been the UK partnership alone, comprising Mr and Mrs Clowes, on whose behalf the application had been made in November 1984 (4.12). I look later, in Chapter 8, at the consequences of the faults which I have identified here.

4.90 I turn next to the Department's decision in December 1984 that, rather than taking any other possible course, they should ask the partnership to allow access to its books and records in order, to put it shortly, to seek reassurance as to the partnership's conduct of its business and as to the safety of investors' funds. I should mention at this point that it has been contended on behalf of investors that the Department's freedom of action in dealing with the partnership during this 1984–85 period had been inhibited by the bad advice given in 1975–76 (Chapter 3). I have however found it convenient to defer until Chapter 8 my detailed consideration of this argument, and I do not therefore address it in the paragraphs which follow.

4.91 As to the Department's decision to seek reassurance, I have recorded their general policy of not prosecuting unlicensed dealers unless there was strong suspicion of wrongdoing or that investors' funds were at risk, but rather of seeking to bring such dealers within the regulatory net (2.3). I have also shown that other approaches, including a possible reference to the tribunal (see 1.5 and 1.6), had been considered and rejected (4.22). In addition it has to be borne in mind that, although doubts had been expressed from very reputable quarters concerning the partnership's operations (over and above their being unlicensed), the Department had at this stage no firm evidence that anything in the partnership's affairs was otherwise than entirely in order. All in all, it seemed to me that I could not regard the Department's decision at this point as having been maladministrative.

February to April 1985

4.92 Following the Department's decision in December 1984 that the matter should be progressed by way of an investigation by CIB, the next major turning point came when it was found that the CIB investigation could not proceed. The circumstances in which that investigation came to a halt are shown in paragraphs 4.29 and 4.32. It is clear, however, that the investigation, so far as it had gone, had added to what the Department already knew significant additional information—none of which showed to the partnership's advantage. In particular it had revealed the absence of any audit or reconciliation of the clients' accounts since the business had started, a failure to allocate cash balances, a failure to maintain proper records and an inability readily to produce requisite information. The reaction within the Licensing Unit was that the "verification" which it had been hoped would emerge from the CIB investigation should be sought by other means—notably through Spicers (4.33 and 4.34). In particular the principal envisaged that the partnership should be told that the Department wished to see the outcome of a full audit by Spicers of the client accounts by the end of March or thereabouts, with the implication that notice of intention to refuse the partnership's application would be given if a satisfactory audit report was not forthcoming. And his draft submission recommended that meantime no decision should be taken on the application. However, when the submission came to be made to the PUSS on 19 March (4.39) it recommended that a licence should be granted without waiting for the outcome of Spicers' audit, saying "we should be able, in negotiations, to get sufficient assurance, with the verification exercise itself, to grant [a licence]". The PUSS accepted this recommendation, while "putting the ball into the Treasury's court" by indicating that he would not proceed as he was disposed to if they or the Bank of England were about to take action on the basis of illegal deposit-taking (4.40). There followed, on 26 March, a meeting attended by DTI, Treasury and Bank of England officials, the record of which makes it plain that it was envisaged that, so far as the Department were concerned, the commissioning of an audit by Spicers, as distinct from its completion, would be sufficient for licensing purposes, provided that certain other requirements were met (4.42); and the joint note which followed was to the same effect (4.43). The outcome was that the Department's letter of 2 April to Herbert Smith (4.47) was framed so as to convey, by implication, the same message. There are also a number of indications in the subsequent documentation that the Department saw resolution of the Banking Act problem as the only impediment to the grant of a licence, notwithstanding that Spicers' report had not yet been received. However, because of the time it took to resolve the Banking Act problem, a licence was not, in the event, granted until after Spicers' report had been received.

4.93 It is clear, to my mind, that this change—from deferring any decision on the grant of a licence until the audit report was available to accepting that the commissioning of such a report would be sufficient—had its origin in the warning by the assistant solicitor (4.36) of the danger that if the matter was allowed to drag on the Department would be held to have been negligent if it turned out that something was wrong, particularly in relation to new business taken on since they had become aware of the difficulties. The assistant solicitor’s recommendation was for much firmer action, with the partnership being told that either they stopped taking on new business and took steps to protect the existing assets or the Department would take immediate action. The submission to the PUSS, however, introduced the concept of there being a danger of negligence liability unless the taking on of new business while the records were being audited was “stopped or legitimised” (my emphasis), and went on to refer to a legitimising licence as securing the Department from liability (4.39). This theme of a potential negligence liability as a factor favouring the grant of a licence before a full audit had been carried out appeared also in the further submission of 21 March and in the PUSS’s letter of 22 March to the Economic Secretary (4.40). And to the same effect was the assistant secretary’s expression, on 25 March, of a preference for not determining the application for the time being “unless there is no other solution to the liability problem” (4.42). (See also paragraph 12(b) of the joint note (4.43).)

4.94 It was asserted, however, by those involved that, despite appearances, their concern in recommending a legitimising licence had been the safeguarding of investors and not the protection of the Department. This raised, to my mind, the question of what advantage to investors might have come from a legitimising licence. The context in which that had to be examined was of course that what investors needed to be guarded against was the possibility that there might be something seriously amiss with the partnership’s operations, a matter about which the Department were not yet in a position to be fully satisfied—hence the perceived need for Spicers to be instructed. In that context it seemed to me that several positive disadvantages could have been seen as arising from a legitimising licence. In the first place, it could only serve to increase the confidence of investors, existing as well as new. In the second place, once a licence had been granted pressure on the partnership to co-operate in progressing an audit would, I believe, have been significantly reduced. In the third place, and most important, the grant of a licence would have placed the Department in a much more difficult position if they had come to believe that there was in fact something seriously amiss. Unlicensed, the partnership would have been trading illegally—a crucial factor in there being a prospect of halting their operations (see 4.44, point (e)). Licensed, they would have had the right to take the matter to the tribunal if there had been a move to revoke their licence (1.6). As to offsetting advantages to investors from the grant of a legitimising licence, it seemed to me difficult to find any. Implicit in the assistant solicitor’s account (4.41) was a suggestion that the advantage lay in the fact that a licence would have subjected the partnership to the Licensed Dealer Rules. As regards “new money”, however, he evidently saw the necessary protection as being capable of being provided only by the extra-statutory means of a requirement for separate and independent accounting. (It is to be observed, in this connection, that in the submission of 19 March (4.39) the proposal for a legitimising licence appears to have been aimed at solving the problem of the partnership taking on new business.) As regards “old money”, I believe it would have been naive to suppose that, if there was in fact something seriously amiss with the partnership’s operations, granting them a licence would be more efficacious in persuading them to turn over a new leaf than continuing to hold over them the threat of refusing a licence. It also seems relevant, in this connection, to refer to the principal’s reported response to a Bank of England enquiry on 3 May (4.60) that compliance with the Licensed Dealer Rules “meant no more than Midland Bank already provided by way of service to Barlow Clowes”. To my mind, the fact that the Department’s letter of 2 April asked only for information about arrangements for protecting assets of existing clients (4.47, item (b)), and not for any action, serves also to emphasise how little could be done, on the Department’s approach, towards safeguarding “old money”.

4.95 It is convenient to look, at this point, at the extent to which two of the safeguards for investors which the assistant solicitor mentioned in his account (4.41) were implemented in practice. I take first the prime consideration in what the assistant solicitor described as the “hierarchy of considerations to be taken into account”, namely the protection of new investors. This, he said, he saw as achievable by a requirement that “new funds should be accounted for separately from existing funds, under independent supervision”. As to that, the requirement in item (c) of the Department’s letter of 2 April (4.47) was confirmation by the partnership that “until satisfactory information in (d) below has been received” any new funds, from whatever source, received by the partnership would be separately and independently accounted for in a separate trust account. (It was not made entirely clear by the wording whether the “satisfactory information in (d) below” related to information that Spicers had been instructed or to the outcome of their work, but the principal has said that the latter was intended.) Herbert Smith’s response to this requirement was to say (4.53) that “monies received from customers, whether received prior to the date of your letter or thereafter, are being accounted for in accounts designated as clients’ accounts”, although elsewhere in their letter Herbert Smith said that the partnership did not intend to accept new deposits once the proposed company had received a licence. The comment by the principal on this response was that it did not go very far at all but was acceptable as an interim statement and as justification for allowing the partnership more time (4.56). In evidence to me the principal acknowledged that the requirement had not been “fully dealt with”, but he explained that he thought the Department had been asking a good deal in the letter of 2 April and that it had become a question of judgment as to how far it was appropriate to accept the assurances that were forthcoming. There is no indication that the matter was taken any further by the Department. Herbert Smith informed them on 3 October that the new arrangements with Lloyds Bank had been in operation since 1 July (4.78), and it seems that from that date the partnership did not accept new funds.

4.96 I look next at the requirement in item (a) of the letter of 2 April, which was for a going-concern certificate by Spicers, sought because the existing report by Walker & Vaughan (4.12) was out of date and did not take account “either of developments since November 1984 (notably the Government’s decision to end the practice of ‘bond-washing’) nor the work presently being undertaken by [Spicers] in relation to the client accounts” (4.47). In his account (4.41) the assistant solicitor said that the going-concern certificate was an important part of an assessment that the partnership were “reasonably above board”, so as to justify legitimising them. A firm, he said, which has to pay back large amounts to clients or meet large claims for damages, beyond its resources, could not reasonably be expected to continue as a going concern. The certificate provided by Spicers (4.53) related to the year commencing 1 July 1984 and was qualified as follows: “We have not carried out an audit for Barlow Clowes and Partners and this report is based on the information you have given us and upon discussions with you regarding the assumptions underlying the financing requirements for the year ending 30 June 1985 for which you are solely responsible and which inevitably contain uncertainties inherent in any projection of future events for an extended period.” The principal’s comment on this was that Spicers’ certificate was of little use because of its early expiry date but that the Department could be content with that for the time being, because a new certificate was expected to be submitted with the licence application in respect of the company. But he added that the certificate was clear evidence of Spicers’ confidence in the firm (4.56). When the company’s application was made (4.64) it gave the partnership as one of the company’s expected sources of business, in respect of business the partnership had already undertaken. (At that time it was envisaged that the partnership’s funds would be managed by the company, although the clients’ relationship would remain with the partnership (point (e) of Herbert Smith’s letter of 18 April—4.53).) The going-concern certificate which accompanied the company’s application was qualified in the same way as that given in respect of the partnership had been. Subsequently it was recognised that, with the company intending to deal only with new money, the partnership also would need a licence (4.72). No action was taken, however, to obtain an up-dated going-concern certificate in respect of the partnership, and the outcome was that

when the partnership's licence was issued for the year commencing 28 October 1985 (4.80) all the Department had was the certificate relating to the year ended 30 June 1985—they had no going-concern certificate in respect of the year covered by the licence. (The Principal Officer told me, in this connection, that the Department contended that the absence of such a certificate was of no detriment to investors, since (a) a duly verified licence application for the partnership for 1986–87 came in 1986 (see 5.7) and (b) it appeared from the monitoring returns covering the partnership's operations to 30 June 1986 (see 5.14) that the business had been in order.)

4.97 I refer also, at this point, to a matter which was mentioned in the Department's letter of 2 April, but did not figure in their list of requirements. This was the subject of the partnership's records. As I have already indicated, the CIB investigation had revealed a failure to maintain proper records and an inability readily to produce requisite information. The letter merely mentioned that the principal understood that Spicers were currently engaged on an exercise "generally to bring the records up to standard". (He has explained that his understanding came from his conversation with Mr A of Herbert Smith on 26 February (4.33).) It appeared to me that this was a less than satisfactory footing on which to contemplate licensing the partnership—even though, once licensed, the Licensed Dealer Rules would apply to them. But—as a consequence, it seemed to me, of the decision that the partnership could be licensed at an early date—the Department were in no position to exact, as a prerequisite to the grant of a licence, any kind of assurance that the deficiencies had already been remedied.

4.98 Finally, before summarising my views on this part of the case, I should refer to a suggestion, made on behalf of the complainants, that the Department's approach to the question whether the proper course was not to bring the partnership's operations to a halt had been flawed by misconception on their part that peremptory action against the partnership would have precipitated a "collapse" which would have caused damage to investors. Reference was made, in this connection, to paragraph 5 of the submission of 19 March (4.39), to the mention in the PUSS's letter of 21 March (4.40) of the absence of "adequate mechanisms to protect the investors from a collapse" and to the similar sentiment expressed in the Department's letter of 2 April (4.47) to Herbert Smith. It was suggested, on behalf of the complainants, that if the Department had given proper consideration to the effect of a closure of the partnership they would have realised that a "collapse" would not necessarily have had any effect on the value of gilt-edged stocks held by the partnership for investors, and reference was made in this connection to the fact that when the company had collapsed in June 1988 the entire investment portfolio had been sold at market value and without loss. In his comments to me on this point the Principal Officer responded by suggesting that the argument for the investors missed the main point of concern. This had been to ensure that the funds were properly administered, so that if there was a deficiency, whether as a result of fraud or by reason of the fact that promises had been made (about the return on the gilts under management) which could not be fulfilled, the assets could be distributed rateably among the creditors. Otherwise there was a risk that the least able to protect themselves would be left with nothing. The concern, he added, had been equally to ensure that, if the management was fraudulent, the assets or their proceeds were not transferred to locations from which they could not be recovered. The situation in 1988 had been quite different in that, following the statutory investigation into the company, it had been possible to seek the appointment of a provisional liquidator, who was able to protect the assets immediately and subsequently sell the company's portfolio so as to enable an orderly distribution in the interests of all investors. I did not find the Department's arguments here entirely convincing. Indeed it seemed to me that the assistant solicitor, in his account (4.41), had put the consideration of avoiding a disorderly collapse in a more appropriate perspective. Thus as I read his account he put that consideration low in the order of priorities, to be taken into account if, but only if, the interests of existing and future investors could be adequately protected and there was an assessment that the business was reasonably above board. To my

mind there was a tendency, in the Department's thinking, to place greater weight on the risk of a disorderly collapse as an argument against preemptory action than it properly deserved.

4.99 I turn then to my main findings on this episode in the case. Given the limitation on my jurisdiction to which I have earlier referred (paragraph 6 of the Introduction), what I have to consider here is whether the decision taken by the Department, and implemented by means of their letter of 2 April, was taken maladministratively. To my mind it was. In particular I believe that the attractions of granting a licence, as a shield against accusations that the Department had—with knowledge that the partnership was unlicensed—allowed them to carry on taking investors' money, were allowed to cloud the thinking within the Department. As a result, in my judgment, too little thought was given to the question whether a legitimising licence would be beneficial to investors. If proper thought had been given to that, I think the conclusion must have been that it would not be beneficial, for the reasons I have set out in detail in paragraph 4.94 above. I consider also that the decision in question was flawed to a degree by undue weight being given to the question of a disorderly collapse. Finally I should add, on this aspect of the case, that on any view there was a lamentable gap between the intentions of the requirements imposed by the letter of 2 April, particularly that relating to separate and independent accounting, and the vigour with which they were followed up. I consider the consequences of my findings here in Chapter 8 below.

April to October 1985

4.100 Following receipt of Herbert Smith's letter of 18 April, with its enclosures, the Department's attention was focused mainly on the Banking Act issue and proposals for resolving that. The original proposals made by Herbert Smith in their letter of 18 April (4.53, item (e)) envisaged that the custodian arrangements, in addition to applying to 'new money', should be applied to 'old money' as well, via a management agreement between the partnership and the new company. In the event, however, the custodian arrangements with Lloyds Bank applied only to new money (4.74). There was some talk of existing clients being transferred into the new arrangements—but no commitment that that would be done (4.75). And it seems that little or nothing was subsequently done by way of transferring existing customers into the Lloyds Bank custodian arrangements. This led investors to complain to me that the Department should have required that existing customers were given the protection of the custodian arrangements. As to that, while sympathising with the investors whose funds were with the partnership—and who appear to have suffered by contrast with those whose funds were with the company—I cannot regard their complaint on this score as having any real justification. As I see things, the fact that investors with the company obtained the protection of the custodian arrangements was a product of the need to avoid, for the future, contraventions of the Banking Act. It was not a case of some investors being treated better than others for PF(1) Act purposes.

4.101 As to Spicers' work, their report had been expected in a relatively short time (30 June having been mentioned—4.57). In the meantime, the authorities had as some reassurance the statements by Spicers in their letter of 18 April (4.52) that: "During the work we have so far carried out we have not become aware of any matter which would indicate that client securities or cash have been misappropriated. The length of time taken to reconcile the client accounts is due principally to the large number of clients, the lack of earlier detailed reconciliations and the small number of individuals with the depth of knowledge necessary to resolve specific queries." The product of Spicers' work did not emerge, in the event, until the end of July, and it took the form set out in paragraph 4.76 above. I have also recorded in that paragraph the comments of the departmental accountant to whom the document was shown, seemingly without any accompanying papers and with little in the way of information.

4.102 Because of my doubts about how the document could, or should, have been read I obtained advice on it from Mr Pearson, who (as I explained in the Introduction) gave me assistance on accountancy matters. He told me that in his view the certificate provided by Spicers, taken in isolation, merely stated that

Spicers had satisfied themselves that the assets held on behalf of clients were as stated. It did not, he told me, taken in isolation, provide any positive comfort as to the completeness of the records concerning client account balances, nor as to the accuracy of the client account recording system; nor did it confirm that these records had been properly maintained. He would, he said, have expected a normal client account certificate to deal with all these matters. He went on to say that he would not therefore agree with the verdict of the departmental accountant that the certificate gave "as reasonable an assurance as one can expect". In normal circumstances one could have expected more. The circumstances had not however, he thought, been normal and, by 1 August 1985, those concerned in the licensing saga seemed to have taken the view that any "clean" certificate from Spicers would provide confirmation that the client accounts were then under control. In adopting that position they were not, in Mr Pearson's view, being unreasonable. The Department had been justified, in his view, in believing that had Spicers found anything in the course of their work which made them unhappy with the quantum of liabilities to clients at 28 December 1984, rather than the composition of the clients' funds at that date, Spicers would have said so. Mr Pearson said he drew support for that observation from the fact that in their letter of 18 April Spicers had given the confirmation which I have quoted in the preceding paragraph. Had Spicers' work subsequently revealed any major problem, prior to their certificate of 1 August, the Department were entitled to assume, in Mr Pearson's view, that they would have said so. I have also recorded in paragraph 4.77 the evidence of Mr B of Spicers as to how the Department were entitled to view the statement and report.

4.103 It seems to me that the steps the Department took to satisfy themselves that the statement and report dated 1 August 1985 were satisfactory and could properly be relied on fell short of what the situation really called for. Nevertheless, in the light of what I have recorded, it cannot in my view be said, that the Department were ultimately at fault in regarding Spicers as having completed their remit with a satisfactory outcome. However, because Spicers' instructions had come from the UK partnership and had been to audit their client accounts (see 4.53, item (d)), the statement and report did not cover the client accounts of the Jersey partnership. In addition, as I go on to explain, I have found cause to consider whether the remit to Spicers had itself been wide enough to deal with the concerns which had been expressed to the Department concerning the partnership's operations.

4.104 It is relevant at this point to mention a criticism of the Department's approach which was advanced on behalf of the complainants. This was to the effect that the Department had attached undue weight to the calibre of the professional advisers retained by the partnership and that this seemed to have rendered them unable to consider objectively whether the assurances they received were adequate and should have been relied on without further questioning. The Principal Officer's response to this criticism drew a distinction between the partnership's solicitors and the auditors. The solicitors, he said, would not be expected to report matters which caused them concern but equally would not be expected to mislead. The auditors, he argued, were in a different position, owing well-recognised obligations to people other than their clients. Although the relationship of auditor and audit client might be covered by the usual considerations of commercial confidence, there were circumstances in which the auditor was not bound by any duty of confidentiality he might otherwise owe. For example, where the auditor found evidence of irregularities or other illegal acts, it might be his public duty, the Principal Officer said, to bring such information to the notice of the appropriate authorities. As regards the solicitors it seems to me that the views of Herbert Smith, which I have recorded in paragraphs 4.48 and 4.55, differ little if at all from the Principal Officer's view. As regards the auditors, I have recorded the views of Spicers at paragraph 4.81. What they told me about the duty of confidentiality and the circumstances in which accountants were relieved of that duty seemed to me to differ from the Principal Officer's views only in emphasis, if it differed at all. However the points made by Spicers about the difference between acting for the partnership in an accounting/auditing role and being employed by the Department as investigating accountants seemed to me to have some force, and to be of some

significance in the context of the route chosen by the Department for obtaining the verification they sought. This was that Spicers' instructions were to come from the partnership, subject to the proviso that the result of the work done by Spicers in pursuance of those instructions was to be made available to the Department. It is to be noted, in this connection, that the Bank of England official who telephoned the principal following the meeting on 26 March (4.42) seemingly envisaged that Spicers would be made, in effect, investigating accountants. The principal's reaction was that to take that course might prejudice the partnership's willingness to co-operate. He agreed however with the Bank official's view of the importance of having adequate terms of reference. For my part, I consider that a decision that Spicers should not have the role of investigating accountants made all important the content of the instructions which the partnership was to be required to give to Spicers. For those instructions, once defined, would set limits to the work of Spicers—and to the information which the Department could expect to receive—from which it would not be possible readily to depart. I look therefore at the adequacy of what the Department stipulated for, given the circumstances of which they were aware and the nature of the concerns which had been expressed to them.

4.105 A number of those who had expressed concern about the partnership's operations had referred only to its unlicensed status—a circumstance of which the Department were, of course, aware—while others had mentioned relatively intangible matters, such as general “unease”, or concern about past associations or slowness in payment and cash-flow problems. There had however been a distinct theme in several of the expressions of concern, namely doubt about the value of the partnership's guarantees and, more particularly, a doubt whether Barlow Clowes could—in the words used by the principal when he wrote to the Assistant Treasury Solicitor on 4 December 1984 (4.18)—“pay its guaranteed return on gilts invested without eroding client capital”. (In this connection I should say that I am persuaded, on balance, that Miss Bourke's was one of the voices expressing doubt on this point to the Department—see paragraphs 4.83 to 4.85.) The Stock Exchange itself had expressed doubt on this point, so I do not think it could properly be dismissed simply as coming from disgruntled competitors. And in the same connection I see as fair comment the observation of the Bank of England official (4.19), in response to the principal's mention of the absence of complaints from investors, that Barlow Clowes might have been able to repay investors simply because they were always taking in new money. Generally, indeed, I see force in the criticism, which was advanced on behalf of the complainants, that the Department's records show them as regarding the absence of complaints from investors as more significant than it really was.

4.106 No doubt the particular expressions of concern to which I have referred played their part in convincing the Department that there was a need to obtain reassurance as regards investors' assets. But detailed consideration of the nature of the partnership's schemes would, I think, have shown that in some areas there would be problems about obtaining such reassurance. This was particularly so, it seems to me, in the case of Portfolio 30 (see paragraph 7 of the Introduction). The feature of that scheme was that investors, besides having a guarantee of income payments at fixed rates throughout the duration of their investment, were also guaranteed a fixed capital return—*provided* they maintained their investment to maturity. If they withdrew before maturity there was no guarantee of what they would receive. It followed that to obtain full reassurance about the assets of these investors it would be necessary to go beyond simply looking to see what was there. The enquiry would need to be whether what was there would be capable both of funding the guaranteed income distributions and of enabling payment of the guaranteed return of capital if the investment were maintained to maturity.

4.107 In this connection, I have recorded the evidence of Mr B, the Spicers partner concerned, that they had not regarded their instructions to audit the client accounts as requiring them to concern themselves with whether the funds standing to the credit of clients would prove sufficient to enable the partnership to meet future contractual liabilities to clients (4.77). On this subject the view expressed to me by Mr Pearson was that—given that the essence of the client account is that a client's assets, ie that which he has remitted to the agent to utilise on his behalf, are

properly segregated from the agent's own funds and properly accounted for—it must be right, in auditing a client account, to account for the assets at a certain date and not to concern oneself in so doing with any subsequent liabilities which the agent may incur in making good any promises he has made in soliciting the management of the funds. He added that the latter was thus a question to be posed when considering the accounts of the partnership, rather than in the audit of the client accounts.

4.108 In the light of the foregoing I can only conclude that the work by Spicers which was comprised in item (d) of the Department's letter of 2 April (4.47) was not capable of providing the Department with reassurance on the specific concerns under discussion. And the same must, I think, apply to the work (somewhat differently described) which Spicers told the Department, in the opening sentence of their letter of 18 April (4.52), that the partnership had instructed them to carry out. Moreover, although the requirement that a going-concern certificate should be provided (item (a) in the Department's letter of 2 April) could no doubt be seen as necessitating some consideration of the subject of possible future liabilities, I do not think it can be regarded as going far enough (even if it had been properly followed up—4.96) to fill the gap which I have identified. I must ask therefore whether the Department should be regarded as having been at fault in not identifying the gap and in considering how it might be filled. To my mind they must be so regarded. They had the material to show what was promised by the partnership, and it would not have required a great deal of thought to identify the nature of the questions which would have to be looked at to obtain reassurance on the particular matters about which concern had been expressed. It would then have been a matter of asking whether what they were proposing to ask of the partnership would go far enough; and again I think it could reasonably readily have been seen that it was at the very least doubtful whether it would, and appropriate advice could have been obtained. I note in this connection that when a similar concern about possible erosion of capital was canvassed in 1987 (see 6.22 and 6.23) the need for wider instructions than those given to Spicers in 1985 was perceived. I regard the failure which I have identified here as constituting maladministration. Again, I defer until Chapter 8 consideration of the consequences of this failure.

Chapter 5

March 1986—March 1987

5.1 Nothing further appears on the Department's files until March 1986 when the principal who had been responsible for the Licensing Unit the previous year noted from the press that Mr Clowes and Dr Naylor had been appointed executive directors and Mr Newman finance director of James Ferguson Holdings. He pointed this out to the SEO who instructed his executive officer (EO) to ensure that these new directorships were declared when Barlow Clowes next re-applied for a licence. On 23 April the Department sent standard letters to each of Barlow Clowes and Partners and Barlow Clowes and Partners Ltd reminding them of the need to apply for renewal of their licences at least three months before the current licence expiry dates and enclosing the appropriate forms. On 12 May a member of the public wrote to the department saying that Barlow Clowes and Partners Ltd appeared to deal with all investment for the intermediary firm (see 4.60), who were members of NASDIM, and asked for a status check on these two firms before committing himself to an investment. In his reply dated 30 May the SEO said that both firms had the necessary authority to deal in securities, the former being a licensed dealer in securities and the latter belonging to NASDIM.

5.2 On 17 June the Banking Supervisor of Gibraltar telephoned the Bank of England asking about their discussions with Barlow Clowes in 1984–85. He had become interested because Barlow Clowes had advertised for representatives in the Gibraltar press, although they had not approached him. The advertisement had mentioned that they were moving their international headquarters to Gibraltar, but leaving their clients' services and administration in Geneva. He promised to send the Bank a copy of the advertisement. A Bank official telephoned the Department and spoke to the new principal who said, (according to the Bank's records) that there had been no further alarms since the licences had been issued. The principal made no note of the conversation and told me that he could not recall if the question of whether it was the partnership, the new limited company or some other entity which was setting up in Gibraltar had been raised or discussed. The Bank's note concluded that having checked with DTI he suggested to the Banking Supervisor in Gibraltar that he need do no more than be on his guard as to the nature of the operation. He noted that it was not clear whether the Barlow Clowes in the advertisement was the partnership or the new limited company. Early in July the Gibraltar Banking Supervisor telephoned the principal repeating what he had previously told the Bank. He said that there was no licensing system for dealing in securities in Gibraltar and he asked if the Department knew anything against Barlow Clowes. The principal recorded that he gave the Banking Supervisor a brief history of the firm adding that they had "had no cause for concern since they were licensed". He said that he would pass on any information DTI might obtain about Barlow Clowes's offshore activities. He noted the papers "Although it is of interest that BC are moving offshore, I do not think we have cause for alarm. Gibraltar is not perhaps the location to inspire confidence. But we knew that BC had some offshore operations when we licensed them. When their licence renewal application comes in, we could usefully look for any changes in their activities and drop [the Banking Supervisor] a line. If the opportunity arises, we could ask BC what they are up to and look out for any information that comes our way".

5.3 On 29 July Herbert Smith wrote to the Department explaining the purpose of a meeting which they had arranged for 30 July. They said that they wished to discuss rule 19 of the Licensed Dealers (Conduct of Business) Rules 1983 (see 1.11(e)) and the proposed sale of Barlow Clowes to James Ferguson Holdings plc.

So far as rule 19 was concerned they explained the impracticalities of supplying Barlow Clowes's clients with contract notes in view of the large number of transactions that were taking place. They proposed to get round this problem by adding a clause to the portfolio management agreement, a draft of which they enclosed for the Department's comments. This envisaged that the client would appoint Barlow Clowes his agent to receive and retain in electronic form all contract notes, reports and valuations in respect of the client's portfolio, copies to be provided to the client within seven days if requested. The draft clause also envisaged that Barlow Clowes would send clients valuations of their portfolios at least once a year (as required by Conduct of Business Rule 7(3)(c)(iii)—see 1.11(d)). The meeting took place on 30 July 1986, attended by departmental officials (including an assistant solicitor), Mr Clowes, Dr Naylor and Mr A (the partner from Herbert Smith). The Department's note recorded that Mr Clowes explained that because of the large number of transactions taking place he did not issue contract notes himself, but relied on those issued to him, as bare trustee, by stockbrokers. In order to comply with rule 19 he proposed to retain contract notes electronically as agent of the client, making details available to clients only if requested to do so. He said that a similar problem had arisen in respect of tax vouchers and the Inland Revenue had agreed his proposals. Mr Clowes said he thought the proposal would be acceptable to his clients because as his services were "not discretionary" they knew what was happening to their funds and they would not wish to be inundated with paper. The assistant solicitor pointed out that rule 19 required contract notes to be signed; moreover, she drew attention to section 78 of the Finance (1909–10) Act 1910 (which requires contract notes to be issued in respect of every transaction). She also said, however, that a client could authorise Barlow Clowes to issue the contract note to itself. I asked the principal who had attended the meeting what had he understood by Mr Clowes's remark that the funds under management were "not discretionary and clients knew what was happening". He told me that he had thought this simply to mean that clients fully understood the sort of operation being carried on by Barlow Clowes, that is, one of investment of clients' monies in gilt-edged securities. He accepted, however, that without being sent contract notes the clients would have been ignorant of the precise investments allocated to them at any particular time during a year—though they would know that their money was invested in gilts. It was, he said, of the essence of Barlow Clowes's scheme that money was to be moved from one gilt to another. The principal also said in evidence that he had relied upon the departmental solicitor's advice given in the course of the meeting on the question of whether dispensing with sending individual contract notes to clients at the time of each transaction was permissible under the Licensed Dealers Rules.

5.4 The meeting of 30 July then went on to discuss the proposed takeover by Ferguson during which the principal pointed out that there was a need to notify the Department immediately on the change of ownership and to provide details of new controllers. He then asked for information about the overseas operations of Barlow Clowes. According to the record, Mr Clowes said that he had set up a partnership in Jersey in 1976 to service expatriates. This had run out of space for expansion by 1983 and had been moved to Geneva, where it was proposed that it would deal in gilts and possibly equities for expatriates under management agreements. He said there was also a company registered in the Cayman Islands, controlled and managed in Gibraltar "which looks after discretionary management". He said it was his intention that his international operations would form part of the Ferguson group, which, being a plc, might facilitate his obtaining a deposit-taking licence. The principal told me that he could not recall if at the time of the meeting he had thought that the Jersey partnership referred to by Mr Clowes was the same or a different entity from the UK partnership. His understanding at the time had been that if the Jersey office was an offshore office of the UK partnership they would be authorised under the Act by the existing licence but he thought that a separate partnership would have required a separate licence if it had been carrying on the business of dealing in securities in Great Britain. He told me that he had not pursued further the question of the offshore activities beyond asking Mr Clowes about them at the meeting. He had understood that the offshore partnership had been directed at expatriates and did not recall having seen the Portfolio 28 brochure which had been on the Department's files since December

1983 (see 4.1). Nor had he seen any need to report back to the Banking Supervisor in Gibraltar as a result of anything he had learnt at the meeting about the Gibraltar operations. Herbert Smith made no formal note of this meeting but Mr A made available to me his manuscript notes. These make clear that Mr Clowes said at the meeting that all of the Jersey, Geneva and Gibraltar-based operations were aimed at the expatriate market.

5.5 On 12 August Herbert Smith wrote to the Department letting them know that the portfolio management agreement was to be amended in the way proposed at the meeting on 30 July. The amendment simply had the effect of stating that Barlow Clowes, as agent of the client, would receive and retain contract notes "in written documentary form", the words "in electronic form" being deleted. The SEO noted that this seemed "all right". Herbert Smith promised also to send copies of some circulars shortly to be sent to the shareholders of James Ferguson Holdings plc and a draft application form for a representative's licence in respect of a Ferguson director who was to be appointed to the board of Barlow Clowes and Partners Ltd. In a separate letter, also dated 12 August Herbert Smith sent application forms for the renewal of both principal's licences mentioning that an EO in the Licensing Unit had agreed a two-week extension of the permitted time for lodging the application. The EO, who was relatively new to the job at the time, told my officers that she would have discussed with a senior officer the request for an extension of time before agreeing to it. This would have been in line with standing instructions at that time. The licence application forms in respect of both the company and the partnership showed a change of bankers from Midland Bank plc to Lloyds Bank plc. The company's application form also showed a change of account date for the company from 30 June to 31 March annually and correspondingly brought forward the last date for submission of the relevant monitoring return by three months to 30 September 1987. (One was due to be submitted by 31 December 1986 in respect of the period ended 30 June 1986.) There is no indication on the case summary form that the EO noticed these changes. The higher executive officer (HEO) told me that a change of account date would have been the kind of change which should have been picked up and put into the unit's computer system. Notification in this way would not, however, have been sufficient notification of the change. Such a change was required to have been notified to the Department separately and immediately it became known under regulation 9(4) of the 1983 Licensing Regulations.

5.6 Nine representatives' licence application forms were submitted including forms in respect of Peter Clowes, Peter Naylor, Derek Tree, Christopher Newman and Robin Ducret. Mr Ducret's application was accompanied by a statement (required in answer to a question on the form) to the effect that he had in September 1985 been called to give evidence at the Central Criminal Court in matters relating to the practices of the gilt-edged settlement department of Hedderwick Stirling Grumbar & Co, prior to that firm ceasing trading in 1981. He said that he had been employed at that time by this firm as a gilt-edged analyst and had been called as a defence witness. Mr Clowes declared in his application that he had been a prosecution witness in the same case. These disclosures were brought to notice by the EO but there is no indication in the files that any action was taken in respect of them. The HEO told me that the purpose of the enquiry on the form had been to elicit information as to whether an applicant had been implicated in any way with fraud matters. He added that the collapse of Hedderwicks had had knock-on effects for a number of people but he had been advised that no employees in the firm of Hedderwick had actually been found guilty of irregular practices. He said that disclosures by different people about the Hedderwick affair had often taken the form of a standard and identical statement. It had become standard practice therefore to disregard the disclosures in the application forms to the giving of evidence about the Hedderwick affair by ex-employees and external witnesses who had not themselves been guilty of an offence. More generally, any disclosure in that section of the official form of information not previously encountered would have been reported to a senior officer; but in this particular case, it would not have been thought necessary to pursue the matter further.

5.7 The going-concern certificates signed by Spicers on 11 August 1986 in respect of both the company and the partnership were again qualified as follows: "We have not carried out an audit of and this report is based on the information you have given us and upon discussions with you regarding the assumptions underlying the financing requirements for the year ending 27 October 1987 for which you are solely responsible and which inevitably contain uncertainties inherent in any projection of future events for an extended period". All of the officers generally concerned with the renewal of licence applications told me that this kind of qualification was not unusual and would not in itself have given any cause for concern. It had not given rise to concern by those officials who had been concerned with the Barlow Clowes renewal application. In response to the SEO's instruction of 25 March (see 5.1) the EO confirmed that both Dr Naylor and Mr Clowes had disclosed their new directorships of James Ferguson Holdings plc. The Department made its usual checks in respect of the new representatives but, in accordance with the normal practice, no additional checks were made in respect of individuals already holding licences. (No checks were made either in respect of Mr Newman who had previously been checked in connection with a licence he had held in respect of another company.)

5.8 On 21 August a Bank of England official telephoned the principal who had relinquished responsibility for the Licensing Unit the previous year. The Bank official made the following note of the conversation,

"I telephoned Mr—at the DTI to say that though we had absolutely no evidence, I thought it right to alert him that we had heard that Mr Tree might not be entirely happy with the way things were going in Barlow Clowes with particular reference to the offshore business. I understood that they might need to review Barlow Clowes's licence before too long and he might decide in the light of my conversation, that it was necessary to make more detailed enquiries than he might otherwise have done. I made it clear that Mr Tree had not suggested this approach and, indeed, had resisted it fearing an over-reaction from the DTI though I understood that he had discussed the matter with Spicers, Barlow Clowes's auditors. I said I was sure that I could trust him to treat this information most circumspectly".

The principal reported the substance of the telephone conversation to the new principal and the assistant secretary. He said that the Bank had been told, via contacts which they regarded as sound, that the managing director of Barlow Clowes and Partners Ltd had expressed serious concern about the company and had mentioned a "possible fraud". The matters of concern were said to involve the UK activities and "not the more recent offshore operations which BC has established". He said the nature of the "possible fraud" was not known but the concern had been brought to the attention of the firm's auditors, Spicers, who had acknowledged the position but had said that there was "no need to worry". The matter had not been drawn to the attention of the police. Mr Tree had been reluctant to agree to the Bank disclosing the matter to DTI for fear of DTI taking hasty action. The principal gave it as his opinion that because the information had come through so many hands the Bank were simply passing on the information "in case it links up with something else we have". He thought that if anything had happened, Spicers' response indicated that it was now under control.

5.9 I have established that on 13 August 1986 Mr Tree had called on an ex-colleague at Midland Bank plc. The bank official recorded that Mr Tree had expressed to him a deep concern about the new limited company of which he had been appointed managing director and that he had been considering resigning his post. He had said that his concern centred on the offshore investments. Spicers had not been instructed to audit the offshore funds and Mr Tree did not think that they were aware of the problems. Mr Tree had thought there could be elements of fraud involved; the investments under control were currently about £80 million in the UK and £150 million offshore. Then, on 15 August, Mr Tree had seen Mr B of Spicers in confidence. Spicers' note of that meeting recorded that Mr Tree had made no specific allegations of fraud or malpractice and that he had made only a number of generalised comments about the way in which business was being

conducted. He had seemed unhappy about some of the activities of the James Ferguson Group with which Spicers were not involved. The partner recorded that he had undertaken to take account of Mr Tree's comments when carrying out his audit work. Also on 15 August officers of Midland Bank plc had called at the Bank of England and passed on the information that Mr Tree thought that there might be elements of fraud in Barlow Clowes's offshore business, following which a Bank of England official had telephoned the Banking Supervisor of Gibraltar to let him know of Mr Tree's concerns; the Banking Supervisor's response had been that he too was concerned about Barlow Clowes but had no locus to act. Spicers have said in evidence that they certainly did not tell Mr Tree that "there was no need to worry", and the Bank of England have also said that they did not tell the Department that Spicers had said that.

5.10 The principal's successor added his own comments to his predecessor's report (5.8) before passing it on to the assistant secretary. He reported the meeting with Mr Clowes and his legal advisers that had taken place on 30 July, describing it as amicable and giving him no cause for concern. He said that the licence was due for renewal in October, that the application, complete with verification by Spicers, looked in order and that they had no reason not to re-license. He said that the arrangements with Lloyds Bank as trustees holding client money and stock afforded clients better protection against fraud than was the case with virtually any other licensed dealer. He found the information from the Bank very vague and in view of Spicers' apparent unconcern, he thought that there was no need for the Department to take action. In his view an approach to Spicers was all that was called for. The assistant secretary agreed that the principal should speak to Spicers and that if that yielded nothing, no further action would be required. The principal told me that he had at the time considered approaching Mr Tree direct but had decided against this course after speaking to the auditors. The principal rang Spicers on 28 August, and recorded that Mr B had told him that he had no more information about the nature of Mr Tree's concerns than DTI had. He had said that he was currently engaged on auditing Barlow Clowes's client account and, having been placed on notice, he proposed to be extra thorough and to give Mr Tree the opportunity to unburden himself. He had told the principal that he was aware of the reliance placed on Spicers by DTI but was aware of nothing to date to indicate client loss. He had ventured the thought that the 'fraud' might be connected with the James Ferguson deal, but said he had nothing to do with that. Ferguson's auditors were Touche Ross. The principal's note concluded: "I thanked him and agreed that he had no option but to play it the way he proposed. We have little choice but to renew, but need to keep a careful eye on things (eg Form 5—the monitoring return—and notification of change of ownership)". The partner noted in his own record of his conversation with the principal that he had emphasised that Spicers were well aware of the reliance being placed on them by the Department in connection with Barlow Clowes. The partner noted, also on 28 August, that he had subsequently spoken to Mr Tree who had said that he was much happier with the situation than he had been at their meeting on 15 August.

5.11 Meanwhile, on 21 August, on submitting the applications for renewal to the SEO, the EO had pointed out that details of Barlow Clowes's sale to Ferguson had not been received. The renewal licences were prepared and signed by the SEO who on 27 August had instructed the EO not to despatch them without the principal's consent. Then, on 29 September the EO asked the principal if she could release the licences and he said that the licences could be sent. He said that the change of ownership should be notified fairly soon. He noted that he had heard nothing further from the auditors in connection with the earlier suspicion of fraud but asked for extra care to be taken with the monitoring returns which were due in December and, in particular, that he be informed if they were late. The EO made a note to that effect and despatched the two principal's licences which were to come into effect on 28 October 1986. Eight representatives' licences had already been despatched, including those of Mr Clowes, Mr Ducret, Mr Newman, Dr Naylor and Mr Tree. (The remaining application was withdrawn on 2 September.)

5.12 A Bank of England official wrote to the principal on 21 November asking if anything had come of the information which the Bank had given to the Department in August about Mr Tree's concerns about Barlow Clowes's offshore

activities. He explained that the Bank retained an interest partly because of the size of their holdings in gilt-edged securities and partly because of Midland Bank's involvement. He went on to say that the Bank understood that Barlow Clowes were well established and active in Gibraltar where they were installing significant computer capacity. He said it had occurred to him that they might be conducting much of their business there rather than in the UK even where clients were resident in the UK. He did not know if this would be to escape regulatory controls or be associated with tax advantages but indicated that he would be interested to hear of anything that the Department could pass on. The principal told me that he could not recall whether he had noticed from the Bank's letter that Mr Tree's concerns had evidently centred on the offshore business rather than the UK business, contrary to what his predecessor had recorded. But he said that had he noticed he would not have attached any significance to this because he felt sure that the auditors—who were aware of the concerns and of the Department's reliance on them as auditors—would have reported to the Department any evidence of fraud that had come to light. When replying to the Bank on 26 November, the principal said that the licences had been renewed. He said that he had spoken to the relevant Spicers partner the previous August and that the partner had been aware of Mr Tree's concerns and also of the reliance placed on his firm by the regulators. He also told the Bank of the meeting which had taken place on 30 July and all of what he had then been told about Mr Clowes's overseas activities. He continued, "I have no concrete reason to worry about Barlow Clowes's off-shore expansion, although one naturally tends to look askance at businesses controlled from Gibraltar and harbour unworthy thoughts about the real motives in moving there. If the overseas business is carrying on the business of dealing in securities in the UK, it will need authorisation under the present legislation (unless it is acting on behalf of a licensed dealer or other authorised person) ... We have received no complaints about Barlow Clowes and have no cause for concern apart from your report of Mr Tree's worries—and these are nowhere near enough to justify regulatory action by the Department. If you become aware of any other straws in the wind, I would be glad to learn of them." He promised to let the Bank know if anything material came to light. Also on 26 November the principal wrote to a member of the public who had written to the Department on 22 November enquiring about Barlow Clowes and Partners' status. In his reply he said that the partnership was a licensed dealer but that it was not the Department's practice to give any sort of endorsement of, or warranty for, a particular investment business. I asked the principal how much weight he had attached to the lack of complaints about Barlow Clowes. He said that, had there been any complaints, that could have been a matter for concern and, to that extent, their absence was reassuring; but that an absence of complaints did not necessarily demonstrate that an operation was sound. I also asked the principal to explain what he had meant by the sentence in brackets (see above) in his letter to the Bank of 26 November. The principal explained that this had been an attempt to paraphrase the purport of sections 1 and 2 of the PF(I) Act that if an offshore company had clients in the UK, it did not necessarily mean that they would need a licence if they were using a licensed dealer or an otherwise exempt person in the UK.

5.13 On 22 January 1987 the Department sent both the partnership and the company (through Herbert Smith) standard reminders that the monitoring returns (due at the latest by the end of December 1986) were overdue. On the same day the EO notified the principal who telephoned Spicers on 23 January. The principal noted that the Spicers partner, Mr B, had told him that he was sure that the assets were there but Barlow Clowes were still carrying out some reconciliation work he had asked them to do. Mr B said he was not concerned and that Mr Tree was now happy. Mr B told me that he accepted that he would have said words to the effect that "Mr Tree is now happy". He referred in this connection to a postscript dated 18 December which he had added to his note of his conversation with the principal on 28 August. This reads: "I phoned DT to see if he was still unhappy and he said that things had improved greatly and he was no longer concerned on the matters which had prompted him to visit me on 15/8/86". When I questioned Mr Tree about these events, he told me that his worries had begun immediately he had taken up his position as managing director of Barlow Clowes and Partners Ltd when he had learnt of the serious nature of the concerns of both the Department

and the Bank of England before the issue of the first licence and he felt that he had been misled. (This did not, he said, mean that he had previously been unaware of concern on the part of the Department—for he had been aware at that stage of the need to appoint a custodian trustee to deal with an alleged breach of the Banking Act; but it had only been after taking up his new appointment that he had discovered that the business was under threat of closure.) He told me that the concerns which had caused him to approach Midland Bank had been his general concern that there might be insufficient funds available to meet Barlow Clowes's promises to their clients (a point which he claimed also to have made to the firm's auditors); general concern that the computer was not being used to predict the best time for carrying out transactions; and his unease at not being able to discover how the overseas bargains were being transacted since they did not appear to be dealt through the London Office. Mr Tree told me that his role as managing director of the UK company had given him no authority over or responsibility for Barlow Clowes International Ltd (BCI). He had however felt concern that BCI appeared to have no knowledge of the domicile of the investors' funds under their control or how dealings in the necessary gilt-edged market transactions were handled. He said that he had had no direct influence over these matters but had been concerned that a failure of the offshore company could adversely affect or indeed bring about the failure of the UK company. He said that it was upon being told that fictitious entries might have been put on to the computer that he had been prompted to go to Midland Bank. Mr Tree told me that he had left it to his ex-colleague—who had, he had thought been party to some of Midland's discussions with Barlow Clowes and the Department prior to the issue of the first licence—to take such action as he considered necessary so far as the regulators were concerned. He went on to say that he might have spoken to Spicers at about the time of Mr B's record of their conversation on 18 December and it was possible that he had indicated that there had been some improvements in some areas—but he had not been "happy". He said that at that time he had taken legal advice as to how he could negotiate a release date from his contract with Barlow Clowes and Partners Ltd, without causing a loss of confidence in the business. When I asked Mr Tree how he would have responded had the Department approached him direct, he said that he would have told them of his concerns. But he said that he had had very little hard evidence and there was some evidence which pointed in the opposite direction, for example, the auditors were signing off the accounts and did not seem concerned.

5.14 The principal asked to be advised on receipt of the monitoring return whether it was in order. Spicers sent the Department the monitoring return in respect of the company on 3 February 1987, verified by them without qualification. On 12 February the Spicers partner wrote to the principal confirming their telephone conversation that day when the partner had explained that the partnership's monitoring return had not been completed because reconciliation work was outstanding. He said that the matter was being given "absolute priority" and asked for the deadline for submission to be extended to 28 February 1987. The principal replied the following day, agreeing to the extension and stressing the importance of meeting the new deadline. On 27 February Spicers sent the Department a FAX copy of the partnership's monitoring return signed by Mr Clowes and on 5 March they sent the original copy duly verified by them without qualification. The EO—having seen that the figures, as returned, of client money accepted or held during the relevant period included some large negative figures—concluded that they had been incorrectly presented. Accordingly, on 13 March she returned the monitoring return to the partnership asking for amendments to be made and for the form to be re-submitted through Spicers. The EO told my officers that she had returned the monitoring return for amendment without having consulted senior officers because negative figures were simply not acceptable. Senior officers have confirmed to me that this was the correct procedure. I have seen from the file that the EO told the principal that she had returned the unacceptable monitoring return and that they discussed the matter. A note on the file also records that the principal thought that the large negative figure (of £52.6 million) shown in the box headed "amount applied in making investments for clients" probably reflected net sales of investments, but as the figures seemed to balance he saw no immediate cause for alarm. He asked to be kept informed and to be told if a response was not received within two weeks.

(In his evidence to me regarding the handling of matters here, the principal has commented that the most likely explanation of a negative entry was that the auditors had misinterpreted the form. He added that the Department would not have adopted a sinister interpretation of such a happening before receiving an explanation from the auditors.) Spicers submitted the amended return on 24 March explaining that the amendments represented the grossing up of receipts and payments, particularly relating to purchases and sales of investments, which had been netted off in the earlier return. The HEO (who was not himself involved with these events) told me that the explanation given by Spicers was quite common—it being sometimes impractical for the auditor in the time available to get beyond a reconciliation of the net figures to total up all of the monies passing in and all of the monies passing out of a business. The EO referred the amended return to the principal who returned the file through the SEO commenting, “Presumably the return is now satisfactory. (The numbers seem to tally but I am not used to looking at Forms 5.) The amounts paid in are quite staggering”. He later said in evidence that he thought the funds taken in seemed large because they represented the same funds, sold over and over again because of the bond-washing activities that were taking place. There appeared to have been some £55 million under management at the end of the period, compared with some £89 million at the beginning of the period, which seemed to him to indicate that the partnership funds had indeed been running down. The principal handed over the case to his successor at the end of March 1987.

Findings 5.15 I look first at the information which came to the Department during this period about the overseas side of the business. The communications from the Banking Supervisor in Gibraltar (5.2) which came through the Bank of England, and then direct to the Department, gave no hint that the offshore business was deriving custom from UK residents and, although the Bank themselves speculated to that effect (5.12), there was no evidence to cast doubt on the representations by Mr Clowes that the offshore funds were for expatriates (5.4). I found no fault with the Department’s handling of the overseas aspects of the case during this period.

5.16 It has been represented to me on behalf of investors that insufficient attention was paid to the concern voiced by Mr Tree, which came to the Department’s notice during this period (5.8). It was certainly the case that some weight had in the past been placed upon the significance of Mr Tree’s presence at Barlow Clowes; taken with his position as managing director of Barlow Clowes and Partners Limited, his concern was clearly a factor to be regarded seriously. Against this, however, Mr Tree had not approached the Department directly nor indeed had he approached the Bank of England, but had confined himself to mentioning his worries to Midland Bank, through whom the message travelled on to the Bank of England and thence to the Department. The hesitancy which this implied was underlined by the terms in which the Bank passed the information on to the Department, saying that “Mr Tree had not suggested [the] approach and, indeed, had resisted it fearing an over-reaction from DTI...”. And although Mr Tree’s concerns appeared to be about a possible fraud, the police had not been informed. (I note here a misunderstanding as to the side of the Barlow Clowes operations to which this warning referred. The Bank’s understanding was that the warning had particular reference to the *offshore* business, and their records indicate that that was what they told the outgoing principal. However his report to his colleagues was to the opposite effect. The misunderstanding was unfortunate but, given that the Bank of England passed on the information to the Banking Supervisor in Gibraltar, it is difficult to suggest that it had any adverse effect.) The Department’s reaction was to approach the auditors, rather than Mr Tree. I did not find that unreasonable, given the terms in which the information had reached them. And, having myself interviewed Mr Tree (5.13), I do not consider that the Department would have found themselves significantly further forward if they had gone direct to him. I note also that the Department were later told that Mr Tree was “now happy”. I find no fault with the Department’s actions here.

5.17 I turn then to the Department’s handling of Barlow Clowes’s proposals with regard to the requirements of rule 19 of the Conduct of Business Rules (5.3). They

proposed an amendment of the portfolio management agreement to allow Barlow Clowes, as agent of the client, to receive and retain contract notes. Advice given by a representative from the Solicitor's Office was that a client could authorise Barlow Clowes to issue the contract notes to itself. That seemed to me to mean that, however unsatisfactory the result might be thought, there would be no breach of rule 19 if, with a management agreement in the suggested form the company issued the requisite contract notes to itself rather than to its clients. In the circumstances I can see no basis for criticising the Department here.

Chapter 6

April 1987—October 1987

6.1 On 10 April 1987 two representatives from the Stock Exchange met officials from the Department in order to exchange experiences and opinions about Barlow Clowes and Partners Ltd, because the company had applied to the Stock Exchange for membership. Responsibility for the Licensing Unit had changed to a different principal shortly before this meeting and so both principals attended, with the SEO. The Department's note of the meeting recorded that a Stock Exchange representative said that he had found Mr Clowes reluctant to talk about the partnership or the group structure, and he said it had taken some probing to find out that there were Swiss and Gibraltar based companies. The Stock Exchange had examined James Ferguson's accounts which revealed receipt of a loan of £300,000 from Barlow Clowes Nominees Ltd, and the company—despite a request to do so—had not yet produced documentation to support the loan; but so far as the business activity was concerned, client money appeared to have been properly invested, and the Stock Exchange had been told of the intention to transfer the partnership business to the company.

6.2 The Department's note went on to record that the Stock Exchange had examined two client accounts at random. The computer-produced records of these accounts were intitled "audit trails" (which is the description I will adopt in referring to them). These audit trails, it was said, had suggested a regular policy of buying ex-dividend and selling cum-dividend, with the comment that such a procedure would have enabled the high interest rates promised by the company to be maintained—but at the cost of a slow erosion of capital; and because clients were guaranteed capital at the end of their contract, it was thought that capital erosion could give rise to financial problems as contracts ended. The clients would not be aware of this situation because they were not sent regular valuations, as they should have been in accordance with their management agreements. The Stock Exchange would require regular statements to be sent to clients in the event of Barlow Clowes becoming a member. One of the Stock Exchange representatives said that, before he could support the application, he would need a satisfactory explanation about the loan and re-assurance about the maintenance of client portfolios; and he added that further and higher hurdles would follow when the rulebook of The Securities Association ("TSA"), then being formulated, became applicable. The principal who had recently left the section told the meeting that he understood that the Gibraltar based company served expatriates and that the monitoring returns (for the year ended 30 June 1986) showed that the partnership handled far more money than the company. He also passed on what the Department had learnt about Mr Tree's concerns. One of the Stock Exchange representatives said that Mr Tree, who had left Barlow Clowes, was an old acquaintance. He had written to him asking for an opportunity to talk to him and he was awaiting a reply. The Department's note recorded that they and the Stock Exchange would watch for any signs that Barlow Clowes would have difficulty in meeting commitments, and would keep in touch; meanwhile, the Stock Exchange would probe the loan to James Ferguson, and "the cashflow as a function of contract maturities".

6.3 The SEO minuted the (new) principal on 13 April saying that the only action which suggested itself to him at that stage was for him to write to Barlow Clowes asking about the proposed merger with Fergusons and reminding them of their obligation to report to the Department changes of control. The principal told me that he had then retained the file until 22 May, so that he could read up the background to the case (not having had an opportunity to do so before the meeting

on 10 April) and could review what other courses of action might be open to the Department and whether one aspect raised at the 10 April meeting—that of the audit trails—should be referred to the IDU Directors in the Department (who were businessmen on temporary secondment) for comment. He also was in communication with CIB and the Stock Exchange—see paragraph 6.5. However, before these contacts, on 15 April the Stock Exchange sent the Department, in confidence, the following documents:

- (a) the accounts of James Ferguson Holdings plc as at 31 March 1986;
- (b) accounts for Barlow Clowes Group companies to 30 September 1986, and for the partnership to 30 June 1986;
- (c) the proposed James Ferguson Holdings group structure;
- (d) two client valuations which had been given to them during their recent visit to the firm. (These were the “audit trails” referred to in paragraph 6.2).

They promised to let the Department know how the firm’s application for membership progressed.

6.4 On 23 April 1987 a prospective investor wrote to the Department from an address in Spain. This correspondent said that she was considering investing with Barlow Clowes Ltd [*sic*] who, she said, had recently set up business in Gibraltar, and had been advertising frequently in the press and on television; she was attracted by their Portfolio 68, but wished to know more about their integrity before committing money to them. An EO replied on 20 May confirming that both Barlow Clowes and Partners and Barlow Clowes and Partners Ltd were licensed in the UK, and that the Department had no reason to suspect that they were not conducting their business in accordance with the PF(I) Act and rules. But the reply went on to say that the Department could not speak for the Gibraltar based company and the enquirer was advised to “look to whoever regulates that business in Gibraltar for information”. The EO told my officers that before writing this letter she had consulted a senior officer; her understanding was that places such as Gibraltar fell outside the Department’s regulatory powers.

6.5 Meanwhile, the new principal reported the 10 April meeting to CIB on 29 April and, according to CIB’s file note, said that his section “had ‘unease’ over a particular case, a company in the Barlow Clowes operation”. CIB reminded him of their non-statutory enquiries (in 1985), looked out the file on them, and confirmed that they would be happy to help again if required. During May and June the Stock Exchange were in touch with the Inland Revenue and the Bank of England. On 5 May the Bank suggested that the Stock Exchange should consult the Department. On 12 May, the principal telephoned the Stock Exchange to enquire about Barlow Clowes’s membership application and to ask whether the Stock Exchange had received any response from Mr Tree. He was told that answers were still awaited from Barlow Clowes and that the application for membership would not proceed until they had satisfied themselves with regard to their enquiries and that nothing of significance had come of their enquiries with Mr Tree. Following this conversation, the Stock Exchange sent the Department an advertisement which had appeared in the Daily Telegraph on 9 April 1987 concerning James Ferguson’s re-admission to listing, which had taken place on 13 April. On 22 May the principal replied to the SEO’s note of 13 April (see 6.3) asking him to write as he had proposed. He said he had delayed dealing with the matter in the hope that something useful might have emerged from the Stock Exchange’s enquiries of Mr Tree. He asked the SEO to return the file because he was minded to refer the two audit trails to the IDU Directors for comment.

6.6 I asked the principal whether he had been prompted to consider asking the IDU Directors to look at the sample audit trails because of the concern expressed by the Stock Exchange that Barlow Clowes might not have had sufficient money to meet their obligations, and could be eroding capital in order to make income payments. He told me, however, that he had been casting around for ideas as to how to follow up the information from the Stock Exchange. It was also represented to me that he would not have been concerned with questions such as

the erosion of capital through investment activity—though the principal later amended this to say that he had not been concerned *only* with such questions—licence applications did not call for details of the products being offered, nor did a dealer have to clear with the Department any new type of product he wished to offer. These were factors which might have meant more to the Stock Exchange, and he said that his proposed course of action had been prompted by the more general questions raised by the Stock Exchange. He told me that his reading of the file had provided him with some comfort; in particular, he had been reassured by the amount of care taken by his predecessors before the issue of the first licence, the clean monitoring returns received earlier in the year, the file note of January 1987 (5.13 above) recording Spicers' assurance "that the assets were there" and the special custodian arrangement for clients' funds. The principal pointed out that he had come from totally different work, without training in or experience of enforcement and regulatory duties—having been for some two years outside the Department; that his assistant secretary had joined the unit only a week before he had; that he had had a range of other work in addition to licensing; that the section had been both busy and short-staffed; and that the file had been voluminous. He had attached importance to the advice he had received from the SEO, who was very experienced in the unit but had been concerned to see whether there was any further action he could take. In the end he had instructed the SEO to act as the SEO had initially suggested (6.3).

6.7 On 15 June the Department sent standard reminders to the partnership and the company (via Herbert Smith) reminding them of their need to apply for licence renewals on time (by 27 July). On 17 June the SEO instructed the EO to write enquiring about the change of control. On 19 June the Bank urged the Stock Exchange to make known to the Department what they had learnt about Barlow Clowes. The Stock Exchange officials concerned were at that time compiling an internal paper for the Stock Exchange Membership Department in which their concerns were to be expounded at length. The Stock Exchange told the Bank that a copy of this paper would be sent to the Department shortly. On 2 July, the Stock Exchange sent both the Licensing Unit and CIB copies of a draft paper in which concerns about the suitability of Barlow Clowes for membership of the Stock Exchange were set down.

6.8 The Stock Exchange's draft document set out their principal observations which, while not purporting to be exhaustive, were considered sufficient to assess whether Barlow Clowes and Partners Ltd should be admitted to membership. It began by noting that there seemed to be some confusion as to the company's intentions for the future, one of the directors having recently told them that Barlow Clowes's direction was "changing all the time" and that the portfolios were to be run down. The main observations were:

- (a) The Stock Exchange had examined the company's and the partnership's accounts but were told that these represented only the company's own monies—"the company maintained no accounting record relating to portfolio transactions". The company claimed to deal only in gilts, but evidence of their dealing in equities also had been found, the Stock Exchange concluding that the accounts could be regarded as suspect because they made no reference to such business; there were also problems over the veracity of the audited accounts of Barlow Clowes Nominees Ltd.
- (b) Gilt portfolio schemes operated by the company were said to be valued at about £8.5 million, while the partnership had some £55 million under management with about £300 million cashflow per annum. There were said to be two portfolios then operating in the UK, Portfolios 30 and 37. Two similar schemes were operated by Barlow Clowes International Ltd, apparently for expatriates and non-residents. The deals were done through London, International being a client of Barlow Clowes for this purpose.
- (c) The Stock Exchange had invited the comments of the Inland Revenue on the brochures supplied by Barlow Clowes to their clients. They had said that the Portfolio 37 brochure "does not adequately describe the tax implications of investment in Portfolio 37", and the report commented that it appeared therefore to be misleading.

- (d) Sales and purchases were made in bulk, a notional purchase or sale being allotted to the individual account maintained on the computer for each client represented in the bargain made with the market maker, but the clients were not issued with contract notes or valuations. Lloyds Bank acted as a custodian trustee, but was accountable only to Barlow Clowes. There was some confusion as to whether Barlow Clowes was operating discretionary accounts for individual clients or bulk-operating portfolios like a unit trust or a mutual fund. The Stock Exchange might require a legal opinion on this point.
- (e) The management agreement signed by clients was in very wide terms and did not adequately cover matters important to the client such as the main objectives (whether income or growth, and in what proportions), and what distribution payments to expect, which he learnt only after the investment had been made. Details about the yield, supplied to clients who had invested in Portfolio 30, were misleading and could make the investment look more attractive than it really was. Portfolio 37 documentation supplied to clients made no mention of fees.
- (f) After investment, a client would receive no contract notes or statements detailing changes on his account until maturity—possibly for 10 years. This would be a wholesale breach of Stock Exchange Rules and Regulations. On pointing this out to the company, the Stock Exchange had discovered that the company did not keep separate accounts as such for clients, but maintained “audit trails” containing the sort of information which the Stock Exchange would want sent to clients on a regular basis. The Stock Exchange had learnt that in order to satisfy the Department on the subject of contract notes a clause had been inserted in the management agreement. This clause said that valuations would be sent to clients at least once a year, but it appeared to be the case that this was not done. The matter of contract notes/statements had been left in abeyance, but the Stock Exchange would want to see something sent to clients at least once or twice before admitting the company to the Stock Exchange because of the possible adverse effect and publicity that would have to be borne by the Stock Exchange if only a moderate proportion of the 15–20,000 clients queried them—particularly as the audit trails seen by the Stock Exchange indicated that current values of investments were lower than the sums originally sent by clients for investment.
- (g) The authors of the paper went on to say that, while they were not gilt experts, it did seem to them that the method of operation of the schemes left little room for manoeuvre and that, if the market were to go against Barlow Clowes, there might be insufficient monies remaining in the portfolios to satisfy all the guaranteed income and maturities of the clients concerned particularly if there were, for any reason, to be a run on the funds. They said that Mr Tree also had expressed concern as to the adequacy of the portfolios, particularly as he believed that they had not been subjected to a full audit by Spicers.
- (h) Stock Exchange enquiries had revealed that Barlow Clowes, while claiming to deal only in gilts, had dealt in equities also—in most cases in James Ferguson shares or those of “target” companies, or for Group companies or others apparently closely connected with Ferguson. Barlow Clowes Nominees Ltd claimed to act only as a nominee company, in relation to gilts business, but had also dealt in shares for Tifa (see below) and Ryeman Ltd. Barlow Clowes said that the deals in question had been incorrectly booked by the stockbrokers concerned, but the stockbrokers said that no query had been raised at any stage.
- (i) James Ferguson’s accounts revealed a loan of £300,000 by the nominee company, not shown in the nominee company’s accounts, details of which were not explained to Surveillance Division’s satisfaction by the auditors, Spicers. The authors of the paper were inclined to doubt whether the nominee company accounts had been subject to a searching audit. Barlow

Clowes had said that the loan had originated from Ryeman Ltd (which owned 525,000 shares in James Ferguson), which was an Isle of Man registered company; but Stock Exchange enquiries had revealed that it was not registered there. Ryeman appeared to be a company of doubtful background whose relationship with Barlow Clowes and Ferguson was not fully known. It was recalled that in the Hedderwick case—see 3.6 above—there had been concern about the use by Barlow Clowes Nominees Ltd of stock owned by clients.

- (j) Ferguson appeared to be heavily involved with Tifa AG, a Swiss based company with an address in Liechtenstein owned and run by Mr David Mitchell. The view had been expressed by one stockbroker that Ferguson was effectively run from Switzerland or Liechtenstein. Tifa had acquired, through Barlow Clowes Nominees, a large number of shares in Bristol Channel Ship Repairers plc, and held further shares in another of that company's major shareholders, C H Bailey, but the close relationship between Tifa and Ferguson had not been adequately represented either to the Stock Exchange or in the prospectus concerned with Ferguson's takeover of Barlow Clowes and Bristol Channel Ship Repairers, and it was possible that Ferguson would not have been readmitted to listing had the full picture been known. Mr Mitchell had been a director of Barlow Clowes International Ltd from its incorporation on 17 October 1985 until 21 March 1986. It was thought that this company was the same operation that had previously existed in Jersey and then Switzerland.
- (k) Mr Tree had resigned his post partly because of the concerns mentioned above (see g) and partly also because of an apparent web of secrecy—which was being experienced also by the Stock Exchange. Delays experienced by the Stock Exchange in eliciting information, and the bare minimum provided, suggested that the company had been referring to lawyers or others before replying, which did not inspire confidence.
- (l) There was a possibility that funds and transactions could be switched across the gilt portfolio accounts by means of the Barlow Clowes computer.
- (m) With Mr Tree gone, and other senior personnel heavily involved in other activities, the management structure appeared inadequate, ultimately affecting service to clients.

Among the authors' conclusions was the view that "...there must be substantial doubts as to whether the Barlow Clowes and James Ferguson companies and their directors can be considered to be fit and proper" for membership of the Stock Exchange, and that "Barlow Clowes and Partners Ltd could become nothing more than a vehicle to assist James Ferguson in its takeover activities rather than to act as an agency broker". The paper concluded that the application for membership could not be supported and that there should be a full enquiry into the takeover activities and share dealings of James Ferguson and its related companies and connections, including the Barlow Clowes Group. If the application were to proceed, a legal opinion on the gilt portfolio management agreements and an independent accountant's assessment of the financing of the gilt portfolios, with an eye to a maturity analysis and the ultimate financing ability, was recommended. Appendices to the paper included examples of Barlow Clowes's management agreements and correspondence with clients, the two audit trails referred to in paragraph 6.2 above, details of information obtained from stockbrokers, details of the group structure of James Ferguson Holdings plc, their latest accounts and other relevant correspondence and press cuttings. (In the light of the recommendation in the Stock Exchange draft report that an independent accountant's assessment of the financing of the gilt portfolios should be sought if the membership application was to proceed, I asked two representatives of the Stock Exchange (one of whom was a joint author of the draft report) whether such an assessment was one which an accountant would be able to make. In reply the representatives said that there were two ways of looking at the adequacy of the portfolios. One was where the scheme had to terminate suddenly. The other was the ability to meet commitments on an on-going basis. The recommendation in the draft paper embraced both. The representatives saw the first approach as simply

an arithmetical exercise, setting the current value of the portfolio assets against the liabilities to clients determined in accordance with the clients' respective portfolio management agreements. Some of these, for example, provided for a guaranteed return of capital, others only for the current market value attributable to each client's assets (which would include any profit). They felt that, given proper books and records at Barlow Clowes, such an exercise would have been easy and straightforward. The representatives felt that an "on-going" assessment could be a more difficult one. To some extent it would be an arithmetical exercise, matching present value with the future maturity commitment. It could then be a matter of considering whether, if a difference emerged, it could be made up. It would have been difficult, they thought, to prove positively whether the commitments could be met or not, but they felt that an accountant should have been able to give a view.)

6.9 In their covering letter of 2 July to the Licensing Unit principal, the Stock Exchange commented that their conclusions were "plain to see", and suggested a discussion once the Department had had a chance to read the paper. They added that Peter Clowes had called in that morning to say that he was proposing to shut down the portfolio schemes in the UK, but not in Gibraltar, and offer only a gilt agency/advisory service to those clients and prospective new clients. The Stock Exchange said this had sounded good on the surface but, despite questioning Mr Clowes, they had not found out how this news was to be communicated to the clients. Moreover, they had the distinct impression that Mr Clowes would not be able to finance it all at once. They described the firm as "woolly as ever when it comes down to practical detail". The principal referred the papers to the SEO for advice. He suggested that CIB, to whom the Stock Exchange had sent a copy, would now be the appropriate section to advise, rather than the IDU Directors as he had earlier planned (6.3).

6.10 I have seen that the Stock Exchange also wrote on 2 July to CIB with a copy of their draft paper; in their covering letter they said that in processing Barlow Clowes's application for Stock Exchange membership, the usual routine enquiries had been made, but that the answers were unconvincing and simply begged more questions. The writer said "I have no doubt there is much more to be unearthed on these people by anyone who cares to delve". CIB's reaction on receipt of the papers was to set up a consideration file on Barlow Clowes and Ferguson, and to run checks on all the companies involved. Although they did not communicate this to the Licensing Unit, they thought a joint meeting with the Stock Exchange and the Licensing Unit should be arranged when further papers had been received from the Stock Exchange, possibly at a level as high as the head of CIB. They predicted that the case could end up as a "s177 FSA, or s432/442 CA, or s105 FSA, or any combination" (these references were to powers under the Companies Act 1985 and the Financial Services Act 1986 to conduct investigations into insider dealing, into a company's affairs in the circumstances set out in section 432, into the ownership of a company and into the affairs of an investment business). The various checks were put in hand and copies obtained of Ferguson's and Barlow Clowes's latest accounts. In the meantime, on 7 July, the EO in the Licensing Unit wrote to Barlow Clowes and Partners Ltd reminding them that at the meeting in July 1986 they had said that negotiations were taking place for a merger with Ferguson. She pointed out their obligation under regulation 9(1) to notify any change of controller and asked whether any change had taken place.

6.11 On 10 July the Stock Exchange sent both the Licensing Unit and CIB further papers updating the situation. In his letter to the Licensing Unit principal the Stock Exchange representative said that he was sceptical of the "bad guys becoming clean" touch and was concerned about the future of the UK portfolio clients and the extent of resources within the portfolios. He suggested a meeting the following week. The updating papers included more evidence of share dealings, showing connections between Tifa, C H Bailey, Barlow Clowes, Bristol Channel Ship Repairers and Ferguson. The paper itself reported a meeting at the Stock Exchange on 2 July attended by representatives of the Stock Exchange and Messrs Clowes, Newman, and another member of Barlow Clowes's staff. The meeting had been requested by Mr Newman so that Mr Clowes—who had done most of the talking—could outline his proposals for the future of Barlow Clowes and Partners

Ltd. Mr Clowes had reported that it was his intention to discontinue the portfolios and to deal in securities as an agent, mainly on instructions, but with a limited amount of discretionary business. Everything would be in-house and there would be no custodian arrangement with Lloyds Bank. The business would concentrate on giving professional investment advice to clients, who he envisaged would comprise his existing clients and a new clientele which he hoped to build up through negotiations with trade unions and outlets in clearing bank branches. The business would be “mainly in gilts”. The existing portfolios were expected to be closed by 31 March 1988, by which time it was hoped that existing clients would either have converted their investments into fresh gilts or accepted an offer of a term deposit (a new product which was being contemplated); the process would start in September. Mr Clowes did not intend to offer any tax avoidance schemes in the future, however legitimate. The Stock Exchange had then pressed Mr Clowes on the subject of terminating existing contracts, and he had replied that he thought 95% could be converted within 3–4 months and “muttered about finding a way to close down the rest afterwards”. The Stock Exchange commented in their report that this statement reinforced their feeling that there was insufficient money in the portfolio schemes to enable them all to be paid off immediately. Mr Clowes had outlined the proposed timetable of events, which would include both management reconstruction and changes of policy at Barlow Clowes and Ferguson, and had confirmed that the Gibraltar based portfolios would continue. No commitment as to the progress of the Stock Exchange membership application had been given.

6.12 On 10 July a representative of the Greater Manchester Police telephoned the Department and spoke to an EO, who reported the conversation to the SEO. The police had asked whether Barlow Clowes and Partners were licensed and what police checks had been carried out, and said they were investigating the company and “its possible new controller James Ferguson Ltd”. After being told the dates of the licences and that the Cheshire police check had been negative, they had promised to let the Department know if anything untoward came to light. On 14 July Grangewoods, solicitors acting for Barlow Clowes and Partners Ltd, wrote to the Department advising them that the issued share capital of the company had been sold on 16 April 1987 to James Ferguson Holdings plc. They also advised the Department that on 16 April, pursuant to the terms of the share purchase agreement, Spicers had resigned as auditors of Barlow Clowes and Partners Ltd and Touche Ross had been appointed in their place. They enclosed a form giving information about Ferguson, a form notifying the change of controller verified by Grangewoods, and a copy of a letter from Spicers dated 16 April 1987 in which they gave formal notice as of the date of their resignation as auditors of Barlow Clowes and Partners Ltd. The letter said “There are no circumstances connected with our resignation which we consider should be brought to the notice of the members or the creditors of the company”. (In the absence of any such circumstances, section 390(2) of the Companies Act 1985 required a statement to this effect to be made by resigning auditors.) Grangewoods said that the new auditors who had been appointed to replace Spicers were the chartered accountants Touche Ross. The Finance Director of James Ferguson Holdings plc replied to the letter of 7 July from the EO in the Licensing Unit (6.10) on 15 July, referring her to Grangewoods’ letter of the previous day. And on 17 July the Financial Controller of Barlow Clowes and Partners Ltd wrote to the Department to say that the company’s accounting date had been brought forward from 30 June to 31 March. He asked for confirmation that the next monitoring return should cover the period 1 July 1986 to 31 March 1987.

6.13 On 17 July a meeting took place attended by the authors of the Stock Exchange draft papers, and officials from the Licensing Unit and CIB. In the main, discussion covered the topics raised in the draft report. The Licensing Unit’s note of the meeting recorded that the principal had invited the visitors to expand on their report—see 6.8. They explained that Barlow Clowes’s reticence in answering basic questions had led them to probe further, and that they had noticed in the accounts that Barlow Clowes Nominees Ltd had loaned £300,000 to the company which was negotiating to take them over. The nominee company had also had some transactions with brokers. The loan had however been repaid and the

Exchange had had legal advice that these activities were not illegal. The Licensing Unit's note went on to say that the two audit trails examined by the Stock Exchange showed that current values were less than the original amounts invested. The Inland Revenue had advised that they were satisfied with the accuracy of the Portfolio 30 brochure so far as the tax position was concerned (but not the Portfolio 37 brochure). The Stock Exchange had said that client money was held by Lloyds, but Barlow Clowes "could get at it", and "the management agreement with clients allows BC to do almost anything". Mr Clowes had announced his intention to stop bond-washing and run down the portfolios. There had been a proposal that a firm of stockbrokers would be acquired by the group, but one of the partners in the firm in question had reported that he had found Ferguson secretive when he had called to discuss the matter. Other points raised by the Stock Exchange and noted by the Licensing Unit included mention of links with Ryeman and Tifa, majority Swiss interests in Ferguson, switching of shareholdings and possible ramping of the share price, Ferguson's share price going ahead while their accounts showed consistent losses, and lack of information about Tifa (but with hints that the trail might lead to Lebanon). The principal asked to be told when the Membership Committee of the Stock Exchange had come to a decision.

6.14 A senior examiner also made a note of the meeting for CIB's file (and copied it to FSD). It recorded additionally that the Stock Exchange had found that Ryeman Ltd and Tifa AG were behind Barlow Clowes Nominees Ltd. Both Mr Tree, and the stockbroker whose firm was to have been acquired by Ferguson, had the impression that there was a lot of unexplained money in Ferguson. The Stock Exchange thought that the ultimate source of Tifa might be in Lebanon, and the stockbroker thought that drug money could be involved. Another senior examiner present at the meeting said he thought there were possibly sufficient grounds to justify s447 (of the Companies Act 1985) enquiries, but these would not be appropriate for the partnership, and there were problems of the lack of resources at CIB. He therefore thought s105 (Financial Services Act) enquiries would be more beneficial. The Stock Exchange representative's concern was that Barlow Clowes did not have enough money to meet all their guarantee commitments, and he was worried about what would happen if a considerable number of investors did not continue with their investments when told that the gilt portfolio management was to cease. The Stock Exchange's note of the meeting recorded also that, while being interested in the corporate aspects of the case—especially the possibility of share ramping, lack of resources might mean that the Department could only adopt a watching stance. With regard to the client portfolio situation, however, the Department had been particularly concerned and, if they could find the right resources and powers, and a good reason to do so, had seemed inclined to put inspectors/accountants into Barlow Clowes to investigate both the partnership and the company.

6.15 Following the meeting the Stock Exchange brought the Bank of England up to date. Representatives of the Bank and Stock Exchange spoke again on 21 July when it was agreed that the Bank would tell the Department of their concern about the portfolio scheme clients. On 22 July a Bank official telephoned the principal, who made no note of their conversation. The Bank official noted that the principal had not yet reached a decision as to what action the Department should take. The official recorded that the principal said that the new section 105 powers were "draconian" and he was very reluctant to appoint outsiders to carry out an investigation. The official said it must be a decision for the Department, but he indicated that action along those lines would be very welcome to the Bank. As an alternative, he reminded the principal of the audit that had been carried out by Spicers in 1985, and asked if the Department could commission something similar again; on learning from the principal that Touche Ross were the current auditors, he suggested that the Department should renew the licences only after Touche Ross had produced a full audit report. The Bank official noted that the principal "seized on this suggestion" and asked for advice as to what the Bank might do in similar circumstances if the Banking Act had been involved. The Bank official said that it seemed to him that the most important thing was for DTI to establish just as soon as they could whether in fact the funds were sound financially or not. At the Bank official's suggestion, the principal said he would do some research on the

question of Barlow Clowes's obligations to repay, either at maturity or earlier termination by the managers. The Bank official also advised the principal to let the Treasury know of recent developments, because the Bank would need to do so and would not wish to embarrass the Department. And on 29 July the Bank telephoned the Treasury to let them know of recent developments. The principal told me that he believed that he had probably first advised the assistant secretary of the Barlow Clowes case after the meeting with the Stock Exchange representatives on 17 July, but that he had mentioned the matter only informally, suggesting that the case was a potential problem. He told me that during the summer of 1987 he had been involved with another licensed dealer case which had been subject to a section 447 investigation by CIB officers, which had had to be widened into a section 105 investigation by external investigators, partly because of lack of resources within the Department. He had been concerned at the length of time it had taken to get the section 105 investigation under way, that it was a new and almost untested procedure for licensed dealers, and he had been anxious to find an alternative solution to the Barlow Clowes problem which would produce results more quickly, given the apparently favourable information which his Division held on file on Barlow Clowes. It had been for this reason that he had decided initially that the voluntary audit route suggested to him by the Bank of England would be the most effective to establish whether clients' assets were safe. The principal also said in evidence that he had had doubts whether sufficient good reason existed for a statutory investigation and that he had been mindful of a recent rejection by the High Court of a Departmental petition to wind up a securities dealer. The information provided by the Stock Exchange, whilst giving cause for concern, had to be considered with other information available to the Department. He said that he had been conscious of the clean, albeit belated, monitoring returns submitted earlier in the year and the letter of resignation from Spicers in April 1987 in which they had stated that they had no matters of concern to draw to the attention of the company's creditors. He said that Simmons & Simmons had only recently verified and submitted the company's application for a fresh licence (see 6.16 below) and the Department had received no complaints. The principal said that he had thought that if the company refused to agree to a voluntary audit of the clients' funds, this might have sufficiently strengthened the ground for concern to justify the mounting of an investigation.

6.16 On 27 July, the solicitors Simmons & Simmons wrote to the Department saying that they had been requested to act for Barlow Clowes and Partners Ltd in respect of their licence renewal application. They said that the company had not been proposing to apply for their licence to be renewed because they had applied for membership of the Stock Exchange, which would have exempted them from the need to be licensed; but the Stock Exchange had recently indicated that their approval of the application might be delayed beyond the licence expiry date, and the company were therefore applying for renewal as a precautionary measure. The company's application for a principal's licence, which Simmons & Simmons enclosed, showed the accounting period as ending on 31 March 1988 and annually thereafter, and indicated that the first monitoring return to be submitted to the Department in respect of the current application would be due on 30 September 1988. This form also stated that on 16 April 1987 the business of Barlow Clowes and Partners had been transferred to Barlow Clowes and Partners Ltd and that the partnership had been dissolved. A "relevant corporations" form was submitted in respect of James Ferguson Holdings plc. A number of "relevant group corporations" forms were submitted, including one in respect of Barlow Clowes International Ltd, which showed that company as having been incorporated in Gibraltar on 17 October 1985. Its directors included Peter Clowes, and the nature of the company's business was shown as "Investment accounting; company and trust administration services". In answer to the question "Has a business relationship existed between the company [BCI] and the applicant within the last year?", the following statement was made:

"The applicant carries out two main business activities—investment management and computer related activities. During the last year the applicant did not refer any investment-type business to the company. However, it did provide considerable software/hardware support and

expertise to the company; and also senior management advice in setting up the company's operation in Gibraltar. These activities accounted for 28% of the applicant's gross income in the nine months to 31 March 1987. This business was carried out on an arm's length basis".

In a second letter dated 27 July, Simmons & Simmons sent the Department application forms for the renewal of four representatives' licences, and in a further letter dated 27 July, they sent two further such applications.

6.17 On 30 July the Stock Exchange sent the Department a copy of a letter which had been sent by the Corporate Membership Executive of the Stock Exchange to Barlow Clowes and Partners Ltd. This letter sought confirmation of changes since the submission of the membership application, in particular that the ultimate shareholder of Barlow Clowes and Partners Ltd was now Ferguson Financial Holdings Ltd, that Mr D R Tree had resigned as managing director and was yet to be replaced, and that Barlow Clowes would have ceased its gilt portfolio operations by 21 March 1988 (I think this should have been 31 March) and would concentrate on agency-broking in gilts for small private clients, with no equity-related business. The letter went on to say that the Stock Exchange were concerned that the portfolio schemes should be terminated in a manner satisfactory to the clients in order to avoid complaints being made after the company had joined the Stock Exchange. To satisfy themselves on this point the Stock Exchange requested a detailed description of how the portfolios were to be run down including examples of letters or other documents to be sent to clients. It continued:

"If possible, list the present gilt holdings of each portfolio and the current valuation thereof, stock by stock. Please also state in respect of each portfolio the total amounts of monies invested by, and the maturity values guaranteed to, the clients concerned."

Barlow Clowes were asked to explain the reasons for their seeking membership of the Stock Exchange which, it was pointed out, was ceasing to be a regulatory body so that membership would not provide regulatory cover under the Financial Services Act. The letter also asked for details of Ryeman Ltd and enquired about its connection with Ferguson. On 4 August the Stock Exchange sent a copy of their letter of 30 July to CIB also.

6.18 The Stock Exchange made a note of conversations which took place on 5 August between one of their representatives and the principal, of which there is no record in the Department's papers. The Stock Exchange record says that the principal telephoned the Stock Exchange to inform them that a licence renewal application for the company had been received, and that the Department had been told that the partnership's business had been transferred to the company, and that the partnership had been dissolved. This had been news to the Department, and was also to the Stock Exchange. The principal also reported the telephone call the previous month from the Greater Manchester Police. The Stock Exchange's note records that the principal rang again later after having spoken to a representative of the Greater Manchester Police who was in the Drugs Intelligence Branch. This branch had apparently received word that Barlow Clowes were "shipping cash abroad" using private chartered jets. About £1 million was involved, and it was considered that it was linked with drugs. The jets had been making trips to Switzerland and the West Indies. The police had noted the information but were taking no further immediate action. The principal mentioned also to the Stock Exchange representative the enquiry the Department had received from a Spanish resident who had said that Barlow Clowes had recently set up in Gibraltar and were advertising almost daily on the television and in the press.

6.19 Also on 5 August, Simmons & Simmons wrote to the Department with reference to their letter of 15 June concerning renewal of the partnership's licence. They confirmed that on 16 April 1987 the partnership's business had been transferred to the company and the partnership dissolved, and said that it was not therefore proposed that any application should be made for the partnership's licence to be renewed. It was questioned by the principal whether the licence should be revoked and the SEO suggested that it should, though he said that the revocation would have no practical effect. I asked the principal whether he had

considered if some enquiry ought to be made about the impact of the dissolution of the partnership on the custodian arrangements, and whether the funds from the partnership would be drawn into them. It was represented to me in response that the principal might have assumed that the partnership clients had automatically been transferred into the custodian arrangements, from which he would have drawn great comfort. When I asked him also why he had not made a note of his conversation with the Greater Manchester Police when he had telephoned them, he told me that pressure of work and practical resource difficulties made it difficult to minute all meetings and conversations. He said he had kept the conversation in mind and had referred to it at a later date when summarising the case. But I could find no record of this conversation anywhere on the Department's files, and the principal seemed only vaguely to have recalled it when, as I have seen, he was asked about it by the Department on 13 October 1988. The Greater Manchester Police told me that they had no further contact with the Department about Barlow Clowes following this telephone conversation.

6.20 On 6 August the Stock Exchange sent CIB details which further updated their draft paper. They noted that the additional information seemed to cement the relationship between Ferguson, Ryeman and an individual director. A chief examiner sent copies of the documents to the Licensing Unit principal, and asked to know the latest position following the meeting on 17 July; he noted that the case was awaiting action by the Licensing Unit. A note in the Stock Exchange's papers shows that the principal telephoned the Stock Exchange shortly afterwards for an update on their position, and was told that the case was now in the hands of the Stock Exchange Membership Department. Simmons & Simmons wrote again on 13 August enclosing information in connection with three representatives' licence applications. They said the only matters outstanding were the submission of the same information about one of the directors and the auditors' going-concern certificate. The EO wrote to the company on 18 August, in reply to their letter of 17 July (6.12), confirming that in view of the change in accounting date the Department would expect to receive a monitoring return for the period 1 July 1986 to 31 March 1987, and this was due by 30 September 1987.

6.21 Meanwhile, (as I have learned from the Bank's papers), on 14 August a Bank official had telephoned the principal to see what action the Department was going to take. The Bank official noted:

"They have been having great difficulty with their formal powers under the new Act and [the principal] was very loth to contemplate the hassle and argument involved with the company when he could point to so little quotable evidence. He is not in a position to quote from any of the material supplied by the Stock Exchange. He also said they were having great practical difficulty in actually finding inspectors to appoint, particularly when one had ruled out those with a conflict of interest. I said that that must, of course, be entirely a matter for them to decide though I made it clear that we would have welcomed such an enquiry. I said that I still felt that some sort of check was imperative, and sooner rather than later, and [the principal] agreed there were attractions in the suggestion I made earlier that they should require Barlow Clowes's new auditors, Touche Ross, to carry out a full audit of the clients' funds. I said that I did not think we had ever seen the report produced by Spicers in 1985 and he promised to send me a copy right away. I agreed that we would see whether we could make any suggestions as to the precise wording of the instructions he might ask Barlow Clowes to give to Touche. He seemed to agree that it would be right to require the company to submit this in time for the DTI to decide whether to renew the company's licence, which I think expires in November." (It was in fact due to expire on 27 October.)

6.22 And on 18 August the Bank official wrote to the SEO (in the principal's absence on leave) in pursuance of his offer to advise on the terms of instructions to the auditors, saying that in his telephone conversation with the principal the latter had asked him to consider whether the instructions given to Spicers in 1985 had been entirely appropriate, and he went on:

“Having looked at the Spicers report we believe a report in that format should give reasonable reassurance that the cash and investments which they say exist and they (sic) are holding on behalf of the clients’ funds are indeed so held. What of course is much more difficult to demonstrate is whether the precise plans which were offered to each individual investor are indeed being carried out in the way those investors are entitled to expect, and whether the appropriate amount of investments and cash is actually held to enable the terms of those contracts to be fulfilled in the future.”

6.23 The Bank official therefore said it was his personal view that the new auditors should be asked not only to carry out a further review in the terms in which Spicers reported in 1985, but also to report on whether sufficient assets were held to meet obligations to clients. He suggested also that the Department might wish to follow up Spicers’ comment in their letter of 18 April 1985 that they were reviewing the system of internal control to see what changes had resulted. The Bank official stressed that the matter was one for the Department and said he was writing only because the principal had asked for his advice as to what he would be likely to do if Barlow Clowes were a company authorised under the Banking Act. If the Bank had any doubts at all about a central aspect of the business they would certainly want full information. If this could be obtained voluntarily so much the better, but otherwise they would not hesitate to appoint competent persons to investigate. He added that, since Barlow Clowes would no doubt be anxious to obtain a renewal of their licence, he thought it perfectly reasonable to require them to provide the information he had suggested to enable proper consideration to be given to the application. On the instructions of the principal the SEO referred the matter on 20 August to an assistant solicitor, mentioning that one area of concern was that client capital might have been eroded to keep up dividend payments and asking her if she saw any objection to the Department’s requesting (in a draft letter which the principal had prepared) an audit before renewing the licence, bearing in mind that the Department seemed to have no power to demand this. Copies of the SEO’s note were sent to the assistant secretary and to the principal examiner of CIB. The assistant secretary responded by asking whether the Department could use its powers under s.447 of the Companies Act or s.105 of the Financial Services Act, or ask Touche Ross to act under s.105. The principal examiner referred his copy of the note to the chief examiner, who gave instructions that FSD be asked if they were going to authorise a s105 enquiry which might affect the need for the audit. The assistant secretary told me that the SEO’s note of 20 August had been the first time that he had received anything in writing about Barlow Clowes. The extent of his knowledge before then had been that the principal had met the Stock Exchange in July to discuss Barlow Clowes and that afterwards he had been in touch with the Bank of England about the possibility of obtaining a special report from Barlow Clowes’s auditors. The principal told me that in assessing the case at the time he had considered that the information from the Bank had been more important than that from the Stock Exchange, since the Stock Exchange material had been supplied in strictest confidence and could not have been put to Barlow Clowes. When I put it to the principal that the information from the police might also have been seen as of some significance he said that it had been this information which had tipped the balance in his mind, together with other factors, for going for a s.105 investigation rather than the voluntary audit route as had been suggested by the Bank. Then later, it was represented to me that (as the principal thought was clear from the minute he had written on 9 September 1987—see 6.27 below), it had been the information from the Bank of England which had been decisive in persuading him to change his recommendations for action. On 25 August the SEO informed the partnership that their licence had been revoked, and asked them to submit a monitoring return for the period from 1 July 1986 to the cessation of business.

6.24 A Bank official telephoned the principal on 2 September partly for a progress report and partly in order to pass on the view of the former Government Broker that James Ferguson’s share price had been ramped, presumably to assist in the bid for Buckley’s Breweries. The official was concerned that no action had been taken by the Department. The principal told him he was reluctant to act decisively because there had been no complaints from clients and there had been a

satisfactory audit report two years previously. The Bank official pointed out that one could not expect complaints until a crash had occurred and that, since the 1985 audit report, the Inland Revenue's action on bond-washing appeared to have removed the basis on which Barlow Clowes's gilt plans operated. The principal promised to advise the Bank what action the Department would be taking as soon as he had heard from the departmental solicitors.

6.25 The assistant solicitor to whom it had been addressed replied to the SEO's minute on 7 September, giving her preliminary views on the matter. She thought that the key question related to what the Secretary of State could do if the company refused to agree to a further voluntary audit; the question would arise whether a request for a licence could be refused, either on the ground that the company had refused to supply information, or on the ground of the concerns that had led the Department to seek such information. The latter ground would be the safer. The solicitor thought it desirable that the nature of the Department's concerns should be conveyed to the company, but she said she was unclear why the Department was asking the company to commission an audit rather than exercise its own statutory investigation powers. She pointed out that it appeared that the company had failed to comply with regulations 9(1)(a), 9(1)(b) and 9(1)(g) of the Dealers in Securities (Licensing) Regulations, which would be a ground for refusing a licence under section 5(1) of the PF(1) Act (these regulations obliged the holder of a principal's licence to notify the Department of the appointment or removal of a director, manager or controller or the resignation of an auditor). She added that the company had also been late in filing its monitoring return, and the partnership appeared to have failed to notify the Department that it had ceased to carry on the business of dealing in securities. This would be a breach of section 8(1) for which there was criminal liability. The solicitor advised that if it was proposed to write to the company in advance of reaching a decision on the question of a new licence, then it would be desirable to avoid giving the impression that the Department had decided to overlook these breaches, unless of course it had been so decided.

6.26 I asked the solicitor whether the opinion she had expressed in her minute that contraventions of regulation 9 gave ground for refusing a licence under section 5(1) of the Act was technically correct. I suggested to her that section 5(1) of the Act gave the Department power to revoke a licence for failure to supply information required during its currency, and to refuse a new licence only for failure to supply information required on the occasion of the application—(see 2.12 above). The solicitor said in reply that she thought this was correct but that the point was not free from argument. I asked the solicitor if she had had this distinction in mind at the time of writing her advice of 7 September 1987, and she said that her minute had been essentially for the record only, because things had moved on by the time she had written it. She said that she had not seen the final version of her minute and that the use of the word "refusing" rather than "revoking" had either been a slip of the pen or of the tongue. She pointed out that Sir Godfray Le Quesne's account of the meeting of 18 September (see below) indicated that she appeared to have corrected the point then, since the reference was to revocation under section 5(1) (rather than refusal) being considered.

6.27 On 9 September Simmons & Simmons sent the Department a copy of the auditors' going-concern certificate, outstanding from the licence application papers. This was dated 13 August, and was unqualified. Also on 9 September (before having received the solicitor's note of 7 September) the principal minuted CIB, sending copies to his assistant secretary and to the Solicitor's Office. He also sent the Solicitor's Office copies of the papers received from the Stock Exchange in July and a copy of the letter dated 30 July from the Stock Exchange to Barlow Clowes and Partners Ltd (see 6.17), having marked it "essentially a holding letter to further delay a Stock Exchange decision on membership". He said that a decision needed to be made soon as to what action the Department should take in light of the information obtained from the Stock Exchange. He passed on the Bank's view that there was "a problem waiting to hit us" and the view that share-ramping of Ferguson's shares was going on. He said that he had been thinking of asking the company for a voluntary audit along the lines of the 1985 report prepared by Spicers, which he said had proved satisfactory, but he was now giving

serious consideration to a statutory investigation being authorised and suggested that a meeting be arranged so that the whole matter could be discussed and set out the questions to be considered. CIB's copy of this minute was referred to the head of CIB, who agreed that a s105 investigation would be an appropriate type of investigation both on legal and resource grounds. In preparation for the proposed meeting a senior examiner was advised that the only possible disadvantage of using s105 as opposed to s447 was that the former did not allow an application for a search warrant. Then, on 16 September, another senior examiner referred the papers to a principal examiner saying that, in his view, the principal's minute did not fairly represent events to date and he was unhappy about the implication that CIB had been the cause of any delay. He went on "I do not share [the principal's] view that there was insufficient justification for an investigation, although I do not know if FS uses a different definition of 'good reason' from CIB. It seems to me that good reason was established in July". These comments were not passed to the Licensing Unit.

6.28 A meeting was held on 18 September attended by the assistant secretary and the principal from FSD, a principal examiner from CIB and an assistant solicitor from the Solicitor's Office. None of the files I have examined include any note of what took place at the meeting but the assistant secretary, the principal and the solicitor who attended the meeting have all told me that Sir Godfray Le Quesne's summary of the meeting (so far as they could recall it) in Chapter 6.18 of his report was a fair account. This reads as follows:

"They considered whether there should be an investigation of the company (and, if so, under what power, and by whom it should be conducted); whether the company's licence should be renewed, with or without qualification; and whether any other regulatory action should be taken. I am told that several options were considered. These included immediate revocation of the company's licence under section 5(1) of the Act for failure to give prescribed information. A second option was to give the company immediate notice of intention to revoke its licence under section 5(2) of the Act on the ground it was not fit and proper, and not to renew the licence in October even if the company referred the case to the tribunal. Alternatively, the Department could give the company notice of its intention to revoke the licence (or refuse a new licence), but if the company referred the case to the tribunal, could relicence the company and give notice of intention to revoke the new licence. The company would then be licensed during the tribunal's investigation, but the licence would then be revoked if the tribunal decided against the company. Another option considered was not to take action under section 5 of the Act, but to institute a statutory investigation under the Companies Act or the Financial Services Act. The conclusion was to make a submission to the Minister (i) that there should be an investigation of the company under section 105 of the FSA, conducted by a lawyer and an accountant, and (ii) that the company's licence should be renewed, qualified only if by the time of the renewal the investigation had already started".

Sir Godfray's account went on to record:

"The officials concerned have told me that they had in mind a covering letter to the company underlining that notice of intention to revoke the licence could be given if the investigation produced any information to suggest that was necessary. (There was no power under the PF(I) Act to attach any formal conditions to the grant of a licence.) Since companies were not warned in advance of investigations, such a letter would only be written if the investigation had started."

6.29 The principal told me that the reason why no note of the meeting had been made was that it had originally been intended to rehearse all the options discussed in a submission to the Minister and this would, in effect, be the record of the meeting also. The options were, the principal said, contained in the second draft (see 6.39). For his part, the assistant secretary told me that it would not have been sensible for the principal to have produced both a detailed note of the meeting and

a draft submission, as the latter would reflect the facts discussed, the options for action and the conclusions reached. On 21 September the principal examiner reported to a chief examiner the decision to investigate Barlow Clowes and Partners Ltd under s105 FSA, and said that there had been some discussion about the terms on which the licence should be renewed, the assistant secretary's view having been that there would be insufficient time for the enquiry to be under way before the licence was due for renewal, or rather within the normal period before 28 October when a response to the application for renewal would be given. He said that so far as Ferguson was concerned, the Department would give consideration to the allegations made by the Stock Exchange, but it was felt that the Stock Exchange case was rather lacking in fact and that the Stock Exchange should be asked to firm-up their information. On 22 September the assistant secretary minuted the principal, responding to his minute of 9 September and recording the conclusions of the meeting on 18 September, saying: "There should be an investigation under section 105 conducted by non-departmental staff. There should be one lawyer and one accountant on the ticket, and the accountant should not be from Touche Ross. We should renew the licence with effect from 28 October and qualify this renewal only if the investigation had already started. You are drafting a submission to Mr Maude on the above lines". (Mr Maude had succeeded Mr Howard as Parliamentary Under Secretary of State for Corporate and Consumer Affairs in June 1987.)

6.30 On 24 September, Touche Ross wrote to the EO in the Licensing Unit referring to an earlier telephone conversation and saying that they had recently been appointed as auditors and they were currently engaged in the audit for the nine months ended 31 March 1987. They said that the monitoring return was due to be submitted to the Department by 30 September 1987 but they asked for an extension to this deadline to enable them to complete the statutory audit. They said "we consider that it is essential that the full statutory audit is completed before the monitoring return is filed as this will allow us to carry out a more detailed examination of our client's system and internal controls". Although the letter was addressed to the EO, it was shown to the principal (who told me that he remembered discussing with the EO what should be said in reply). For her part, the EO told my officers that she had had a number of telephone conversations with Touche Ross following their letter in which she had tried, unsuccessfully, to pin them down to a deadline for submitting the return. She had kept the principal fully informed. Although the papers do not make this clear Touche Ross confirmed to my officer, through their solicitors, that the request for extra time was intended to relate both to the monitoring return due from the company and that due from the (then dissolved) partnership. They said that work on both the company and the partnership audits had only recently been commenced when the request was made, and that the need to complete the audit before reporting on the monitoring return had been felt in the case of the partnership as in the case of the company.

6.31 I asked the principal whether he had considered the request by Touche Ross for more time to submit the monitoring return surprising, given that it had been made less than a week before the due date, that the company had evidently known since August 1986 that the next monitoring return would be due on 30 September 1987 (5.5), and that Touche Ross would (on the basis of the information contained in Grangewoods' letter of 14 July—paragraph 6.12) have been appointed auditors the previous April (following the takeover by James Ferguson). The principal told me that if a professional firm offered to carry out a full statutory audit (the Bank of England itself having been recommending a voluntary audit) it was a comfort; and he had not considered it questionable that newly appointed accountants of Touche Ross's standing had found themselves unable to sign the monitoring return before they had carried out a statutory audit. The partner concerned at Touche Ross, told me that when the request for an extension of time was made a considerable amount of work remained to be carried out on the audits, because Barlow Clowes had not been ready for them until late summer, and his firm had commenced work only in early September. He said that he had not seen anything suspicious in this, and if asked by the Department to comment on the situation would have said that his firm had no reason to suspect that anything was wrong. The partner went on to explain that after the Ferguson takeover in April 1987, the

company's routine work had piled up, and there had been the holiday season, with the result that his clients had not been able to give instructions before the end of the summer; although this left the timetable very tight, such situations were not unusual. When I asked the partner what would have happened if the Department's response to the request for more time had been that they regarded the monitoring return as important and could extend time only, say, until 21 October, threatening revocation if the return had not then been produced, he said that Touche Ross could have met the deadline by making additional resources available, subject of course to the client providing all the information needed in time, (in which connection, the Touche Ross partner added, however, that his firm had already started experiencing difficulties in getting material from their client).

6.32 I asked the principal whether he had discussed the request from Touche Ross with the assistant secretary. He said that he had not because, when he had been shown the letter, he had been engaged in preparing the second draft of the submission to the Minister in which it would be referred to and which would be circulated for comment. He said that he had seen the letter as raising a question mark as to whether the voluntary audit route might not, after all, have been a better route than a statutory investigation, since Touche Ross were about to conduct an audit. I put it to the principal that, although at the meeting on 18 September the option of revoking the licence because of breaches of the regulations had been dismissed because such breaches had been regarded as too technical, the subsequent letter from Touche Ross could have foreshadowed a much less technical breach—that of failure to submit a monitoring return on the due date. I asked whether consideration had been given to regarding the absence of a monitoring return—a key feature in the licensing system—as ground for revocation, for example allowing Touche Ross a limited time but indicating the possibility of revocation before renewal if the monitoring return was not produced.

6.33 In reply, the principal pointed out that monitoring returns would not always be required at the time of renewal of a licence. He said that (for the reasons he had given me, and in anticipation of a full audit, including the auditing of clients' accounts) he had not considered the failure to submit a monitoring return as providing another option to the Department, nor had he considered re-convening the meeting. He said that the way forward had been decided at the meeting on 18 September and he saw the letter from Touche Ross only in the context of a need to add further material to the submission which he was then preparing, on which everybody would have an opportunity to comment. The assistant secretary told me that he had no recollection of when the fact of the late monitoring return had been drawn to his attention. It had not been referred to in the first draft of the submission (dated 1 October), but it had been referred to in the second and third drafts. However, his recollection was that the references in those drafts to normal practice had been in response to his request. He concluded that he had probably heard between the first draft and the second draft (which seems to have been circulated on 5 October). The assistant secretary told me that when he had heard that the monitoring return was late he had noted that this was a further breach of the regulations by Barlow Clowes, and thus potentially a cause for concern. On the other hand, he said, their last monitoring return had been late but clean and, on the information given Touche Ross seemed to have put forward a genuine reason for the new return being late. In the light of this, he had asked the principal to find out what was the normal practice if a monitoring return was late at the time of licence renewal, and in re-drafting the submission, to say that the normal practice would be applied to the case of Barlow Clowes.

6.34 Meanwhile, on 28 September, the Deputy Governor of the Bank of England had written to the Permanent Secretary of the Department, and to the Chairman of the Stock Exchange, referring to the Stock Exchange paper which had been prepared earlier in the year following Barlow Clowes and Partners Ltd's application for Stock Exchange membership. He said that the paper referred to a general reluctance on the part of the company to provide information promptly and accurately and it expressed concerns that their methods of operation might not meet Stock Exchange requirements on matters such as supplying information to clients. The report had also cast doubts on the accuracy of Barlow Clowes's

records and the effectiveness of their systems. The Bank had become aware of unease in the market about Barlow Clowes and its parent, James Ferguson. In particular concerns had been expressed about the possibility of share manipulation. The letter concluded, "We find all this rather worrying. Just as in 1985, our concern remains that the size of the Barlow Clowes operation could lead to a major "City scandal". It is clear that at this stage the Bank can play only a limited role, but I thought we should make you aware of our general unease and of the need for the situation to be looked at as closely as possible by all those concerned". The Stock Exchange responded to the Bank's letter on 30 September, a representative telephoning the Deputy Governor. He said that action was primarily for the Department. The Stock Exchange was investigating the alleged share manipulation and was unlikely to grant membership in the near future. The principal forwarded a copy of the Bank's letter to CIB who were considering the information about Ferguson, promising that a draft submission about Barlow Clowes would reach them shortly.

6.35 On 1 October the principal circulated copies of his first draft submission to the assistant secretary, the principal examiner, the assistant solicitor and the SEO inviting comments within 24 hours so that the Bank's letter could be dealt with at the same time. The recommendation contained in the first draft submission was that "an investigation should be carried out under section 105 FSA by non-departmental inspectors comprising an accountant who would provide administrative back-up, together with a solicitor. The Bank of England should be informed of the action taken". The concerns expressed by the Stock Exchange were mentioned, together with the fact that no full audit of the portfolio funds had been done since 1985. But no mention was made in the draft of the outstanding monitoring return, or of the breaches of the regulations which had occurred. The only reference to the renewal of the licence was that:

"The Department will be obliged to renew BC's principal's licence with effect from 28 October otherwise BC will be put out of business thus exposing the thousands of BC investors to further risk. If section 105 inspectors can be found and commissioned before that date, the granting of the licence will be qualified so as to refer to the commencement of the investigation."

6.36 I asked the principal why his first draft submission had not referred either to the late monitoring return or to the other breaches of the regulations. He pointed out that the request to be allowed to submit a late monitoring return had not been shown to him by the time he had completed the first draft of the submission and that, unknown to the assistant solicitor concerned (see 6.25) the other breaches of the regulations had been rectified. He also told me that he had wished to summarise the case as succinctly as possible for the Minister. The solicitor told me that she had telephoned the principal on receipt of her copy of the first draft submission. She had made some specific points, and a few general comments one of which had been that the draft did not pay sufficient attention to the pros and cons of refusing or revoking the licence as opposed to recommending an investigation under section 105. CIB requested two amendments to the draft relating to their position, and these were incorporated by the principal in his second draft.

6.37 The recommendations in the second draft, which was again circulated to the solicitor, CIB and the SEO, apparently on 5 October, were as follows:

- "(i) An investigation should be carried out under section 105 FSA into BC by non-departmental investigators. They should be an accountant, who would provide administrative back-up, together with a solicitor.
- (ii) CIB should consider further what to do about JFH.
- (iii) BC meanwhile should be granted a further licence with effect from 28 October, conditional upon the receipt of a satisfactory monitoring return.
- (iv) The Bank of England should be informed of the action taken."

6.38 The submission went on to suggest that if the recommendations were agreed, the new licence should be issued within the next few days. Paragraph 10 of the second draft submission, a much longer document than the first, read:

“Following the takeover earlier in the year, JFH’s own solicitors and auditors were appointed in July to advise BC on the renewal of its licence in October. A partially complete application was lodged immediately in July with remaining documents following during August and early September, and appears in order. However, the new auditors (Touche Ross at Leeds) have advised in the last few days that because of JFH’s different financial year, BC’s next monitoring return was now due three months earlier on 30 September 1987. Touche Ross have asked for an extension of the deadline to enable them to carry out a full statutory audit which we understand will include a full audit of the client accounts. These audits have only just begun and will be completed as soon as possible but, although we have pressed, the auditors are not yet prepared to promise a date by which the monitoring return will be available. If a monitoring return is due at the time of licence renewal it is normal practice to wait for the return, or grant a licence conditional upon the receipt of a satisfactory return. There is no express power under the PF(I) Act provisions to require an audit of the clients’ account to be furnished to the Department”.

6.39 The second draft submission mentioned that there had been no complaints about Barlow Clowes, but commented that this was not surprising in view of their failure to supply clients with information about their investments after the initial management agreement. As giving cause for concern the draft mentioned, in addition to the contents of the Stock Exchange draft report, “the failure to comply with the Department’s own rules and regulations in the first four months of the year”. As regards that, the draft said: “it appears that there have been three separate ‘technical’ contraventions of the Licensing Regulations for failure to notify changes, which would provide grounds for refusing the grant of a new licence or revoking an existing one outright, under section 5(1) of the PF(I) Act. The failure to notify the Department that the partnership had ceased to carry on the business of dealing in securities is a breach of section 8(1) of the PF(I) Act, for which there is criminal liability. Furthermore, if—as the Stock Exchange report suggests—BC have failed to send clients annual reports on their portfolios this breaches the Conduct of Business Rules; such breaches provide grounds under section 5(2) of the PF(I) Act for giving notice of intention to refuse or revoke a licence because an applicant or licence holder is not considered fit and proper to hold a licence”. Later, the draft posed the question of what action could be taken “given (a) apparent breaches of the Licensing Regulations and Conduct of Business Rules, and the information in the Stock Exchange draft report and (b) the fact that the PF(I) Act licensing system is essentially a system of annual licences and that BC’s current licence expires on 27 October”. The draft went on to say that the choices appeared to be:

- “(i) refusing BC’s application for a new licence, under section 5(1) of the Act for failure to provide information,
- (ii) renewing the licence but simultaneously issuing a notice of intention to revoke under section 5(2) because BC is no longer considered fit and proper to hold a licence,
- (iii) renewing the licence (subject to receipt of a satisfactory monitoring return) and to postpone any action whilst statutory enquiry/investigatory powers are exercised against BC (and JFH)”.

6.40 As to option (i) the draft said that because of the way the PF(I) Act was drafted “the Department has the power to refuse BC a licence outright, without appeal to the Licensed Dealers Tribunal, under s.5(1) for failure to provide required information under the Licensing Regulations (eg changes in directors and auditors). However this action would be draconian and probably precipitate the collapse of the business ... It is not a practicable option where a large on-going business is concerned [and there could be a strong risk of judicial review]”. (These last words had been added in manuscript.) Option (ii) was discounted on the basis

that if Barlow Clowes exercised their right of appeal to the tribunal the Department could not be confident, in the absence of further information, that a case for revocation could be put together; a further drawback would be "that the tribunal would decide what to investigate, so the Department would not be in control of matters under enquiry". The draft therefore recommended option (iii). It continued by saying that, if a section 105 investigation was agreed, "BC's licence will need to be renewed with effect from 28 October (we would need to issue this licence in the next few days). We recommend that this licence is granted provided a satisfactory monitoring return is received from Touche Ross in due course."

6.41 I asked the assistant solicitor if she could recall what comments she had made on the principal's second draft submission. She told me that her recollection was patchy but that she did recall having raised queries on paragraphs 6 and 10 of the submission. One had related to a minor point of emphasis in regard to the lateness of the monitoring return (due at the end of December 1986) where she had pointed out that it was over a month (rather than "a few weeks") late. Another had, she thought, been to ask the principal on what basis he was allowing the auditors more time in respect of the monitoring return due at the end of September 1987. She believed that she had probably also told the principal that the Act did not allow the "conditional" issue of a licence and that she had then mentioned the possibility of using the failure to submit the monitoring return as a ground for revocation of the licence. The solicitor told me that she might have commented on the reference in the second draft to "technical" breaches because, generally, she felt that regulatory breaches should be taken seriously.

6.42 When I asked the principal about his second draft submission, he agreed that under the terms of the PF(I) Act it had not been possible to attach conditions to the issue of a licence (though the term "conditionally" had, he said, been used informally in the unit where a licence was issued or renewed "subject to review"). He further accepted that the reference to auditors having been appointed in July had been inaccurate (though it had reflected, he said, the reference in the Touche Ross letter of 24 September to their having been "recently appointed"). I also questioned the principal about the impression given by the statement in the second draft that the auditors had advised in the last few days that the next monitoring return was now due 3 months earlier on 30 September. I asked the principal whether there had not been a fourth option open to the Department which should have been included in his second draft submission—that of revoking the existing licence for failure to provide the monitoring return. He agreed that this had been a possibility but said that the return was to be accompanied by the statutory audit. I then put it to him that the first option in the second draft—that of refusing the new application under section 5(1) for failure to provide information—was incorrectly phrased, and I suggested to him that it should have referred to the possibility of revocation. His view was that because the licence was so close to its expiry date, the wording was correct. He said that he had at the time believed that failures to notify changes, such as changes in control, provided sufficient ground for the Department to refuse an application under section 5(1)—though this had not been clear. I discussed the same points with the assistant secretary who told me that he too had thought that failure to produce prescribed information during the currency of a licence gave the Department ground under section 5(1) to refuse a fresh licence application. He said that he thought that the source of his belief might have been the solicitor's minute of 7 September which had said (apparently in error—see 6.25) that a breach of regulation 9 would have been grounds for refusing a licence under section 5(1) of the Act. (I should add here that both the assistant secretary and the principal have told me that they were not aware of the earlier legal advice given in November 1984 (2.12).)

6.43 A third draft submission was prepared and extensively amended in manuscript—a process completed by 12 October. This draft had attached to it an annex into which certain information had been transferred, namely the background history of the case, a summary of the Stock Exchange's report, mention of the position about the late monitoring return, reference to the Bank's unease about the situation and reference to the absence of complaints. The options

set out in the main body of the submission, were the same as those described in the second draft (6.39) except that option (iii) now read:

“(iii) renewing the licence (subject to review if a satisfactory monitoring return is not received) and to postpone any action whilst statutory enquiry/investigatory powers are exercised against BC (and possibly JFH).”

The recommendations in the third draft were the same as those in the second draft (6.37) except that recommendation (iii) now read:

“(iii) BC meanwhile should be granted a further licence with effect from 28 October, subject to review if a satisfactory monitoring return is not received within a reasonable time.”

6.44 In the third draft the reference to technical contraventions (which appeared in the main body of the draft submission) now read: “Since the beginning of the year it appears that there have been three separate ‘technical’ contraventions of the Licensing Regulations of failure to submit returns or notify changes ...”, the words “submit returns or” being included as a manuscript addition to the typescript. Discussion of the issue of the late monitoring return was removed from the submission to the annex. In typescript the discussion was in almost precisely the same terms as in the second draft (6.38 above), save for the penultimate sentence which read, in the typescript, “If a monitoring return is due at the time of licence renewal it is normal practice to wait for this return, or to grant a licence subject to review if a satisfactory return is not received”. Manuscript changes to this sentence made it read “In these circumstances, it is normal practice to grant a licence, subject to review if a satisfactory return is not received.” There were also numerous other manuscript alterations to the passage, which made it read as it appeared in paragraph 9 of the Annex to the ultimate submission (see 6.49 below). The manuscript alterations included changing “Touche Ross have asked for an extension ...” to “We have agreed to an extension ...”

6.45 The assistant solicitor told me that she had no recollection of having seen this third draft (and she was able subsequently to confirm from her records that this version of the draft had not in fact come to her). I asked her if she had any knowledge of the wording (as it had finally appeared in paragraph 9 of the annex—which I asked her to look at): “It is normal practice to grant a licence subject to review if a satisfactory return is not received”. The solicitor told me that she was not aware of the departmental solicitors having agreed this form of wording in the Barlow Clowes case, nor was she aware of it as a general rule. She told me that she had considered the matter recently and had concluded (though it was of course no more than a personal opinion formed with hindsight well after the events in question and relating solely to the narrow point as to whether there could have been a revocation of the new licence either under section 5(1), for failure to deliver the monitoring return due in the *previous* licence period, or under section 5(2) solely because of a *subsequent* delay in delivering the return) that, once the new licence had been issued, the Department could only have taken action to revoke it under section 5(2) of the Act on the ground that the licence holder was no longer considered fit and proper to hold a licence—and the lateness of a monitoring return would probably have been insufficient in isolation to take such action. Her view was that once the licence had been renewed, the Department had lost its chance of acting under section 5(1).

6.46 The assistant secretary told me that he had been responsible for the fact that the submission had contained a reference to normal practice. He said that he had instructed the principal to find out what was the normal practice if a monitoring return was overdue at the time of licence renewal, and to say in the submission that normal practice should be followed in the Barlow Clowes case. He had been told that normal practice in the circumstances of the Barlow Clowes case was to act as the submission recommended. He added that no-one in FSD or the Solicitor’s Office had commented after the submission had been put forward that there was anything in it that was incorrect in fact or in law. The principal told me that because both he and the assistant secretary were new to FSD, he would have relied upon the experienced colleagues in the unit to advise him about normal practice,

although he could not now remember whom he had consulted and could not explain why the description of normal practice had been amended by the removal of the words “it is normal practice to wait for the return, or grant a licence conditional upon the receipt of a satisfactory return” (6.38), which had appeared in the second draft. But both the SEO and an HEO who would have been the likely persons whom the principal would have consulted told me that they had no recollection of having been asked what was the normal practice. The SEO added that this was not to say that consultation could not have taken place, and both he and the HEO told me that, had they been asked, their reply would have been that there was no normal practice because this had not been a normal situation. When a monitoring return was overdue, it was the Department’s practice to send a stock letter saying that the licence would be revoked if the return—or a satisfactory explanation of its absence—was not sent to the Department within three weeks. The SEO told me that if the stock letter produced neither the monitoring return nor an adequate explanation of its absence, then the Department’s practice was to revoke the licence. He said that the Department had become progressively stricter about late monitoring returns, particularly after a licensed dealer had been through the first cycle of submitting them. An explanation of the delay would have been considered on its merits. (The SEO added that while the events which had occurred meant that this was not a normal case—the wording finally chosen about normal practice, in so far as it referred to the situation in which a monitoring return was due round about the licence renewal date, fairly, if rather imprecisely, reflected how a renewal would have been approached.)

6.47 I asked the SEO if he recognised the formula “subject to review if a satisfactory monitoring return is not received within a reasonable time”. He told me that there had been no precedent for the set of circumstances in the Barlow Clowes case and he knew of no other case where a licence had been renewed where the same terms had been used. He thought that the formula had been tailored to meet the Barlow Clowes case. He described the circumstances, with the date for renewal shortly after the date for submission of the monitoring return and a change of auditor and of accounting date as anything but normal. Had he been approached by the principal at the time he would have been unable to cite precedents because there were none. The SEO said he had known of cases where the words “subject to review” had been used where, for example, a firm was under investigation by the Stock Exchange and the Department indicated that it reserved the right to rethink the licence when the results of the investigation were known. However, both the SEO and the HEO confirmed that their understanding had been that the Department had no power to attach conditions to the granting of a licence. The SEO added that this did not imply that the Department could not review, and say that it would review, a licence if a particular circumstance were to arise. Similarly the HEO referred to “suitable cautions being made with a further licence about settling outstanding obligations etc”. The assistant secretary told me that he had believed at the time of these events that the Department had power to revoke a licence for failure to provide information due under a previous licence. He pointed out that the form of words used in the submission did not make any sense without this belief. I asked the assistant secretary whether, in light of his belief that revocation of a new licence was possible for failure to provide information due in respect of the previous licence, less thought had been given to the option—not included in any of the drafts—of revoking the existing licence for failure to provide a monitoring return, or to give the auditors a deadline before revocation. He confirmed that this had been the case. He said that he had seen the issue of a new licence as not precluding the possibility of revoking the licence if the monitoring returns were not provided. He had expected that the statutory investigation would be swift, and would provide either grounds for reassurance, or the basis for a winding-up petition or for notice of intention to revoke the licence. He added that the effect of revocation would have been the same as that attributed to refusal in paragraph 12 of the submission (6.49 below).

6.48 I asked the principal whether the returns he had referred to in the third draft when mentioning “technical” offences had been the monitoring returns. He confirmed this and agreed that the implication was that the absence of a monitoring return was seen only as a “technical” offence. (He added in this

connection that the inclusion in the text of the submission under "Background"—see 6.49 below—of a reference to a "failure to submit returns" had been an error, given that the issue of the late filing of the monitoring return had been located in a quite different part of the submission, both in the second and third drafts.) Both he and the assistant secretary told me that the reason why some material including that concerning the late monitoring return had been transferred to an annex was simply that the submission as drafted had been too long. Standing instructions were that submissions to Ministers were to be concise. I asked the principal whether the words in paragraph 9 of the annex that "We have agreed to an extension of the deadline" had been correct at the time. He told me that this must have reflected a decision made within the Department and confirmed that Touche Ross had not been told in writing of the decision until the EO had written—on his instructions—on 23 October (6.52 below). (The principal told me that his recollection was that he had given the EO instructions not to contact Touche Ross in writing until a decision had been taken on the submission. But although he could not now be certain of this, he thought that they might have been told by telephone before then of the Department's agreement to the extension. For her part, the EO told my officer that she did not inform Touche Ross by telephone of the decision to extend the deadline in advance of her letter.) The principal agreed that the form of wording he had used in the submission made it appear that the option of the Department's taking action in the absence of a monitoring return was closed, when in fact the option remained open, and he said that he assumed that in the final stages of drafting it had been decided that they needed to reach a decision on Touche Ross's request before the submission went to the Minister. The assistant secretary told me he could not recall whether he and the principal had agreed the time extension or whether it had been a matter which the principal had dealt with on his own. When I asked the partner concerned at Touche Ross whether his firm had any record or recollection of the extension of time being agreed or indicated before the letter of 23 October, he told me that he had discussed the matter with the manager in his office who had at the time been in contact with the Department by telephone and, although neither he nor his manager could remember any such indication being given, it seemed to him from the length of time between the request on 24 September, and the reply on 23 October, that his firm must have received some "comfort" from the Department. This feeling was, he said, reinforced by the fact that the Department had sought a target date for the submission of the returns in a telephone conversation with his firm on 2 October—after the due date for delivery had already passed—which suggested to him that some comfort would have been drawn from the Department's apparent attitude. However the partner indicated that no agreement to the extension had been notified before the letter of 23 October.

6.49 The submission was put to Mr Maude on 13 October and was as follows:

**"BARLOW CLOWES & PARTNERS LTD: PROPOSED
INVESTIGATION UNDER FINANCIAL SERVICES ACT SECTION
105**

Issue

1. Barlow Clowes and Partners Ltd ("BC") hold a principal's licence to deal in securities under the Prevention of Fraud (Investments) Act 1958. This licence expires on 27 October. The first such annual licence was granted in October 1985, but only after reference to Ministers. BC applied to join the Stock Exchange last January and, in a draft report passed in confidence to the Department, the Stock Exchange have expressed concern about BC's fitness and propriety, and have criticised BC's newly-acquired parent, James Ferguson Holdings plc (JFH). The Bank of England have also expressed unease about both BC and JFH.

2. Should BC and/or JFH be investigated? If so, under which statutory powers and should the investigation be carried out by CIB officers or by outsiders? Should BC be re-licensed with effect from 28 October?

Recommendations

3. (i) BC should be investigated under s105 of the Financial Services Act 1986 (FS Act) by non-departmental investigators. They should be an accountant, who would provide administrative back-up, together with a solicitor.
- (ii) CIB should consider further what to do about JFH.
- (iii) BC meanwhile should be granted a further licence with effect from 28 October, subject to review if a satisfactory monitoring return is not received within a reasonable time.
- (iv) The Bank of England should be informed of the action taken.

Timing

4. As soon as practicable. If the recommendations are agreed, we should issue the new licence in the next few days so as to avoid disrupting BC's business by denying them authorisation.

Background

5. In the 23 months since Barlow Clowes—the partnership and BC—were granted licences, only the first 10 months to August 1986 have been free from regulatory concern. There were rumours of a possible fraud in August 1986, but they were not thought to provide sufficient “good reason” to commence enquiries under section 447 of the Companies Act. Since the beginning of this year it appears that there have been three separate “technical” contraventions of the Licensing Regulations for failure to submit returns or notify changes, which would provide grounds for refusing the grant of a new licence, or revoking an existing one. The failure to notify the Department that the partnership had ceased to carry on the business of dealing in securities is a breach of section 8(1) of the PF(I) Act, which is a crime.

6. Furthermore, if—as The Stock Exchange report suggests—BC have failed to send to clients annual reports on their portfolios, this breaches the Licensed Dealers (Conduct of Business) Rules; such breaches provide grounds for giving notice of intention to refuse or revoke a licence because an applicant or licence holder appears not to be, or no longer to be, fit and proper.

7. We and the Bank of England fear that BC *may* have misled investors about BC's two gilt-edged portfolio “bond-washing” schemes and that insufficient cash may be available to fulfil early redemption of contracts. The Stock Exchange and the Bank of England have also provided material to the Department which raises doubts about the fitness and propriety of JFH, which acquired BC in April. The Deputy Governor recently wrote to [the Permanent Secretary] expressing his “general unease” about the BC and JFH operations and asking that the situation be kept under close review. He is concerned that, in the event of a liquidation, there might be insufficient funds to pay creditors in full, and that another major “City scandal” could break. Some of our concerns about BC may be reduced by a statutory audit which BC's new auditors have just begun but we do not believe that these concerns will be removed altogether without further investigation.

8. We have received no complaints from investors against BC, which currently has 10,000–15,000 clients and £63m under management. Annex A describes what we know of BC and JFH in more detail.

Argument

9. Whilst the Department takes a serious view of dilatoriness or carelessness in complying with the relevant rules and regulations, a more immediate public interest concern is whether the absence of annual portfolio reports to clients is masking fraudulent activity. We cannot be certain that the audit being carried out by Touche Ross's Leeds office will enable this question to be fully answered. Neither can we be sure that, if and when the portfolio schemes are discontinued, there will not be complaints from investors who consider that they have been misled about, for example, the

rates of interest receivable or the types of gilts invested in. The Bank of England believe that an audit of a clients' account which forms part of a statutory audit would not necessarily remove the concerns over possible fraud, because the "spot check" or testing techniques normally selected for such audits would not be sufficiently thorough; in any case, they have expressed to us verbally some reservations in the light of experience in other cases about the ability of certain regional offices of even the top accountancy firms to carry out an audit of this type with the necessary rigour. Against that, if an investigation is started at public expense, it will cover much of the same ground—albeit in the greater detail required—as have Touche Ross, within only a few weeks.

10. On balance, given the adverse information we have obtained about what still remains a large investment business, and the fact that Barlow Clowes caused such difficulties in 1984–85, we believe action needs to be taken now. We should not run the risk of waiting for a statutory audit by a new firm of auditors which might result in a qualified report or inadequate assurances on the client accounts, when we could have taken other decisions now.

11. The question arises therefore of what action can be taken, given (a) apparent breaches of the Licensing Regulations and the Conduct of Business Rules, and the information in the Stock Exchange draft report, and (b) the fact that the PF(I) Act licensing system is a system of annual licences and that BC's current licence expires on 27 October. The choices appear to be

- (i) refusing BC's application for a new licence, under section 5(1) of the Act for failure to provide information.
- (ii) renewing the licence but simultaneously issuing a notice of intention to revoke it under section 5(2) on the ground that BC appear to be no longer fit and proper to hold one.
- (iii) renewing the licence (subject to review if a satisfactory monitoring return¹ is not received) and taking no regulatory action until we have a report from an investigation.

12. Option (i) would be draconian and probably precipitate the collapse of the business. Given BC's size, the number of clients, and the amount of funds under investment, this option is at least as unattractive now as was the option considered by Ministers in 1985 to refuse to grant the partnership its first licence. It is not a practicable option where a large on-going business is concerned, and it would in any case carry a strong risk of judicial review.

13. If we follow option (ii), there would be no announcement, but BC would probably exercise their right to ask for a reference to the tribunal. We cannot be confident, in the absence of further information at this stage, that the tribunal would decide that the proper course would be to revoke BC's licence.

14. We therefore recommend option (iii). What we would be seeking to establish is: whether the cash and investments which BC say they are holding on behalf of the clients' funds are indeed so held; whether the precise portfolio schemes and plans offered to each individual investor are being carried out in a way that those investors are entitled to expect; whether the appropriate amount of investments and cash are actually held to enable the terms of these contracts to be fulfilled in the future; and, lastly, whether proper systems of internal control and effective records and procedures are being adopted. In addition, a report derived from an investigation would provide stronger grounds for petitioning for the winding-up of BC and for giving notice of intention to revoke, should these courses of action be required at a later date. We also know that the Bank of England would welcome such an investigation.

¹Accountant's report on the licence holder's custody of client monies and securities (required by the rules.)

15. In considering which powers should be used—those under s.447 of the Companies Act 1985 which can only be exercised by officers of the Department or those under s.105 of the Financial Services Act 1986—we have taken into account the fact that a case of this sort will require significant accountancy personnel resources, perhaps with specialist computer experience, which CIB are unable to provide. We also believe that the wider powers available in section 105 will be useful to the investigators, and will allow them to identify more easily any further lines of enquiry eg into inter-company transactions between BC and JFH. We therefore recommend an investigation under section 105, into BC, carried out by an outside accountant (with administrative support from his firm), together with a solicitor whose expertise would be useful.

16. CIB will consider separately what action, if any, it takes in relation to JFH, and under which powers, in the light of the information received from The Stock Exchange and the Bank of England. An enquiry under s.447 may be the most practicable, but advice will be submitted separately in due course.

17. There are sufficient funds to cover the cost of the investigation in FS5's agreed estimate for 1987–88. We estimate that £100,000 will be required.

ANNEX A

1. During 1984 the Department discovered from press advertisements that a business based in the City run by Mr Peter Clowes called Barlow Clowes and Partners (“the partnership”) had developed a very substantial (£80m) business in gilt-edged portfolio “bond washing” schemes without having any authorisation to deal in securities under the Prevention of Fraud (Investments) Act 1958 (PFI Act). After pressure from the Department, the partnership applied for a licence. It was also discovered at the same time that the partnership had been accepting deposits in breach of the Banking Act 1979.

2. After considering the various possible courses of action (prosecutions for unlicensed dealing, refusing the licence, and granting the licence subject to the Department and the Bank of England first obtaining satisfactory assurances that the business was sound and being conducted properly), the then PUSS/CCA, Mr Fletcher, agreed with the Economic Secretary, Treasury, on the last course of action as being in the best interests of investors. After lengthy negotiations with the partnership's newly appointed City solicitors and accountants, the Department obtained the assurances it sought. In October 1985 the then PUSS/CCA, Mr Howard agreed to the granting of principal's licences both for the partnership (for existing business) and for a newly-created limited company, Barlow Clowes and Partners Ltd (BC), for new business. The Department's intention was that, over time, all business would be transferred to BC, to which—unlike the partnership—the Companies Act investigation powers could be applied if required (the Financial Services Act had not then been enacted). The Banking Act position was regularised when Lloyd's Bank agreed to act as custodian trustee for the receipt of funds destined for the portfolios; the Bank of England decided to take no action on past breaches of the Banking Act.

3. The two licences took effect on 28 October 1985, and since then the Department has sought to ensure that the various PFI Act provisions and regulations have been complied with. In August 1986 the Bank of England informed the Department of some rumours of fraudulent activity but the partnership's auditors (Spicer and Pegler), who had heard the rumours, were not aware of anything to indicate loss of client money.

4. At that time it was also learnt that James Ferguson Holdings (JFH), a computer systems and investment holding company, of which Mr Peter Clowes was, and remains, the largest shareholder and a director, was planning a takeover of the partnership, and BC. As there was no further information to substantiate the fraud rumours, it was decided that there was no good reason for instituting enquiries under section 447 of the Companies Act, and that the licences should be renewed in October 1986, but that the position should be watched closely.

5. The first monitoring returns for both the partnership and BC, which should have been lodged by end December 1986, became overdue. They eventually arrived a few weeks late during February 1987; that for the partnership required further clarification, which was obtained. In April 1987 the partnership was dissolved and all business transferred to BC. No attempt was made to notify the Department promptly of these changes and they were only notified at the Department's request in July. The partnership's licence has since been revoked.

6. Further concern about BC arose during the summer when The Stock Exchange sent the Department, on a confidential basis, a copy of a lengthy draft report which its Surveillance Division had prepared for submission to its Membership Department, following an application by BC for membership of The Stock Exchange in January 1987. The Stock Exchange's draft report indicates that BC propose to discontinue their gilt-edged portfolio schemes in order to offer a gilt-edge agency/advice service instead. The Stock Exchange believe that the portfolio scheme clients have been misled about the schemes in which they have invested and that they have not been kept properly informed about the precise value of their holdings. They fear that capital may have been eroded to maintain interest payments, and that if the schemes were discontinued, there could be a storm of complaints and possibly a run on BC. The report also refers to a general reluctance by BC to provide information promptly, casts doubts on the accuracy of their records and the effectiveness of their systems, and states that no full audit has been done of the portfolio funds since 1985.

7. The Stock Exchange report also expresses concern about the activities of the parent, JFH, and those of other interests, some outside UK jurisdiction, which hold stakes in JFH. The report gives grounds for suspecting that Companies Act offences may have been, or are being, committed, particularly in connection with share ramping and take-over bids. (The CIB are considering these aspects, together with other information recently provided by the Bank of England).

8. The Stock Exchange have not yet decided on BC's application for membership but at present it seems likely that this will be turned down. BC may be considering making an application to another SRO eg [Investment Management Regulatory Organisation] ("IMRO"), and BC indeed may eventually be unable to obtain authorisation under the Financial Services Act to carry on investment business.

9. Following the takeover earlier in the year, JFH's own solicitors and auditors were appointed in July to advise BC on the renewal of its licence in October. However too little time has been left for complying with the rules and again forms have been arriving late or are overdue (though late documentation in this context is not a problem unique to BC). An application was lodged immediately in July, but only partially complete and with remaining documents following during subsequent weeks; the application only now appears to be in order. However, the new auditors (Touche Ross at Leeds) have advised in the last few days that because of JFH's different financial year, BC's next monitoring return was now due three months earlier on 30 September 1987. We have agreed to an extension of the deadline to enable them to carry out a full statutory audit, which has begun and we are told will include a full audit of the client accounts. At the time of sending forward this submission, a deadline has not been set for completion of the audit and they are unlikely to be able to submit the

monitoring return until after the current licence expires on 27 October. In these circumstances, it is normal practice to grant a licence, together with a letter stating that it is subject to review if a satisfactory return is not received. There is no power under the PFI Act to require an audit of the clients' account to be furnished to the Department.

10. The Department has consulted the Bank of England's Banking Supervision Division about the Stock Exchange draft report and we have been examining with them the options available for obtaining the audit data required.

11. Throughout the period since BC's licences were first granted in October 1985, the Department has received no complaints from investors about BC (but this is hardly surprising if BC have not sent any information to them, apart from the initial management agreement and contract documents)."

6.50 The Bank's records show that the principal had in the meantime on 5 October telephoned the Bank to say that officials were minded to recommend to Ministers that there should be an investigation under s105 FSA. The Bank's file note records that the principal reported to them the request of the auditors for an extension in the time for submitting the monitoring return and indicated that this had raised a question in his mind as to whether a statutory investigation would still be appropriate. (Touche Ross, he explained, were not aware of the Department's concerns.) The Bank official's note of the conversation goes on to record his having said to the principal that "it was not, seemingly, wholly clear how extensively Touche Ross would be investigating, or what the precise time-table for their work was" and that there could be no certainty that Touche Ross's findings would become available to the authorities, so that it would seem difficult to rely on the work as an alternative to an official investigation. On 8 October Simmons & Simmons had sent the Department an application form in respect of the remaining applicant for a representative's licence, completing the licence renewal application papers. The EO gave instructions for the application forms to be processed and, exceptionally, for a full check on this applicant to be carried out. On 12 October the principal submitted a draft reply to the letter from the Deputy Governor of the Bank of England, explaining that the letter had arrived while a submission to Ministers was in the course of preparation. He said that the Bank's letter failed to mention lengthy discussions between FSD and the Bank, and he said he had informed the Bank of the proposal to recommend to Ministers that an investigation under s105 be carried out, but he understood that the Deputy Governor had decided to write in any event to put the Bank's views on record at senior level. The principal suggested that a reply should be sent to the Bank as soon as Mr Maude's decision was known.

6.51 On 14 October Mr Maude indicated agreement with the recommendations in paragraph 3 of the submission. And on 16 October the Permanent Secretary wrote to the Deputy Governor telling him of the decision to authorise an investigation under s105 FSA, and to renew the principal's licence in the meantime. He said that further consideration was being given to James Ferguson Holdings plc. On 22 October the Deputy Governor replied, saying, "I am pleased to hear of the action which is being taken in respect of this company". Meanwhile on 15 October the principal let the Stock Exchange know, in confidence, that Ministers had now given the go-ahead for an investigation into Barlow Clowes. He mentioned the difficulties of appointing inspectors from the point of view of conflicts of interest and wished to ascertain the identity of the auditors and solicitors of various parties so that the chosen inspectors did not come from those firms. The Stock Exchange provided him with the information available to them. The principal drew up a provisional list of firms who could not be asked to help with the investigation because of possible conflicts of interest. At the same time, the Department's standard checks on the licence application were being carried out.

6.52 On 23 October the EO wrote to Touche Ross saying that the Department was agreeable to the granting of an extension of time to submit the monitoring return for Barlow Clowes and Partners Ltd, and she asked them to let her know what timetable they planned to follow in completing the statutory audit and sending the monitoring return to the Department. The letter went on "as you will see from the enclosed copy of a letter to Messrs Simmons & Simmons, the further licence effective from 28 October has been granted subject to the receipt of a satisfactory monitoring return within a reasonable time". And a letter of the same date, addressed to "Barlow Clowes and Partners Ltd c/o Simmons & Simmons", enclosed a principal's licence effective from 28 October. The letter went on to say "I must draw your attention to the fact that this licence is granted subject to review if a satisfactory monitoring return (Form 5), covering the nine months up to 31 March 1987, is not received within a reasonable time. This return should have been submitted by 30 September 1987, but since Touche Ross & Co have only recently been appointed auditors for your clients we have granted them an extension to this deadline". (In strictness, the extension will in fact have been granted not to Touche Ross, but to the company, as the licence holder—see 1.14). Representative's licences were sent to Messrs Clowes, Ducret, Naylor and others (Mr Newman's having been sent earlier). On 28 October, a Stock Exchange representative telephoned the principal to exchange information on progress. She reported to him the Stock Exchange's enquiry into share dealing in Ferguson, the possibility of finding out who was behind Ryeman Ltd, and a discussion she had had with one of the directors of Barlow Clowes who had told her that they would not be seeking Stock Exchange membership until they had converted the gilt portfolios. The principal reported this conversation to CIB the same day.

Findings 6.53 At the meeting with the Stock Exchange representatives on 10 April (6.1 and 6.2) officials from the Department were told of a number of matters giving cause for concern. There was the loan from Barlow Clowes Nominees. There was again, as there had been in 1984 to 1985 (see Chapter 4), the question of erosion of capital. There was also the absence of information to investors. And finally there was the fact that Mr Tree had left the company. Little action was taken by the officials as a result of the meeting but, on balance, I did not find that unreasonable. The Stock Exchange's enquiries were continuing, and indeed it was they who were in the best position to probe further into the matters of concern, having the *locus* to do so by reason of the company's application for membership. However, I found very questionable the seeming attitude that it was no (or little) concern of the Department that investors' capital might be being eroded (6.6).

6.54 In early July the Department received the Stock Exchange's draft paper (6.7) and this was discussed, at the suggestion of the Stock Exchange, at a meeting on 17 July (6.13). Such additional information as reached the Department after 17 July added very little, in my opinion, to what the Department already knew. The explanation of the interest of the Greater Manchester Police (6.18) was a possible exception to this, but the Department received that on 5 August. Nevertheless it was not until 18 September that a decision was made that a section 105 investigation should be recommended to the Minister (6.28), and the submission to that effect did not reach him until 13 October (6.49). The delays involved were altogether unacceptable in my view, and I had no doubt that they amounted to maladministration.

6.55 As regards the decision which was taken, albeit belatedly, on 18 September to the effect that a section 105 investigation should be recommended, I could see no basis for criticising that. The account of the discussion (6.28) suggests that the available alternatives were properly discussed and considered.

6.56 I look now at the action taken following receipt of Touche Ross's request of 24 September for an extension of time for filing the monitoring return due by 30 September (6.30). Here my concern was that it appeared to me that the request opened up a new option for action by the Department, and that that new option might not have been given proper consideration. The option was to respond to Touche Ross by saying, in appropriate terms, that the absence of a monitoring

return was a serious matter and that, while the Department could allow an extension of time to a specified date, falling before the expiry of the current licence on 27 October, consideration would need to be given to revoking the licence if a satisfactory and duly verified monitoring return were not received by the specified date. (The non-receipt of the monitoring return by 30 September which Touche Ross's letter foreshadowed would have amounted to a failure to furnish information required during the currency of the existing licence, and would therefore have been a ground, under section 5(1) of the PF(I) Act (1.5), on which that licence might be revoked without any right of the company to refer the matter to the tribunal, although not a ground under section 5(1) for refusing the application which had been made for a renewal of the licence (see 2.12).)

6.57 I found no indications that any immediate consideration was given within the Licensing Unit to the possibility of taking action on the lines I have indicated. It seemed to me, however, that consideration should have been given, and given urgently, to that possibility. It was not a routine case with which the Licensing Unit were dealing. It was a case in which serious concerns had been expressed about the company, sufficient for it to have been already decided that, subject to the Minister's approval, a section 105 investigation was warranted. It seemed to me, moreover, that different considerations would have applied to the failure to furnish a monitoring return from the considerations which applied to the failures to which the assistant solicitor had referred in her minute of 7 September (6.25) and which had been discussed at the meeting on 18 September. Those failures had occurred in the early part of the year and had been cured well before the 18 September meeting. In addition, to my mind, the monitoring return stood alone in importance in the post-1983 licensing system. Also relevant was the fact, which would have been perceived if the matter had been properly addressed, that adoption of the course I have mentioned did not need to be regarded as an alternative to the proposed section 105 investigation—both courses could have been pursued in parallel.

6.58 One of the reasons why the course I have mentioned was not addressed as a matter of urgency seemed to me to have been the inadequate grasp within the Licensing Unit of the detail of their powers under the Act which they had the task of administering. In particular it was thought that failures to provide information required during the currency of the existing licence could be a ground for refusing the renewal application under section 5(1)(6.42). Indeed that misconception found its way into the submission to Mr Maude (6.49, paragraph 11). It may be that the assistant solicitor's loose wording in her minute of 7 September (6.25 and 6.26) and the possible absence of any comment by her on the wording of choice (i) in the second draft of the submission (6.39 and 6.41) contributed somewhat to the misconception. But I would have expected there to have been a clear grasp of the position within the Licensing Unit following its receipt of the advice which I have set out in paragraph 2.12. There was also, I noted, a belief that failure to provide information required during the currency of the existing licence could be a ground for revocation of the new licence (6.47). It was—or should have been—plain, however, that such a failure was not a ground for revocation of the new licence under section 5(1). Notice of revocation would have had to be given under section 5(2), with a right to go to the tribunal; and it would have been more than doubtful whether the failure would, on its own, have been a sufficient basis for a 'not fit and proper' conclusion (see 6.45).

6.59 I turn now to look at the manner in which the question of the monitoring return was dealt with in the submission to Mr Maude of 13 October (6.49). In the main body of the submission it was noticed only to the extent that in paragraph 5 the "technical contraventions of the Licensing Regulations" were made to include "failure to submit returns". The matter was however addressed in paragraph 9 of the annex to the submission. Here there are three particular matters to which it is necessary to draw attention. The first is the statement that "the new auditors (Touche Ross at Leeds) have advised in the last few days that because of JFH's different financial year, BC's next monitoring return was now due three months earlier on 30 September 1987". The facts were altogether different. The company had apparently realised as early as August the previous year that the 1987

monitoring return would be due by 30 September (5.5); and on 17 July 1987 they had asked the Department for confirmation of that date (6.12), which was given on 18 August (6.20). All that had happened “in the last few days” had been the request for an extension of time by Touche Ross, who had become the company’s auditors on 16 April (6.12). The second matter requiring attention is the statement “we have agreed to an extension of the deadline...”, which had been introduced by manuscript amendment of the third draft of the submission (6.44). I have recorded in paragraph 6.48 the evidence I obtained on this point. My finding is that the extension had *not* been “agreed” in the sense conveyed by the submission, viz that the Department’s agreement had been notified to Touche Ross. The third matter is the statement “In these circumstances [ie that Touche Ross were unlikely to be able to submit the monitoring return until after the current licence had expired on 27 October] it is normal practice to grant a licence, together with a letter stating that it is subject to review if a satisfactory return is not received”. The evidence I obtained on this subject is set out in paragraphs 6.45 to 6.47; but in addition it is to be noted that the Department told Sir Godfray Le Quesne that if a monitoring return was outstanding at the time of renewal, a fresh licence was normally refused (2.4). It seems to me that what was said in the submission must be regarded as having overstated the reality to a significant extent.

6.60 The result was, in my view, that on the topic of the monitoring return the submission conveyed a distinctly misleading impression. It suggested that the absence of a monitoring return was attributable to its not having been realised, until “the last few days”, that one was required by 30 September. The reality—that, although this must have been realised much earlier, the request for an extension had not come until less than a week before the due date—could have been seen as raising significant question marks in the case of a company which it was proposed should be investigated because serious concerns had been expressed about its conduct. Generally, it seemed to me, the slant of the submission was to gloss over the matter of the monitoring return. But I was particularly critical of the fact that the submission indicated that the request for further time had already been acceded to. The result was that the continued existence of a power to revoke, on the particular ground of the absence of the monitoring return, was not revealed. It might perhaps be suggested in mitigation that by the date of the submission, 13 October, so much time had been allowed to pass since Touche Ross’s request that to have required a verified monitoring return before the expiry of the current licence, with a threat of revocation in default, would have been regarded as unfair, thus making the existence of a theoretical power to do that irrelevant. But that would serve only to highlight what I regard as the significant element of maladministration, namely the original failure to perceive, and give urgent consideration to, the additional option which I have described in paragraph 6.56.

6.61 I consider in Chapter 8 the consequences of the maladministration which I found in the events covered by this Chapter.

Chapter 7

November 1987—June 1988

7.1 On 6 November Mr Maude was told that suitable people to act as investigators had been found. The submission included the following:

“The delay in submitting names has been caused by the usual difficulties of finding people who are able to start immediately and who also have no conflicts of interest. In addition the recent spate of appointments of inspectors to investigate insider dealing resulted in exhaustion of the list of recommended accountants provided by the Institute of Chartered Accountants of England and Wales in the course of the selection process for this investigation. CIB therefore had to seek new names.”

7.2 The investigators were briefed and were told, among other things, that:

“What the Department is seeking to establish is whether the cash and investments which BC say they are holding on behalf of the clients’ funds are indeed so held;

—whether the precise portfolio schemes and plans offered to each individual investor are being carried out in a way that those investors are entitled to expect;

—whether the appropriate amount of investments and cash are actually held to enable the terms of these contracts to be fulfilled in the future;

—and, lastly, whether proper systems of internal control and effective records and procedures have been adopted.”

The investigators were also told that a report derived from an investigation would provide stronger grounds for petitioning for the winding-up of Barlow Clowes and for giving notice of intention to revoke their principal’s licence should these courses of action be required at a later date. Attached to the briefing note was a copy of Annex A as submitted to Mr Maude on 13 October (see 6.49) and a large number of papers giving background information. Further background material was sent to the investigators during November, at their request.

7.3 The Stock Exchange, CIB and FSD kept in close touch, the Stock Exchange informing the Department at a meeting on 9 November that Barlow Clowes’s application for membership had been “put on ice”. It was felt that the Department had insufficient information to investigate Ferguson, on whom a watching brief was to be kept. The investigators were appointed on 13 November. On 27 November the principal raised with his assistant secretary the question of whether the Department should notify SIB of the investigation and possibly IMRO, the self-regulating body to which it was believed Barlow Clowes was intending to apply for membership. Following the investigators’ first visit to Barlow Clowes’s premises on 25 November, a representative of Simpson Curtis, solicitors acting for James Ferguson Holdings plc, telephoned the Department to express concern about the investigation and requesting a meeting. The Department made clear that they would be unable to disclose the grounds for the investigation but arranged for a meeting to be held on 30 November to be attended by a representative from James Ferguson Holdings plc and Barlow Clowes Gilt Managers Ltd (formerly Barlow Clowes and Partners Ltd), and representatives from Touche Ross and Simpson Curtis.

7.4 At the meeting, which was attended on behalf of the Department by the principal, the assistant secretary and an assistant solicitor from the prosecution and investigation division of the Solicitor’s Office, the Department repeated that

they were unable to disclose the grounds for the investigation but promised to remind the investigators of the need for speed in completing their task. According to the Department's note of the meeting, the Simpson Curtis representative promised full co-operation on behalf of his clients. During the meeting the Touche Ross representative said that his firm were not prepared to sign off the outstanding monitoring returns now that a section 105 investigation was under way. The Barlow Clowes representative said that only seven to ten days' work was required to complete the returns but that his staff would find it difficult to assist both the accountants and the investigators at the same time. Simpson Curtis asked whether unaudited returns could be submitted. The Department's note of the meeting recorded that the assistant secretary promised to consider this point and that, later the same day, Touche Ross were told by telephone (subject to confirmation in writing) that unaudited returns should be submitted to the Department. Subsequently the principal wrote to Touche Ross, on 4 December, confirming the telephone message that the Department wished to receive unaudited monitoring returns for Barlow Clowes and Partners for the period 1 July 1986 to the date of dissolution in April 1987 and for Barlow Clowes and Partners Ltd for the period 1 July 1986 to 31 March 1987. The assistant secretary has told me that the relevant departmental solicitors were informed of the decision to ask for unaudited monitoring returns. (Touche Ross have told me that they notified their clients that unaudited returns had been requested and I have seen that such returns—covering in both the case of the partnership and the company the period from 1 July 1986 to 31 March 1987—were in fact submitted to the Department by Barlow Clowes under cover of a letter dated 24 December—see 7.8 below.)

7.5 I am satisfied from the evidence they have given that only the assistant secretary and the principal were involved in the decision to ask for unaudited monitoring returns to be submitted. The assistant secretary has said that he and the principal considered revoking the licence forthwith or allowing, for the time being, unaudited returns. They decided on the latter course and have explained in evidence that they thought, since the returns—according to Touche Ross—were so near to completion, that it would be better to have them unaudited than not to have them at all. Their thinking at the time had been that since October the company had been on notice that the licence would be reviewed if a satisfactory monitoring return were not forthcoming within a reasonable time. Their belief on 30 November had been that the investigation would be concluded swiftly—especially because the company was offering to co-operate fully and itself wanted a speedy conclusion. In that case, and if the investigation were to lead to a satisfactory report, Touche Ross could be expected to sign the monitoring return; if not, then the Department would take action to wind up the company (as in fact happened) or take other appropriate action. The assistant secretary said that it had appeared to them that the factors referred to in the submission to the Minister on 13 October—which resulted in a balanced judgment in favour of licensing the company whilst undertaking an investigation—still pertained and that therefore it was not necessary to bring matters afresh to the attention of the Minister. They had felt it better to get a report from the Department's own investigators into the financial position of the clients' funds, even if this involved delay in obtaining the audited monitoring returns. They had also felt that the investigators could usefully consider the unaudited papers and, if appropriate, verify them. To this end, they had contacted Touche Ross immediately.

7.6 In the meantime the investigators had asked the Department for information about the companies in the Barlow Clowes and James Ferguson Groups including Barlow Clowes International Ltd. As regards the latter, the principal made enquiries of his colleagues as to whom in Gibraltar he should contact for such information. He was given the name of Mr J H Bautista, the Financial Sector Advisor who happened to be paying a visit to the Department on 3 December. The principal telephoned Mr Bautista and asked if he would bring with him information about the Gibraltar-registered Barlow Clowes International Ltd. This Mr Bautista did, calling in on the principal and the SEO for a brief informal discussion. (No note of the conversation was made and in evidence the principal has said that he had not on that occasion told Mr Bautista of the investigation into the UK-based firm. Nor had he asked about the activities of Barlow Clowes

International Ltd.) On 7 December, the investigators asked the Department for information about two other Gibraltar-registered companies, Barlow Clowes (Nominees) Ltd and Hermes Management Services Ltd. Mr Bautista sent this information to the principal on 15 December. There was further contact on 31 December when the principal wrote to Mr Bautista requesting a complete copy of the file on Barlow Clowes International Ltd. In his letter of 31 December the principal mentioned that he had passed the documents enclosed with Mr Bautista's letter of 15 December "to the investigator in the case I mentioned to you" (which mention would, the principal said, have been in a telephone call made by him on 8 December seeking the information for which the investigators had asked). Mr Bautista replied on 3 March 1988 enclosing copies of documents filed by Barlow Clowes International Ltd at the Companies Registry. All of the documents were passed to the investigators.

7.7 The investigators have said in evidence that they had conducted their investigation on the basis of giving oral reports to the Department whenever matters of serious concern came to light. No note appears on the Department's file of the first progress meeting which took place on 10 December. At that meeting the investigators gave an account of progress since their appointment. They said in evidence that the following matters had been mentioned:

"1. Nothing was available or had been provided to the investigators for the partnership funds, which constituted the older and larger part of the client funds under management.

2. There was no retrospective list of client balances available for any part of the system.

3. Our computer password did not allow access to any directors' or senior employees' clients' account held within the computer system.

4. No reconciliations between total investments held and the clients' investment balances had been forthcoming.

5. No retrospective list of gilt prices was available.

6. Comments on specific findings on the limited company funds included:

(i) criticisms of bank reconciliations

(ii) criticisms of fees charges

(iii) existence of negative client cash balances

(iv) backdating of certain entries

(v) removal of one letter of complaint from client folder

(vi) low rate of return fixed on Portfolio 78

(vii) delivery of stock into the system by Peter Clowes, sold for £520,581 to make good a loss on Portfolio 78."

The investigators kept in close touch with the Department, sending copies of relevant correspondence and telephoning with progress reports. On 15 December the investigators told the Department that they needed to inspect the records of all of the banks which held Barlow Clowes's accounts (both in respect of the company and the partnership) in order to understand precisely how the accounts were operated and in the case of Lloyds to see how the trust arrangements operated. The investigators said in this respect that they had noted that the portfolio management agreement used by the company differed from the draft attached to the trust deed. This request led to the Department's considering whether the investigators ought to be given authority to investigate the partnership as well as the company. In the event, the investigators had no need to ask for an extension of their initial authorisation. On 21 December the assistant secretary decided that SIB should be informed of the investigation (and any other section 105 investigations in progress) and he notified SIB accordingly, and told them that Barlow Clowes had agreed to disclose the investigation to IMRO if they applied for membership. (The Department have explained that it would not have been lawful to pass information about the investigation (as distinct from the fact that an investigation

was being undertaken) before the SRO was recognised and were aware that SIB were to institute arrangements for recognised SROs to consult them about applications. They would also not have thought it right to reveal the existence of a statutory investigation to an unrecognised SRO. IMRO was recognised on 27 January 1988—see also 7.17).

7.8 On 24 December Barlow Clowes Gilt Managers Ltd sent the Department unaudited monitoring returns in respect of both the partnership and the company for the period 1 July 1986 to 31 March 1987. They said that they had sent copies also to Touche Ross. The partnership's return showed that there were 8,896 client portfolios valued at £46,852,312 while the company had 1,497 portfolios valued at £8,242,488. Noting this, the SEO commented to the assistant secretary on 29 December that even at that late stage the partnership still held the bulk of the money. He recommended that the Department should press for a further monitoring return for the partnership to cover the period from 1 April 1987 to the dissolution and he felt that the figure of £1,767,461 described in the partnership's return as the amount paid out other than as an "amount applied for making investments for clients, amount paid to ... the holder of the principal's licence ... and amount paid to clients" required explanation. The assistant secretary agreed and the SEO instructed the EO accordingly.

7.9 On 6 January 1988 the investigators wrote to the principal referring to their meeting on 10 December and offering some further thoughts on the "timing implications of our investigations". They sought confirmation—given that Barlow Clowes Gilt Managers Ltd would have interim authorisation under the FSA if they made a timely application to join a self-regulating organisation (see 1.15)—that if their investigations should lead to a decision by the Department to give notice of intention to revoke the PF(I) Act licence, the powers of intervention available under the FSA 1986 would be available from the day that Act was expected to become fully operative. The investigators felt that, for technical reasons, the company had a strong incentive to delay their work and they said that their experience to date suggested that the company might delay matters under the PF(I) Act regime for an inordinate length of time. They said that the advantage of the FSA procedures seemed to be that, although there was a right to have the matter referred to the Financial Services Tribunal, the reference itself did not have the effect, as it would have under the PF(I) Act, of suspending the action taken against the authorised person. This might, they said, suggest that delay until April might lead to a swifter conclusion. They said that the point of their enquiry was to ascertain whether they had correctly understood "the general framework within which we are working". They added that their team in Poynton had been told that information relating to the partnership's funds would not be available until 18 January. They said, "This inaccessibility of course in itself constitutes a serious breach of the rules". On the same day the investigators wrote to Mr Clowes reminding him of a number of matters about which they were waiting to hear from him and reminding him of his promise to co-operate fully with the investigation. They wrote also to Simpson Curtis expressing disappointment at the lack of co-operation from their clients and expressing surprise at having been told that it was completely impossible to access the computer system for any client information in respect of clients who originally invested through the partnership, as opposed to the company. On 8 January the principal sought advice within FSD on the question raised by the investigators saying that he thought that their letter of 6 January stated the position correctly. He said, however, that the Department had no wish to see the investigators' report deliberately delayed until after the coming into force of the FSA, simply to foreclose the company's right to appeal under the 1958 Act procedures. The principal asked the Solicitor's Office to advise whether the delays being experienced by the investigators justified any action being taken against the company's licence. The assistant secretary (also on 8 January) indicated that the Department could consider either writing to Barlow Clowes saying that they were disturbed about the inaccessibility of information or giving notice of intention to revoke the licence. He added, however, that the difficulty with the latter course was that a section 105 investigation could lead to a winding-up petition and persistence with the investigation would leave that option open.

7.10 On 12 January a departmental solicitor confirmed that the legal position was as stated by the investigators (7.9). Action could in theory be taken by SIB (after the appointed day) under Chapter VI of the FSA before a final section 105 report was received by transmitting such information as was available through the section 180(1)(e) gateway, provided such information was regarded by SIB as adequate grounds. (This section of the FSA exempted from the normal restrictions on disclosure of information, disclosures required to enable or assist a body, such as SIB, to discharge its functions under the Act.) So far as taking action against the licence was concerned, she thought that provided it could be shown that the books and records relevant to the partnership which had not been produced to the investigators belonged to the company, then there might be grounds for revocation under section 5(2) of the Act. But she thought it arguable that the books and records did not belong to the company. She suggested that before she considered the relevant correspondence in detail the principal should discuss with her whether there was a serious possibility that action should be taken against the company before the results of the investigation were known. On 14 January the official in FSD to whom the principal had addressed his minute replied saying that he agreed with the solicitor's analysis of the position under the FSA. He said that he also saw no difficulty in taking action before the section 105 report had been received. He said that it had to appear to the Secretary of State desirable for the protection of investors that the powers of intervention should be exercised but offered the view that this case appeared to justify their use.

7.11 On 15 January Barlow Clowes Gilt Managers Ltd notified the Department of the appointment of three new directors and of the resignation of two directors, one of whom was Dr Peter Naylor. (Dr Naylor had already informed the Department of his resignation on 14 December 1987.) The letter of 15 January also notified the Department of a change of the registered office of Barlow Clowes Gilt Managers Ltd to Queensway House, London Road South, Poynton, Cheshire.

7.12 In December 1987 the Department had learnt that the Inland Revenue Special Office had an interest in the tax affairs of both Barlow Clowes and Partners Ltd and James Ferguson Holdings plc and an internal meeting to discuss the position was arranged to take place on 21 January 1988. In preparation for this meeting the principal sought information from the investigators about their progress. Both of the investigators spoke to the principal on 19 January and the principal made the following file note of his conversation with Mr Hoffman which was copied to the assistant secretary, Solicitor's Branch, CIB and the FS Unit:

"S105 investigation: Barlow Clowes Gilt Managers Ltd (BCGM)

Mr Hoffman, the accountant investigator, telephoned at some length on 19 January in order to report on the state of play with the investigation. Mr Ziman also made a much briefer, separate call shortly before Mr Hoffman rang, on the same lines. (I had asked for information in preparation for the internal stocktaking meeting on 21 January before Ms—— (Inland Revenue) calls the following day.)

SUMMARY

Frustrating lack of progress. Co-operation and computer data received last December from BCGM on "Limited's" new funds but very little indeed since then on the former partnership's old funds (which are 4 to 5 times greater in size). Peter Clowes checking all data handed over and clearly in sole control of BCGM. Serious breaches apparent of the Licensed Dealers Rules; from that standpoint already clear that BCGM not "fit and proper". Given the lack of co-operation, not known whether fraud has been or is being committed on clients but on such evidence as is available BCGM could probably meet commitments if there was a run on its schemes, so *believe* no urgent action required by DTI. BCGM probably do not comply with tax regulations either; links with overseas funds still unexplored because of no data. S105 team may have to pull out if no further co-operation forthcoming soon. BCGM's situation should not be allowed to continue. Report could be provided by, say, end March if required, but necessarily incomplete, and possibly only interim.

DETAIL

The investigators had provided a preliminary verbal report to the assistant secretary and an assistant solicitor on 20 December which was largely based on information derived from an examination of "Limited's" funds data. They had noted certain breaches and errors and that funds had been put in to make good certain losses; this injection of funds still required examination.

Progress since 20 December

This report related to the investigation on the "Partnership" funds. Information had been requested in early December but, despite the investigators' written protests, it had still not been provided. The Howard Tilly team pulled out shortly before Christmas and then resumed on January 4. Very minor joint trust accounts data had been provided which was worked on for 3 days by 3 accountants but the team again pulled out at the end of that week, after making a formal request for data to be provided on 18 January. On that day, very little further information was provided although it had been promised. Not one piece of paper nor a summary had yet been handed over on the major Zero Account. Data on 300 client audit trails was requested on 18 January overnight but data on only 4 was handed over from the computer on 19 January. Until the investigators could obtain direct access to the computer, it was unlikely any further information would be provided quickly. The investigators might get what they wanted eventually but it was not clear how long they would have to wait for it.

A BCGM Board meeting was being held on 19 January and the investigator would press again later in the day. Further interviews were being held at Poynton am 21 and pm 22 January and Peter Clowes was being interviewed in London on 28 January.

Peter Clowes

Peter Clowes (PC) was in sole control of the BCGM operation although Mr Naylor, who had now left, probably had been aware of the operation of the computer system also. PC personally vetted all information passed over to the s.105 team; this gave him scope to alter it too. PC seemed to know "the game was up" and that the investigators were finding irregularities; no more money was being taken in; he might be making "other plans", since he was very shrewd.

Irregularities etc

Obvious breaches of the [Licensed Dealers Rules] had been committed. There were several aspects of BCGM's operations which needed explaining; backdated entries were continually being put through, possibly to alter mistakes, but since it was a paperless office no trail was left of what had been changed. In the absence of any computer printouts, there were no records to study for the past year. If any had been produced in the past, they were now shredded. There had never been a time during the investigation to date when a totally clear position had been shown. There was no doubt whatsoever that from a rulebook viewpoint, BCGM were not fit and proper. Funds were inadequately controlled and therefore built-in safeguards were insufficient, and there was nothing to stop sizeable withdrawals being made, although there was no *evidence* of this having happened.

Client funds/overseas funds/tax aspects

There was no evidence of clients not having got their money back nor were the investigators aware of any complaints against BCGM. But it was not clear whether, on completion of contracts, clients knew how much to expect from their investments, so long as the income was more than they had put in.

The links with BCGM's overseas funds were still a mystery. These overseas funds were believed to be considerable, based in Gibraltar, unlicensed and unregulated. Scope for intermingling of funds existed. The Accrued Income Scheme was not administered correctly; clients were not advised properly, so they were unable to submit proper tax returns. The Inland Revenue's investigation would probably be lengthy (on past form) and both the company and the partnership might be held liable.

Does DTI need to act now?

There *appeared* to be no urgency for this *at present*; BCGM could probably meet its obligations even if there were a run on the company from adverse publicity. But the Department needed to consider the timing for taking action and the repercussions if it did take any, given the current absence of adverse information on client funds.”

Mr Hoffman has said in evidence that he gave his lengthy oral report to the principal on 19 January essentially to advise him that despite promises from Barlow Clowes that the required partnership information would be available to the investigators on 18 January, this had not been forthcoming, although this continued to be promised from day to day. He did not know in what context the comment that there appeared to be no urgency for action by the Department at present would have come from except possibly in relation to a very short time span to allow the promised information to emerge. He said that he and the principal had discussed matters at length. He emphasised the need to see partnership information printouts and for the investigators’ staff to be given direct access to the computer before they could make judgments on this aspect of the system or indeed the viability of funds. He said in evidence that any comment “made as to urgency for action in general would not have been disposed of by me in the summary way suggested [in the principal’s report of the conversation]”. Nor, indeed, would he have been able to give any assurance that the company could probably meet its obligations when the investigators’ basic problem on the larger partnership funds was precisely that they did not have any information on its size and the total of balances due to clients at that point of time. When Mr Hoffman’s view was put to the principal, he agreed that he might have unintentionally misrepresented, in the summary part of the telephone note, Mr Hoffman’s statements. He said that the detail of the note had, however, been written down at the time of the call and, in his view, reflected exactly what he was told.

7.13 Meanwhile the Stock Exchange had obtained a copy of the share register of James Ferguson Holdings plc as at November 1987 which they forwarded to the Department on 20 January. Copies were supplied to the investigators. On 21 January a meeting was held in the Department attended by the SEO, principal and assistant secretary from the Licensing Unit, departmental solicitors from both the advisory and prosecuting/investigating branches, a principal examiner from CIB and another principal from FSD. The Department’s policy on disclosure of information was discussed and it was agreed that no powers existed under which information other than that publicly available could be passed to the Revenue. The prosecuting/investigating solicitor advised against formally extending the investigators’ brief to cover the partnership because the company had taken over the partnership’s business and presumably therefore its books and records. Furthermore, he thought that such an extension might arouse doubts about the investigators’ earlier locus. After discussion, it was agreed that the investigators should issue a final ultimatum giving the company 14 days to produce the material they required. They should then themselves be asked to produce an interim report after a further 14 days. The note of the meeting concluded, “The need for regulatory action would then be considered, and if action appeared necessary it would not be deferred because of the imminence of the FS Act regime”, (which officials then knew was due to become fully operative during April 1988). Following the meeting the principal examiner briefed the senior examiner who was responsible for the watching brief on James Ferguson Holdings plc. He told him what action had been decided at the meeting and said that the possibility of petitioning for compulsory winding-up was very much in mind. He said that at the meeting both he and the prosecuting/investigating solicitor had expressed much stronger concern about the position than the principal had done in his note of particular conversation with Mr Hoffman on 20 January. He said that they had in particular questioned how it could be surmised that Barlow Clowes Gilt Managers Ltd “could probably meet commitments” if the investigators had been unable to establish the financial position. The senior examiner responded by sending the principal examiner copies of recent minutes bringing him up to date with the

situation. The principal met representatives from the Inland Revenue as arranged on 22 January when it became clear that the Revenue would also be conducting an investigation into the affairs of Barlow Clowes. As previously agreed, the principal disclosed no details of the section 105 investigation to the Revenue. On 25 January the SEO checked that none of SIB, IMRO, FIMBRA or TSA had as yet had an application for membership from Barlow Clowes.

7.14 The section 105 investigators attended a meeting at the Department on 25 January. Present also were the principal and his assistant secretary, the principal examiner, an advisory solicitor and the Assistant Treasury Solicitor, who had been asked by the assistant secretary to attend the meeting because there was a possibility of there being a petition to wind up the company or other civil proceedings. Mr Hoffman has said in evidence that at the meeting the whole problem was discussed at length in the light of findings to date and the delay in receiving the information requested. He said that it was agreed that an ultimatum should be sent to Mr Clowes and that was done the following day. Mr Hoffman said that at the meeting the investigators had been told that a notice of intention to revoke the licence would probably have led only to a lengthy tribunal procedure. The evidence given by the Assistant Treasury Solicitor includes the following account of the meeting:

“I saw no papers beforehand beyond my recollection of what had happened in 1984–85. ... Mr Hoffman explained to the meeting how far the investigators had got. He made it clear that there was a good deal of work to be done by his team before a report could be made to the Secretary of State. He was unhappy at the limited access that his staff had been given to the computer and he suspected that there had been numerous breaches of the Licensed Dealers (Conduct of Business) Rules 1983. He was unable to say whether these breaches were mere technicalities or whether any client had lost money. The company’s officers, particularly Mr Clowes, had been obstructive.

I was at pains to find out from Mr Hoffman whether there were any serious defaults by BCGM such as insolvency, misappropriation of clients’ funds or failure to invest clients’ funds in gilts. If there was evidence of any really serious default I would have suggested to Mr Hoffman and Mr Ziman that they produce a quick interim report concentrating on such default so that we could use it as the basis of an early petition. It was however clear from the replies to questions put by [the CIB representative] and myself to Mr Hoffman and Mr Ziman that they had no good evidence of serious default. They had suspicions but these were not based on any firm evidence. Large sums had been invested in gilts and the certificates were in the safe custody of Midland Bank and Lloyds Bank. The investigators had no grounds for alleging that these would not be sufficient to repay investors in full. Money taken from clients since the incorporation of the company was reasonably well accounted for but so far an inadequate record of accounting for former partnership funds had been produced. [Spicers] had however been satisfied as to these. There was no evidence of misappropriation apart possibly from some minor misapplication of interest. There was no real evidence of insolvency. There was no evidence of obtaining funds from the public by misleading or improper means.

In the circumstances it was clear to me that there was no prospect of a quick petition following a short report. Nevertheless the investigators had serious suspicions about the company and about Mr Clowes personally. There was concern that the company was about to launch a new product. I thought that if a full report was delivered we might be able to assemble sufficient evidence to present a picture to the court that would convince it that the company ought to be wound up. Otherwise we would be left with the unsatisfactory alternative of a withdrawal of PF(I) Act licence. [The CIB representative] and I suggested that the investigators should complete their enquiries and produce a detailed report as soon as they could. They were encouraged to take a tougher line with the company. Clearly if the DTI was to take any action at all against BCGM it would need to present a detailed

picture of unsatisfactory accounting. A few technical objections would not be sufficient and objections must go to the root of the company's business. [The CIB representative] and I outlined the sort of problems that the investigators ought to look out for. I cannot recall any mention of the Gibraltar company at the meeting.

7.15 The Licensing Unit made no formal note of the meeting but the principal examiner reported to the senior examiner as follows:

"BARLOW CLOWES/JAMES FERGUSON

Thank you for your minute of 25 January. The various papers are returned herewith for the file.

2. On 25 January I attended a meeting to discuss the present position re the Barlow Clowes section 105 enquiry.

FERGUSON

3. [The principal] reported that the present position was that the Stock Exchange Professional Standards Panel, headed by the Chairman, were currently considering whether Ferguson shares should be suspended. There is a meeting next week.

REPORT BY THE SECTION 105 INSPECTORS ON THE PRESENT POSITION

4. The major concern was that the company might be about to issue a new product. The inspectors¹ had some conflicting information, and were wondering if the position had been overstated to them. They will be tackling Peter Clowes about this to try to get firm information when they see him on the 28 January. Clearly the issue of a new product before the completion of this, so far unsatisfactory, investigation was of concern to the inspectors.

5. Clients' funds were in effect in 2 parts. The new limited company funds, representing some £7 million under management, seemed to be reasonably in order. Detail had been provided and items were kept separately on computer from the old partnership figures.

6. The old partnership portfolios—6 separate funds—do represent a problem in that the inspectors have been given virtually no information in spite of requests. It is thought that these funds represent the sum of £32 million. The inspectors are unable to say whether there are sufficient assets to cover liabilities in the partnership client accounts, as no information has been made available. They have some concern in that the company funds (£7 million) have from time to time shown a shortfall, and the fear is that the same could apply to the partnership funds.

7. The inspectors have no doubt that the operation is in breach of the Licensed Dealer Regulations. Further, they are of the view that Mr Clowes is not a fit person to be running an operation of this nature. The inspectors, after their appointment in December, faced a long delay in obtaining any information at all—they did not receive any papers from Mr Clowes until 6 January. They have also found that the company's monitoring return to the FS Division was probably grossly overstated as regards clients funds held.

8. Mr Ziman explained that after much stalling from Mr Clowes, only that morning (25 January) inspectors had seen the company's programmer. This officer had explained that any computer problems had been resolved over Christmas, and had given details to the inspectors of a number of printouts that the present system could produce—needless to say it had emerged that the computer could produce information Mr Clowes said it could not.

9. Mr Ziman also made the point that although the company had taken over the partnership funds, those funds in fact remained separate and no steps had been taken to notify clients of any change in the contract.

¹The Department's papers frequently refer to the section 105 investigators as inspectors.

10. It was agreed that:

The inspectors would immediately press the company's solicitors about the prospective new product, and would pursue this with Mr Clowes when they saw him on 28 January for interview.

The inspectors would give the company an ultimatum on the production of information, would specify that information, and would require that it be run on the computer over the weekend of 30 and 31 January. They would couch this request in formal terms.

The inspectors—somewhat reluctantly—also agreed that if full information was not provided by Mr Clowes in response to these demands, they should provide the Department immediately with an interim report so that the Department could consider what action to take (eg in the ultimate, a petition for compulsory winding-up.”

The following day the principal examiner wrote to the Assistant Treasury Solicitor enclosing for his information, and to give him something of a feel of events at that time, a copy of CIB's report of 7 March 1985 (4.38). This was the first time he had seen it.

7.16 On 26 January the EO wrote to Barlow Clowes Gilt Managers Ltd asking for an explanation of a figure shown in the unaudited monitoring return sent to the Department on 24 December 1987 (see 7.8) and for a further monitoring return in respect of the partnership to cover the period from 1 April 1987 to the date of dissolution. The principal gave instructions for a reminder to be sent on 11 March. This was done on 25 March, the company being asked for a reply within two weeks. The company responded on 14 April sending an unaudited monitoring return in respect of the partnership for the period 1 July 1986 to 16 April 1987. In answer to the Department's query about the figure shown in the original return as amount paid out other than in making investments for, or payment out to clients, or payment as fees, the company said that they had purchased and sold clients' stock through third parties. In the original monitoring return they had shown the receipts and payments in respect of these sales and purchases separately. They said they believed that it would have been more accurate to match the two transactions. This they had now done, leaving a figure of £6,104, which they said represented bank charges and interest. The Department sent to the section 105 investigators copies of all of the papers relating to the unaudited monitoring returns.

7.17 On 28 January the assistant secretary wrote to SIB formally notifying them of a number of section 105 investigations under way. Of Barlow Clowes he said, "I told [you about this case] a few weeks ago. Barlow Clowes told us when the investigation began that they would wish to disclose it to any SROs they applied to—they mentioned IMRO and the TSA. However, we cannot be sure that they will, and you should ensure that recognised SROs are put on warning to consult us about this company. The timing of the report is uncertain, as there have been delays in getting information out of Barlow Clowes. We will need to keep in touch about this case". During a visit to the Licensing Unit on 5 February representatives of IMRO discussed a number of firms giving them cause for concern, including Barlow Clowes.

7.18 Also on 5 February the principal wrote to the investigators in response to their letter of 6 January (see 7.9), confirming that they had correctly understood Barlow Clowes's position under the PF(I) Act. He went on to explain that SIB would be able to take action under the relevant sections of the FSA once they had come into force, even before the section 105 report had been completed, if appropriate. He said that a decision as to whether action should be taken under the PF(I) Act or the FSA would depend upon the timing of the report and the policy adopted regarding enforcement action. He said that a decision would be made in the light of all the relevant circumstances. The letter also recorded the decision made at the meeting held on 25 January 1988 that "the investigators should put themselves in a position to provide an urgent written interim report should they continue to be unable to obtain the information they sought or (and this were were told afterwards is now unlikely) new products were about to be launched".

7.19 On 23 February the principal examiner sent a minute to the assistant secretary reminding him of the meeting which had taken place on 25 January. He said that the investigators had been intending to visit Mr Clowes on 28 January and that, failing a satisfactory response from him, they were to submit an interim report to the Department. He asked whether a winding-up petition was still a possibility. As a result of this enquiry the assistant secretary made contact with the investigators and a further briefing meeting (of which no formal note was made) was held on 1 March. Mr Hoffman said in evidence that it had by then become clear that very serious matters were at issue and he and Mr Ziman were engaged in trying to obtain documentary proof to be supplied as part of their report. The principal recorded at a later date (22 March) that the investigators had at the meeting on 1 March reported a "mysterious credit, possibly from overseas and at the end of January/early February, of some £16 million worth of funds to the 'partnership' zero account for which Midland Bank act in a safe custody role". (This credit seemed to be related to earlier transactions as a result of which there had been a substantial outflow of money realised from the sale of securities, giving rise to a shortfall of some £10 million in amounts held in clients accounts.) In evidence one of the officials concerned has said that as a result of this significant discovery, the affair had assumed a much more serious character.

7.20 There then followed a meeting on 4 March attended by the principal and his assistant secretary from FSD, the principal examiner, the Assistant Treasury Solicitor, a departmental solicitor and Mr Hoffman. The principal examiner once again reported the meeting to a senior examiner, FSD making no formal note. His report was as follows:

"BARLOW CLOWES/JAMES FERGUSON

On 4 March I attended a further meeting to discuss this case.

2. Mr Hoffman reported on the present position, saying that the situation was now such that the inspectors were of the view that action by the Department should be considered, including the possibility of a petition under section 440. A principal worry was the possible risk to information in the computer system which appears to be solely controlled by Peter Clowes.

3. There are no hard printouts of the old partnership records—this information is only held in the computer, accessed by Clowes. These funds total some £40 million. In respect of the partnership securities, Midland Bank hold for safe custody only and there is no real protection for clients.

4. In respect of the company securities, Lloyds Bank are custodian trustees.

5. The inspectors are of the view that there have been a number of breaches of the Licensed Dealers Rules, and that the monitoring return for 1986 was reckless—the return for 1987 was a draft only.

6. Following meetings at the end of January, Clowes has provided information about the partnership funds but only, the inspectors say, after he had laundered the computer entries. Broadly speaking on the figures provided, the inspectors have verified that the stock held by the Midland Bank as at the end of January 1988 relates to the client accounts as now stated by Clowes. But the inspectors have found that at the end of January, to balance the books, £14 million nominal of gilts (market value of £16 million) was fed into the system—apparently from Clowes or some other outside fund or source. The inspectors have also found cases, from approximately 1984 onwards, where there were sales of securities which were not paid into clients' accounts. These sums, they estimate, total about £10 million which seems to have gone out of the system. They believe that the reinstatement of £14 million of stock, mentioned above, is related.

7. Mr Hoffman reminded the meeting that the company accounts did not include the clients' accounts; as at September 1987 the company appeared to have nett assets of some £723,000, but the inspectors thought that there might have been some losses since then as the company was not taking in new funds at present. However, the company is planning to market new products shortly.

8. Mr Hoffman also mentioned that the Gibraltar company had substantial funds—which they could not check—estimated at £40–£50 million. “Gibraltar” is a fully owned subsidiary of Ferguson and audited accounts are only available to September 1986. The last accounts for Ferguson are to March 1987, but that was prior to its take over of Clowes. The position therefore seems to be as regards Clowes:

The last audited accounts are to 1986.

The company took over the partnership, but clients have not been notified of any change in their contract, and they are not sent periodic statements of accounts.

There is difficulty in checking partnership records in the computer.

The company records can be reconciled but there is some evidence that occasional shortfalls have been made up from outside funds. The Midland Bank held stock is at risk. The Lloyds Bank held stock is at limited risk, in that the inspectors believe that Clowes could get access to those securities if he wished.

There is evidence that funds have gone outside the system, in that the proceeds of sales cannot be traced to clients’ accounts.

There is evidence that funds have been replaced, in respect of the partnership clients, from an outside source.

There are breaches of the Licensed Dealers Rules.

There is difficulty in establishing assets and liabilities over all as regards clients.

9. The inspectors know the names of the brokers through whom securities were sold (but funds not paid to clients’ accounts). All at the meeting were concerned at the existence of the section 105 enquiries leaking to the press. However, the inspectors have virtually finished their enquiries, so far as they can carry them at present. On my recommendation, it was agreed that [the assistant secretary] will approach Mr ... of the Stock Exchange, Surveillance Division, for him—rather than the section 105 inspectors—to approach one or all of the brokers in question, to obtain details of these deals and seek to establish to whom the proceeds were remitted by the brokers.

10. It was agreed that the inspectors would prepare, as soon as possible, a detailed interim report for the Department to consider. [The Assistant Treasury Solicitor] agreed that while there could be considerable difficulties in presenting a petition, this was an appropriate case to put the papers to counsel.”

Following the meeting, on 7 March, the investigators provided the assistant secretary with the details which it had been agreed he would follow up with the Stock Exchange, which he then did. On 10 March the principal sent the investigators the further papers that he had received from Mr Bautista (see 7.6). And on 14 March the assistant secretary wrote to SIB, in response to an enquiry they had made, saying “We are expecting a written interim report from the investigators soon. There is certainly cause for concern in this case”.

7.21 Meanwhile on 23 February a member of the public had written to the Department saying that having made an investment with Barlow Clowes and Partners Ltd, he wanted to know if they were registered under the FSA. The Department’s reply of 8 March directed the enquirer to SIB so far as compliance with the FSA was concerned but said in addition that “this company is currently licensed to deal in securities”. Another member of the public wrote to the Department on 1 March about Barlow Clowes, having first directed his enquiry to the Bank of England. He asked what was meant by the term “licensed dealer” and what criteria were required before a licence was issued. He asked if he was protected in any way from default by the company and whether the Department considered them respectable and reliable. He said that the previous year he had transferred some of his savings to Barlow Clowes International Ltd and he asked

whether he had been wise to do so and whether he was covered in any way. On 11 March the principal referred the letter and his suggested reply to the Solicitor's Office for advice, commenting, "Given the current section 105 investigation, the adverse information reported orally recently by the investigators and the prospect of a compulsory winding-up of this investment business (if counsel agrees), the letter could not be more awkwardly timed". The solicitor, while agreeing with the principal, told him that the Department had no power to tell the enquirer of the existence of a statutory investigation. The principal discussed the letter with the assistant secretary and a further draft was submitted to the departmental solicitor on 23 March. On 25 March the following letter was sent to the enquirer:

"Thank you for your letter of 1 March regarding Barlow Clowes and Partners Ltd.

I can confirm that this company (now called Barlow Clowes Gilt Managers Ltd) is a licensed dealer in securities. This means that it is currently licensed by this Department, under the Prevention of Fraud (Investments) Act 1958, to carry on the business of dealing in securities. This Act is, however, due to be repealed on 29 April 1988, to be replaced by more comprehensive investor protection legislation contained in the Financial Services Act 1986.

You ask what criteria have to be met before a licence is issued. Under the 1958 Act, an applicant for a principal's licence to deal in securities has had to provide certain information about himself as specified in the Dealers in Securities (Licensing) Regulations (Statutory Instrument 1983 No.587). The scrutiny process has involved enquiries with a view to ensuring, as far as possible, that licences are granted only to those who, in the words of the 1958 Act, are "fit and proper" and can be expected to conduct their business properly and in accordance with the Licensed Dealers (Conduct of Business) Rules 1983 (SI 1983 No.585). Additionally, the applicant has had to provide a certificate from his auditor to show that he can be expected to carry on business as a "going concern" for the period of the licence. The holder of a licence has been required to submit, each financial year, a report from an auditor on whether client money and securities have been properly safeguarded. Each licence under the 1958 Act has lasted for 12 months and application for a new licence has therefore had to be made each year. However, all licences in force on 27 February this year have been continued in force until the coming into force next month of the new system contained in the 1986 Act mentioned earlier.

The Secretary of State also has power, under the 1958 Act, if he thinks fit, to give notice of intention to revoke a licence during its currency if it appears to him that the holder is no longer fit and proper. It is not, however, the Department's practice to reveal whether or not such a notice has been given in a particular case or whether the giving of such a notice or any other action against the holder of the licence is being considered, or to comment on the affairs of a particular licensed dealer, or to express an opinion on whether he is more or less respectable or reliable than any other licensed dealer.

In order to carry on investment business when the main provisions of the Financial Services Act 1986 come into force next month, licensed dealers like Barlow Clowes Gilt Managers Ltd will have to be authorised by the Securities and Investments Board or one of the Self Regulating Organisations recognised by it under the Act. Such authorisations are not a matter for this Department to determine. The 1986 Act provides that persons who have applied for such authorisation before a specified day (which was in fact 27 February 1988) will be authorised on an interim basis from the day when the main provisions come into force (29 April) until their applications are determined.

You also asked whether you are protected in any way in the event of default. Under the Licensed Dealers (Conduct of Business) Rules 1983 there is no requirement for client indemnity arrangements, but new clients have to be sent written notice of whether or not there are any such arrangements in force. The 1958 Act does not provide for a compensation fund for losses

sustained by clients whatever the circumstances. One of the main aims of the 1986 Act referred to above is to ensure far more comprehensive and effective compensation arrangements. These new arrangements will, however, only come into force later in 1988, and will apply only to investment businesses fully authorised under the 1986 Act, (ie not to those having interim authorisation), and will not be retrospective.

You mention that you were advised to transfer some of your investments to Barlow Clowes International Ltd, based in Gibraltar. Being offshore, this company is of course not covered by UK securities dealers legislation. The Department does not comment on particular investment advice given to clients."

7.22 On 17 March Simpson Curtis wrote to Mr Ziman, saying that one of Barlow Clowes's prospective new products was ready for launching. They enclosed a draft prospectus relating to the new product—the personalised Gilt Service—which they said had been prepared with the guidance of Simmons & Simmons and Touche Ross Management Consultants. They said that the computer systems had been subjected to an internal review and an independent review by Touche Ross and substantial alterations were being implemented. They said that the proposed launch date was 31 March 1988. Simpson Curtis concluded, "in order that the launch remains on its revised schedule your reply by 25 March is requested". Mr Ziman sent a copy of the letter and enclosures to the Department together with a copy of his reply in which he asked for copies of Touche Ross's advice and documentation relating to the internal review of the computer systems as a matter of urgency. He said he did not understand what reply they were expecting.

7.23 On 22 March the principal sent a minute to the assistant secretary, copying it to those concerned in the Department and in the Treasury Solicitor's Department, summarising the position then reached over the investigation, and recording that he had handed over responsibility for it to an SEO who had just been appointed to a new post in the branch. He said that the investigators had promised their interim report by the end of March and that once this had been received counsel was to be asked to advise on the prospects of a petition to wind up Barlow Clowes and James Ferguson Holdings plc. The investigators were intending to hold a final interview with Mr Clowes on 25 March. He went on, "Enforcement action was likely to be difficult in the court given that Mr Clowes may now have put things to rights and there appeared to be no insolvency, so it would be necessary to demonstrate conclusively that Mr Clowes's conduct was reprehensible". So far as the new product was concerned, he said that the investigators had told him that they took the view that the 31 March deadline was not a serious one and that the proposed initiative was intended to keep up morale within the company. But the principal said that the threat of a new product increased the need for an interim report to be produced as quickly as possible. He concluded by saying that subject to the views of the solicitors the Department should await the interim report of the investigators which had been promised within the next ten days.

7.24 On 24 March Simpson Curtis sent a FAX to Mr Ziman explaining that they would be unable to answer fully his letter of 18 March before 25 March and they asked for an assurance that this need not cause Barlow Clowes to alter their plans for launching their new product. Replying the same day, Mr Ziman said he did not feel that the launch of a new product was a matter of concern for him or his fellow investigator and he explained that copies of the correspondence relating to this matter had been passed to the Department. The SEO who had assumed responsibility for the case wrote to Simpson Curtis on 7 April saying that in the circumstances, it would be inappropriate for the Department to comment on the launch of the new product. He informed Mr Ziman accordingly. Simpson Curtis acknowledged receipt of the letter on 12 April, making no reference to their clients' future plans.

7.25 Mr Maude has said in evidence that, shortly after taking up the position of Parliamentary Under Secretary of State for Corporate Affairs (as it had then become), he had asked for monthly progress reports on the major Companies Act

investigations and the FSA Insider Dealing investigations. On 25 March the assistant secretary minuted the principal agreeing with his proposal to await the interim report from the investigators and stating that the branch should in future include difficult section 105 cases in its monthly report to Mr Maude on insider dealing investigations. The next such monthly report was submitted on 20 April and as regards Barlow Clowes it said that a draft interim report was expected shortly and that the Treasury Solicitor would be seeking the advice of counsel to consider the next steps with a view to early enforcement action being taken if possible.

7.26 Meanwhile, on 31 March the investigators had sent the assistant secretary a provisional draft of a major part of their interim report. On 6 April the assistant secretary acknowledged receipt of the document (the Easter holiday having intervened) sending a copy of his acknowledgment letter and the contents page of the draft report to the Assistant Treasury Solicitor, who on receiving it asked to see the draft, which reached him on 7 April. The Assistant Treasury Solicitor has said in evidence:

“The draft was indeed a bulky document. Not only was it incomplete but it was obviously a provisional draft that might be extensively altered. I should explain that it has always been the DTI’s practice to refuse to disclose reports by officers concerning enquiries under s.447 of the Companies Act 1985. It was clear that the same principle should apply to reports under s.105 of the Financial Services Act 1986. Persons making such reports must be free to say whatever they feel appropriate. Reports may contain material from informants whose confidentiality must be protected. The reports may also contain material which ought not to be placed before the court such as expressions of suspicions not based on sufficient evidence. Public Interest Immunity is always claimed for such reports and this has been upheld in the High Court on several occasions. The practice is for the Treasury Solicitor to turn the report into a draft affidavit, agree the draft with the proposed deponent and then send it to counsel to settle. The affidavit is the main evidence in support of a petition and application for a provisional liquidator.

It was clear to me that a draft affidavit was going to be needed as soon as possible. Even if there was no petition the work would not be wasted as it could be used as evidence before a tribunal, either under the PF(I) Act or a Financial Services Act Tribunal. Major changes needed to be made particularly to the earlier chapters and there were numerous instances where points needed further explanation or points put more forcefully. Drafting the affidavit was a big task.

The provisional draft report was the first substantial material that I was given to read about the progress of the investigation. Earlier accounts had been brief oral descriptions from Mr Hoffman. A number of important documents had not been exhibited to the draft, most notably the Touche Ross “long form report” but the draft contained most of the material on which a decision should be based. The draft revealed very serious inadequacies in BCGM’s accounting and failures to comply with the rules. I was convinced that those in control of BCGM ought to be removed from control of such a large amount of the public’s money. However I was still concerned whether the evidence was sufficient to convince a judge that he ought to take the drastic step of appointing a provisional liquidator and winding the company up. There was no evidence of insolvency. The assets were still safe in the Midland Bank or Lloyds Bank. Although money had been improperly removed from the company’s main accounting system (particularly the £14 million) it had been returned. Nevertheless because I thought that a winding-up petition plus a provisional liquidator was the only way of ensuring speedy protection for existing investors and preventing any new investors subscribing, I advised the DTI to seek Leading Counsel’s advice and to petition if he advised that there was a reasonable chance of success. ... Mr Hoffman and Mr Ziman were not authorised to enquire into the Gibraltar company.”

7.27 The principal examiner has said in evidence that advice over the years from Treasury Counsel was that if the Department were petitioning in cases of solvent companies then there had to be very good, if not exceptional, grounds to secure a winding-up order and the Department's experiences in court had borne out this advice. The difficulty with the Barlow Clowes case had been that the investigators had not been able to say for a very long period of time whether or not the company or the fund was insolvent.

7.28 On 22 April the investigators sent the Department their interim report which was circulated to the Solicitor's Office, the Treasury Solicitor and CIB. A meeting was held on 4 May attended by the assistant secretary, the SEO, a departmental solicitor, a senior examiner from CIB, who had been asked to assist the Treasury Solicitor with accountancy matters, the Assistant Treasury Solicitor and his assistant and the section 105 investigators and their assistant. No formal note of the meeting appears on the Department's files (apart from a short attendance note prepared by the CIB representative) but a more detailed note was made for the Treasury Solicitor's file. In evidence the Assistant Treasury Solicitor has said that the main object of the meeting had been to discuss two draft affidavits (one based on the investigators' reports and the other summarising the conclusions that ought to be drawn) in anticipation of the presentation of a winding-up petition under section 440 of the Companies Act 1985. He said that there had been some discussion about the Gibraltar company but the investigators had said that they had no evidence of Barlow Clowes Gilt Managers' clients' funds being sent to the Gibraltar company. He said that there had been a discussion of the consequences for the Gibraltar company of a petition to wind up the UK company and it was agreed that the Department should alert the Gibraltar authorities. A further problem was whether or not Barlow Clowes Gilt Managers Ltd were carrying on an unauthorised unit trust, a factor which the Assistant Treasury Solicitor said might be crucial to the success of a petition because a substantial tax liability would have made the company insolvent. On 5 May, the day after the meeting, the Treasury Solicitor's office wrote to the departmental solicitor who had attended the meeting asking for a thorough analysis of the unit trust aspect to be made and for the various alternative courses of action open to the Department to be set out in a letter. The solicitor replied on 16 May, setting out the options available as follows:

- (1) SIB had power (under section 28 FSA) to withdraw or suspend the company's authorisation under the FSA.
- (2) SIB either alone or concurrently with the Secretary of State could apply for an injunction (under section 61 FSA) to restrain an anticipated contravention of certain provisions of the Act or SIB's rules.
- (3) SIB could exercise its powers of intervention under Chapter VI of the FSA, which included the power (under section 65) to prohibit the carrying on of business (see 1.15).
- (4) SIB concurrently with the Secretary of State had power (under section 72 FSA) to have the company wound up.

So far as the unit trust point was concerned, the solicitor concluded, after having discussed the matter with other departmental solicitors, that it could not be asserted with certainty that the company had been operating a unit trust. She said the most that could be said in an affidavit was that certain factors indicated that they might have been.

7.29 On 4 May IMRO wrote to the assistant secretary saying that Barlow Clowes Gilt Managers Ltd had applied to them for membership on 22 February. IMRO said that the company had disclosed that a section 105 investigation was under way and they asked (as they had been invited to do during a telephone conversation the previous day with DTI) for a copy of the report to be sent to them. SIB's records show that also on 4 May the assistant secretary discussed with SIB on the telephone the possible use by SIB of their powers of intervention under Chapter VI of the FSA. SIB asked him for a copy of the report, as a matter of urgency. SIB repeated their request during the following week but—SIB told me—the

Department said that because of the sensitive nature of the material the report, if sent to SIB, would need to be sent under cover of a legal letter. SIB have explained in evidence that they were concerned at the delay and at the possible risk to investors, so much so that they considered the possibility of launching their own section 105 investigation. For their part, IMRO have told me that, on 10 May, they telephoned the assistant secretary to discuss their need (absent the provision to them of the interim report), in light of their own knowledge of potential breaches of the IMRO rules, to make an immediate visit to Barlow Clowes and commence their own investigation. They told me that the assistant secretary promised them the report as soon as possible and, having warned them against providing Barlow Clowes with grounds for complaint about enquiries being duplicated, said that IMRO should proceed as they saw fit. (The assistant secretary has told me that he has no recollection of this.) Meanwhile, however, the Department were considering the matter and, also on 10 May, the SEO circulated draft letters for approval by all those concerned. The agreed letters were sent on 13 May to both IMRO and SIB enclosing copies of the interim section 105 investigation report (without the conclusions section) and suggesting an early meeting. IMRO acknowledged receipt of their copy of the report the same day, adding that they were in the course of their own inspection visit at Barlow Clowes Gilt Managers Ltd as interim regulator on behalf of SIB.

7.30 The suggested meeting took place on 17 May attended by representatives of IMRO, SIB and the Treasury Solicitor, departmental officials, and Mr Hoffman. The representative of the Treasury Solicitor's office made a full note of the meeting at which the way forward was discussed. According to this note, the main alternatives were for the Department to apply for a winding-up petition or for SIB to take action under the FSA. The assistant secretary was recorded as having said that the trouble with the PF(I) Act was that it was so long and drawn out. Otherwise, he said, the Department would have withdrawn the licence. IMRO's recent investigation had added support to the investigators' findings. The outcome of the meeting was that SIB would consider what action they should take. The assistant secretary told me that the Department's previous petition for a winding-up order in another case had failed for the first time in living memory. He said that this had been in the minds of those concerned with the Barlow Clowes case, particularly as the same official at the Treasury Solicitor's Department had been involved in both cases. However, the Assistant Treasury Solicitor has said in evidence that he had been less concerned than the assistant secretary about the previous failure which he and counsel had regarded as an eccentric decision. He went on to say that the Department were anxious for a petition—if there was to be one—to be presented by SIB but that SIB were reluctant because all of the preparatory work had already been done and they did not want their first petition to be a controversial one—the Assistant Treasury Solicitor had told them, he said, that the case was difficult and complex and one of the most problematic he had encountered. (I should add here that SIB and IMRO have told me that they do not regard the account of the meeting on 17 May, as recorded in the note from which I have quoted above, as entirely accurate. They gave me their own account—which they supported with contemporary notes from their own records—as follows:

“The assistant secretary said that DTI had considered that the s.105 Interim Report would have justified issuing a notice under the PFI(I) Act to withdraw BCGM's licence, but that that procedure had not been adopted as being too long drawn out. DTI and [the Treasury Solicitor] said that Leading Counsel should be consulted about a winding-up petition, on “just and equitable” grounds, but that the complexity of the case and the absence of “any single bull point” made the prospects uncertain, particularly in the light of a recent adverse court decision in another case.

SIB, having heard Mr Hoffman's oral elaboration on the interim report, and IMRO's findings, expressed a preliminary view that investor interests called for something to be done immediately—which appeared to be making an intervention under Chapter VI powers. This action seemed necessary regardless of the uncertainties expressed about a petition's chances of success, and would take account of Mr Hoffman's view that intervention might quickly lead to insolvency.

It was agreed to pursue both options, DTI and SIB liaising closely, and [the Treasury Solicitor] arranging a joint conference with Leading Counsel as soon as possible, primarily to consider prospects for a winding-up petition, but having regard to Chapter VI intervention powers, which SIB would in any event be urgently considering further.”)

7.31 On 19 May the assistant secretary telephoned the Bank of England to ask if they could suggest a suitable contact in Gibraltar to whom he could speak about the possible effect of action in the UK on Barlow Clowes International Ltd. The Bank suggested that he should contact the Banking Supervisor. On the same day the assistant secretary briefed Mr Maude, the PUSS, as follows:

“BARLOW CLOWES GILT MANAGERS—REGULATORY ACTION

Summary of Recent Developments

1. The investigators appointed under section 106 of the Financial Services Act submitted a signed interim report on 22 April.

2. Barlow Clowes Gilt Managers (BC) has about £40m under management. The report of the investigators showed many breaches of the licensed dealers’ rules. More seriously it showed that at some time a sum of almost £10m disappeared from the funds being managed, but that subsequently about £16m was re-injected into those funds (the latter event being during the investigation). In addition the controls over the assets which are supposed to belong to the clients—ie gilt edged securities which are physically at certain clearing banks—are inadequate in that the securities can be withdrawn without adequate safeguards

3. The report was considered at a meeting with Treasury Solicitors on 4 May. They advised that we should seek counsel’s opinion on whether to petition to wind up the company, but that for that purpose the report would need to be turned into a draft affidavit. Since then [the Treasury Solicitor] and the secretary to the investigators have been working on this 200 page document which is now nearly ready.

4. The report (minus the conclusions section), was disclosed last Friday to the Securities and Investments Board (SIB) and the Investment Management Regulatory Organisation (IMRO). We held a meeting with them on Tuesday morning to consider further action. SIB are now considering whether to exercise their powers of intervention under Chapter VI of the Financial Services Act. It is possible that the SIB Chairman may authorise such action this afternoon, and that it may be taken tomorrow or early next week. SIB would probably wish to keep any such action confidential, but this might not prove either desirable or possible.

5. It is currently planned to put the papers to counsel this weekend with a view to a conference next Wednesday. That conference will probably be a joint one with SIB.

Action Required

6. None. This minute is for information.

Background and Detail

7. Mr Maude agreed to the appointment of investigators into BC (at the time a dealer in securities licensed by the DTI) on 14 October 1987.

8. BC are at present interim authorised to carry on investment business by virtue of their application to IMRO before 27 February.

9. The powers in Chapter VI of the Financial Services Act came into force on 29 April and can only be exercised by the SIB. They permit the Board, in relation to authorised persons, to restrict their business in various possible ways, to impose restrictions on disposing of, or otherwise dealing with, assets, to require the vesting of assets in a trustee, or the maintenance in the United Kingdom of sufficient assets to meet liabilities.

10. There is power to petition to wind up a company under section 440 of the Companies Act, and power to petition to wind up an investment business under section 72 of the FS Act. A petition under the former must be based on information obtained under statutory powers, but a petition under the latter need not be.

11. The section 440 power may be exercised only by the Secretary of State, but the section 72 power may be exercised by either the Secretary of State or the SIB.

12. There is an associated company of Barlow Clowes which is resident in Gibraltar, and which probably also has considerable funds under management. I propose to speak to the Head of Banking Supervision in Gibraltar tomorrow morning to alert him to the situation.

13. SIB have raised the question whether the current section 105 investigators should be appointed by the SIB as well as, or instead of, by the Department in order to facilitate subsequent legal action by the SIB. We are considering with them whether this would be worthwhile.

14. The investigators are Mr L D Ziman, solicitor, of Nabarro Nathanson, and Mr W M Hoffman FCA, of Howard Tilly.”

7.32 Following receipt of a letter dated 19 May from SIB and a discussion on the telephone, the assistant secretary sent the PUSS a further note on 20 May as follows:

“BARLOW CLOWES GILT MANAGERS—REGULATORY ACTION

Summary of Recent Developments

1. There have been the following developments since my minute of yesterday.

2. SIB decided yesterday evening (19 May) to serve on Barlow Clowes (BC) a prohibition under section 65 of the Financial Services Act. The details will be settled in the course of today. The plan is to serve the prohibition on Monday morning.

3. SIB do not at present intend themselves to initiate publicity about this. However they have in mind the fact that UK investors may still be being recommended to place funds with BC or BC international. Even if SIB do not announce the matter, it may of course become publicly known.”

Also on 20 May the assistant secretary wrote to SIB saying that they had agreed that SIB would notify the Gibraltar authorities of their intended action.

7.33 On 23 May SIB served a notice of prohibition under sections 65 and 70 of the FSA on Barlow Clowes Gilt Managers Ltd. This notice prohibited the company from carrying on investment business except with the prior approval of SIB or their agents. The reasons given for the imposition of the prohibitions were:

“The accounting records and systems of Barlow Clowes Gilt Managers Ltd appear to be inadequate to meet the standards required to give appropriate protection to current and possible future investors who could as a result be at serious financial risk. Furthermore the information received from IMRO

(1) has given rise to concern that [the company] does not have procedures or controls over investors’ money and assets which are adequate to fulfil the requirements of IMRO’s rules,

and

(2) has given rise to concern that investments and cash under [the company’s] management have not been or cannot be reconciled with amounts due to investors who have opened accounts with [the company] under the terms and conditions of offerings made by [the company] or by its predecessor”.

7.34 In the meantime, the Treasury Solicitor’s Department had prepared a case to put to counsel and this was forwarded to counsel on 20 May. The CIB principal

examiner had particularly requested that the Department's worries that there might be insufficient grounds to petition for a winding-up order should not slant the case—which was to advise whether there were grounds to petition under section 440 of the Companies Act 1985, or whether there were grounds for regulatory action by SIB or both. A conference with counsel was arranged to take place on 25 May. SIB wrote to the Department immediately before the conference, bringing them up to date with the situation. They reported that the prohibition notice was in place, that the situation was even more worrying than had previously been thought, and said (among other things) that when they had attended Barlow Clowes's offices at Poynton to serve the prohibition notice, Mr Clowes himself had not been present but that other officers of the company had told SIB representatives that the latest printout dated 19 May had shown £46 million of assets against £48 million of obligations to clients. They said that directors of the group had been thinking very seriously over a number of months about the guaranteed repayment to investors and how/whether the company could meet that guarantee. The officers spoke also of a legal uncertainty as to quantifying the obligation to clients who sought to dis-invest in advance of the maturity date of their investment contract—it was possible that the £48 million “current market value of obligations” could be in excess of the “maturity value” amounts due to those same clients. The SIB representatives had been told, on enquiry, that the Gibraltar fund management was entirely separate from the UK fund management but SIB were concerned that there could be mingling of assets and accounts between the two sets of funds. Mr Clowes had proposed that all of the assets of Barlow Clowes Gilt Managers Ltd should be sold and clients repaid in full, any deficit—which he estimated at some £1.6 million—to be met out of his personal funds. SIB expressed concern, however, about the conflicts of interest which might arise from such action and as to how the deficit had arisen. As to Gibraltar, they continued to have no real information and the auditors of that company, moreover, had not yet taken any steps to commence an audit of the clients' funds. These were estimated from the level of fee income involved to be in the region of £50 million. SIB have told me that Mr Clowes came to London later that day (25 May) to press on them his proposals for dealing with the £1.6 million deficit.

7.35 While Mr Clowes was discussing his proposals at length at SIB, the conference with counsel took place on 25 May, attended by the assistant secretary and two departmental solicitors, the Assistant Treasury Solicitor and his assistant, a senior examiner from CIB, the investigators' assistant, a solicitor from SIB and representatives from Cork Gully (SIB's agents at Barlow Clowes Gilt Managers Ltd). The Assistant Treasury Solicitor has said in evidence that counsel advised that, “although the case was not exceptionally strong, there was a reasonably good chance of securing a winding-up of [the company] even if the company opposed. It was decided to make an appointment before the Registrar for an application to appoint a provisional liquidator for the afternoon of Friday 27 May and [my assistant] arranged this. What was not agreed was whether the SIB or the DTI would make the application. I discussed this with [two departmental solicitors and my assistant] early on 26 May. [One of the Department's solicitors] was disappointed that the SIB was not exercising its powers under s67 FSA 1986 which had been passed to avoid having to take the drastic step of liquidation. By then I was convinced that a winding-up was necessary and no alternative would be satisfactory. [The solicitor] reluctantly agreed. There was then a long discussion on the telephone with SIB as to who should petition. I had to go to another meeting at that stage but I subsequently heard from [my assistant] that, almost at the last moment on Friday 27 May, the SIB were persuaded to be the petitioners. The hearing before the Registrar went ahead that afternoon and the Official Receiver was appointed provisional liquidator. The SIB largely relied on the evidence and the draft petition that we had prepared”. The senior examiner also made a note of the conference with counsel which had taken place on 25 May for CIB's file. Among other things he noted that counsel “expressed considerable concern about the Gibraltar company and after lengthy discussions it was decided by all those present that nothing could be done about the Gibraltar company given that it was trading outside the jurisdiction of the United Kingdom”. The Assistant Treasury Solicitor has said in evidence that he had known nothing of BCI until the reference to it at the meeting of 4 March 1988. There had been only a short reference to it in

the draft report of 7 April 1988 and he had supported the investigators' suggestion that they should be instructed to enquire into it. To take action against BCI it would have been necessary to have evidence that it was trading in the UK and that it had assets here. Difficult questions would also doubtless have arisen as to whether the financial intermediaries were agents of BCI. Mr Clowes had refused all information about BCI and any proper enquiry would have been long and difficult and he was determined that such enquiries should not delay action against BCGM. (I should record here—as I did in paragraph 7.30—that SIB have told me that their recollection of events does not correspond exactly with the account which I have quoted from official sources. In particular, they said that, according to their contemporary record of what took place at the conference on 25 May, it was agreed that a final decision as to whom—DTI or SIB—should petition, would if possible be made the following day, when counsel would be consulted again. SIB had, they said, nevertheless instructed litigation solicitors to attend the following day's conference with a view to dealing with the preparation of a petition and a principal affidavit from SIB overnight on 26 May.)

7.36 On 26 May the assistant secretary made the following submission to the PUSS:

"BARLOW CLOWES GILT MANAGERS (BC)—REGULATORY ACTION

Developments since my minute of 20 May

1. The Securities and Investment Board (SIB) issued to BC on 23 May a prohibition notice under section 65 of the Financial Services Act. That notice prohibited BC from carrying on investment business except with the prior approval in writing of the Board, given through its agents, and under supervision. The Department has doubts about the vires of that prohibition notice, but it has not so far been challenged.

2. Counsel advised at a conference yesterday evening that although not without risk a petition could be presented to wind up BC in the public interest, and that that petition should be presented tomorrow. Both the Department and the SIB have power to present such a petition. That advice was given against the background that SIB had ruled out the possibility of its requiring, under section 67 of the Financial Services Act, that the assets of, or managed by, BC should be vested in a trustee, on the ground that the powers could not be made to work.

3. The Department would be concerned if those powers (which were borrowed from insurance legislation) were dismissed without proper consideration. We therefore raised this possibility with SIB again, and a further conference with counsel (involving both us and SIB) is to be held this afternoon which will consider the alternative course of SIB making such a requirement. (It would in no way rule out winding up as well).

4. Action (either a winding-up petition or a section 67 requirement) which will effectively bring the business to an end is in any case likely in the very near future.

5. SIB have agreed that if a winding-up petition is to be presented then they will do it.

6. Investors through Barlow Clowes are typically small investors seeking income from secure investments. Because of the difficulties in establishing the exact position at BC we do not know whether, or to what precise extent, investors will lose money as compared with what they were entitled to, or what they thought they would be entitled to. The amounts at stake are large, over £40m, although the losses are unlikely to be anything like that. Nonetheless we may be talking in terms of millions. Insofar as this happens there may well be criticism of the Department for having granted BC's predecessor (BC & Partners) a licence in 1985, and for allowing BC to remain licensed until the end of the licensing system on 29 April.

7. There was a report in yesterday's "Financial Times" that the Stock Exchange had suspended the listing of James Ferguson, which owns BC, and of which Mr Peter Clowes is the chairman."

(I should add here that SIB have told me that their records show that the further conference with counsel in fact took place on the afternoon of 26 May. According to SIB's records, one of DTI's solicitors again raised the issue of section 67 as an option (this option having been briefly discussed the previous afternoon). Counsel advised against it. Counsel also advised SIB not to agree to the proposals which Mr Clowes had made to SIB during the afternoon and evening of 25 May. The rest of the conference had, SIB said, been devoted to further consideration of SIB's petitioning the next day, making use of the appointment with the Registrar reserved by the Treasury Solicitor and making application for immediate appointment of the Official Receiver as provisional liquidator.)

7.37 Meanwhile, on 16 May a member of the public had written to the Department asking how safe was the money that he had invested in Portfolio 68 with Barlow Clowes International in Gibraltar. He commented, "I do not go for the moon; but rather prefer a safe 10-12% and know that my capital is *safe*." The Department sent the enquirer's letter to SIB and told him that they had done so. The question was discussed of how the Department should respond to enquiries if the existence of the section 105 investigation was queried and if it was asked whether SIB's prohibition order had been prepared on the basis of information provided by the Department. It was agreed that the Department should adhere to the line that their practice was not to comment on the affairs of individual companies, except through the medium of a Parliamentary Question when the existence of the section 105 investigation would be acknowledged. The first reports on the subject of the winding-up proceedings appeared in the press on Saturday 28 May.

7.38 On 27 May the grade 3 solicitor reported to Mr Maude on developments, which he described as reasonably satisfactory. SIB were, he said, taking prompt and effective action; and he indicated that the application to the court was to be made that afternoon. (On 31 May he followed up his report with a note to Mr Maude saying that he had learnt that the application to the court had been completely successful.) In his report of 27 May the solicitor referred to the BCI position as follows:

"The major outstanding problem is that winding-up (and the same will apply to SIB's powers) will not achieve anything as regards the sister company in Gibraltar. We suspect that there is at least as much money owed to investors from there, ie £50m plus, and there is evidence at least some of the investors are in the UK. SIB are in touch with the Gibraltar authorities, who are sympathetic but have no power, and the only way we can do anything is through the common parent, a listed (but currently suspended) plc."

On 1 June the grade 3 solicitor sent a minute to the Head of Investigation Division suggesting that there was reason for an investigation into the re-listing of James Ferguson Holdings plc in March/April 1987 to be initiated in addition to the investigation into Barlow Clowes. This matter was discussed and on 6 June the Head of Investigation Division circulated his thoughts on the matter to FSD and the Solicitor's Office inviting comments. A meeting took place the following day, after which the Head of Investigation Division made a submission to Mr Maude recommending that inspectors be appointed under section 432 of the Companies Act to investigate the affairs of James Ferguson Holdings plc, with particular reference to their takeover of Barlow Clowes and Partners Limited and other companies in April 1987. It was pointed out in the submission that, if inspectors were appointed under section 432(2), section 433(1) would make it possible for them to investigate BCI, to the extent that it was managed from the UK and there were relevant documents in the jurisdiction. CIB's recommendation was accepted and on 10 June Mr Ziman and Mr Hoffman were appointed as the inspectors.

7.39 Meanwhile, following the appointment of special managers to the Official Receiver as provisional liquidator of Barlow Clowes Gilt Managers Ltd, the directors of Barlow Clowes International Ltd had come under pressure from many investors who wished to withdraw their investments. Mr Clowes had subsequently (on 7 June 1988) presented a petition to the Supreme Court of Gibraltar for a winding-up order to be made against BCI, as a result of which, on 8 June, an order

had been made and joint liquidators appointed. On 10 June joint receivers and managers of the assets of the funds known as Portfolios 28, 68, 33 and 39 and any other funds promoted by BCI were appointed by the court.

Findings 7.40 I consider first the decision taken on 30 November (7.4 and 7.5) that unaudited monitoring returns should be submitted. It was, in my view, an unimportant decision, although for more reasons than I think the Licensing Unit officials appreciated at the time. In addition to the facts that audited monitoring returns were obviously not going to be forthcoming until after the investigation had been completed and that unaudited returns might prove useful, there was the fact that the company held a licence, as the result of the decision in October. True, that licence had been granted “subject to review” if a verified monitoring return were not received “within a reasonable time” (6.52). But, in my view, that formula had relatively little content. It could not amount to a condition, failure to comply with which would somehow enable the licence to be brought to an end, because there was no power to impose conditions. The failure to provide the monitoring return could not have been made a ground for revoking the existing licence under section 5(1). That left only use of the failure to provide a verified monitoring return within a reasonable time as an indication that the company was “not fit and proper” for the purposes of a section 5(2) revocation. However, given the particular circumstances in which the decision was taken (7.4), the failure on its own could scarcely have carried any weight as such an indication. It follows that, by agreeing to receive unaudited returns, the Department were not in fact giving up any real right or power that they had.

7.41 That leads me to a more general point concerning the period from October 1987 to the ultimate collapse in late May 1988. It has been suggested to me on behalf of investors that well before the end of that period the Department were in possession of sufficient information to justify revocation of the company’s licence and ought to have taken that course. The fact of the matter was, however, that once the company had been granted its new licence in October 1987 any attempt to revoke that licence would have had to be based on section 5(2) of the PF(I) Act; and, as appears from paragraph 1.6 above, any attempt to revoke the licence under that sub-section would have given the company the right to refer the matter to the tribunal, pending whose report the licence would continue in force. Moreover, in such circumstances the company would not have been trading illegally, and accordingly the basis for an attempt to bring the company’s activities to a halt by the route which had been suggested by counsel in 1985 (see 4.44, point (e)) would not have existed. Accordingly I was not persuaded that in the period under consideration the Department had any real choice other than to pursue the section 105 investigation with a winding-up in view.

7.42 Concern was expressed to me on behalf of investors at the length of time matters took from the decision in October 1987 that there should be a section 105 investigation to the denouement in late May 1988. Their concern was understandable, but it seemed to me that the history of that period, as recounted above, showed the very considerable difficulties which had been encountered in making progress with the investigation and in framing evidence on the basis of which there would be a reasonable prospect of obtaining a winding-up order. Indeed it is noteworthy that even when the order was applied for, those concerned were by no means certain of success. I did not find, therefore, that in respect of this period any blame attached to the Department, or to those acting for them, for avoidable delay.

7.43 Finally, I considered whether, during the period in question, more could have been done than was done to protect investors in BCI. The evidence I have set out makes it clear, however, that the investigators, and through them the Department, were able to obtain virtually no information about the affairs of BCI. That, coupled with, as it seems, very limited powers in the Gibraltar authorities, convinced me that the Department had not been at fault in the respect in question.

Chapter 8

Conclusions

8.1 As the result of my investigation I identified five areas in which there had been, in my view, significant maladministration by the Department. The areas in question were the early licensing errors (3.13), the faults in relation to the Jersey partnership (4.89), the faults in the legitimising licence proposal (4.99), the failure as regards the erosion of capital issue (4.108) and the licensing decisions in 1987 (6.53 *et seq*). I have deferred until this point in my report consideration of the consequences of the maladministration which I had thus found. The crucial question, of course, is whether (or to what extent), absent those elements of maladministration, investors would have been spared the losses with which the great majority of them were left when the group collapsed. As to that, I start by looking at the individual areas of maladministration, to see with what degree of certainty the consequences of the maladministration can be determined.

Early licensing errors

8.2 If it had not been for the licensing errors in the period 1975 to 1981 (Chapter 3), it is virtually certain that the partnership would have received a licence and have had it regularly renewed, at least until the impact of the 1983 regulations and rules was felt. Under the earlier rules there was no mechanism which allowed a licence holder's conduct of his business to be monitored. In the absence of complaints therefore—and there is no record of complaints having been made during that earlier period—it can be assumed that the authorities would have seen no need to make any special enquiry into the conduct of the partnership. There was, however, a feature of that pre-1983 period which deserves mention. This is that the pre-1983 Licensing Regulations, required an applicant for a licence (other than a corporation) in his statutory declaration to give particulars of all businesses carried on by him as a principal during the last five years including, in the case of each business, the nature of the business, the address where carried on, the name of the business and the names, addresses and nationalities of the partners, if any. (The nearest comparable requirement under the 1983 regulations was that individuals were required to state “Present occupation or employment and occupations and employment during the last ten years, including the name of the employer, the nature of the business, the position held, the reason for termination and relevant dates”.) This would have required Mr Clowes to disclose that he had formed with Conwin Services Ltd the Jersey partnership of the same name (Barlow Clowes and Partners) in the 1970s. If Mr Clowes had given that information, it seems doubtful whether it would, at the time, have attracted any interest. But at later points in time, as I indicate below, things might have been different.

8.3 Following the coming into force of the 1983 regulations the partnership would have been required to submit verified monitoring returns for all periods from 1 September 1983, the first such return being due by 31 December 1984 in respect of the period from 1 September 1983 to 30 June 1984. Thereafter, returns would have been due on an annual basis. It must be a matter for speculation whether the introduction of these more rigorous requirements—at a point of time which coincided more or less with the start of substantial advertising by the partnership (see paragraph 9 of the Introduction)—would have given rise to different courses of dealing by the partnership from those which in fact took place. It must also be a matter of speculation whether—assuming no different approach—the partnership would have encountered difficulties in meeting the monitoring return requirements. But if complaints or expressions of concern had come in—and if the partnership's file had contained details of the Jersey partnership (see above)—it seems to me that that might have led to enquiries about

the Jersey partnership. The complaints which the Department received in 1984 and 1985 concerning the UK partnership's unlicensed status would, *ex hypothesi*, not have arisen. But assuming similar business methods, there seems no reason to suppose that concern would not have been expressed, in the way it in fact was, about both the partnership's ability to pay the returns it guaranteed without eroding capital and the other matters which were raised.

8.4 I cannot therefore entirely exclude the possibility that, if the mistakes made in the 1975 to 1981 period had not been made, the outcome for investors would have been different. There is, however, a more specific point to be made about the faulty advice which had been given in 1975–76. This relates to the effect of the earlier episode on the Department's approach to the partnership in the 1984–85 licensing process. The fact that the Department had, in effect, advised the partnership that it did not need a licence made it difficult for the Department to point a finger of blame at them, for example for having built up their business to the size it had attained without bothering to find out whether it was legal or not. More important, by enabling the partnership to point to the Department as the cause of their unlicensed dealing, it could be seen as having placed an obstacle in the path of any procedure against the partnership which was based on the premise that they were operating illegally. I return to this point at paragraph 8.7 below.

The Jersey partnership

8.5 If it had been appreciated that there was a separate Jersey partnership (4.89), the picture facing the Department would have been of two different firms, with the common link of Mr Clowes as dominant partner in each, carrying on very similar businesses under precisely the same name, and each soliciting investment remittances made payable to "Barlow Clowes and Partners Clients' Account". In this context, moreover, the evidence which the Department had of direct marketing in Great Britain by the Jersey firm would have assumed a new significance for licensing purposes, as would also the apparent discrepancy between that evidence (coupled with the terms of the Portfolio 28 leaflet) and Mr Clowes's assertion that Portfolio 28 was designed for, or confined to, expatriates (4.25). Furthermore, in such circumstances a somewhat technical licensing problem would have become apparent. This would have arisen from the fact that the PF(I) Act made no provision for the licensing of partnerships as such. Under the Act licences could only be granted to "persons" (ie individuals or corporations), with the proviso (see 1.4) that the licence might be framed "so as to authorise the holder thereof to carry on the said business, either alone or jointly with any other person being the holder of a principal's licence, under such name or style as the applicant may specify in this application". Accordingly, although the 1983 Licensing Regulations had been drawn so as to cater to a degree for "partnership applications", the outcome of the applications made in November 1984 (4.12) would in law have been the grant of two principal's licences—to Mr Clowes and Mrs Clowes—authorising each of them to carry on business under the style "Barlow Clowes and Partners". In this connection the Principal Officer told me that, in the Department's view, the grant of a principal's licence to Mr Clowes would not have authorised him to carry on business with an unlicensed person—Conwin Services Limited—and that Mr Clowes would have been in breach of such licence if he had done so in Great Britain. The Principal Officer added however that, as the Department understood it, there were real questions as to whether the partnership with Conwin existed or continued to exist throughout the relevant period. My own understanding, from the evidence I have seen, is that the Jersey partnership continued to exist for most, if not all, of 1985.

8.6 Faced with the picture which I have described in the preceding paragraph, it seems to me certain that the Department would have sought to ensure that the investigation which they saw as necessary before any licence would be granted in respect of the Barlow Clowes operation extended to the affairs of the Jersey partnership. Matters of concern would have included the extent to which United Kingdom residents were investors in the Jersey funds, how they had come to be investors in those funds, how those funds were managed, whether they were kept separate from the United Kingdom funds or whether there was intermingling, the ownership, and reputation and fitness of Conwin Services Limited and, ultimately,

whether the Jersey funds as well as the United Kingdom funds could be properly accounted for. Enquiries would, no doubt, have been made of the Jersey authorities, and the Department would have become aware of their views (see 4.6). So far as Mr Clowes was concerned, it seems certain that he would have sought to avoid any such extension of the investigation. (Paragraph 8 of the Introduction to this report indicates that some nine out of ten of the investors in the Jersey funds were United Kingdom residents; and the information I have been given by the joint liquidators of BCGM and BCI indicates that in the period up to December 1984 there had been frequent movements of money or securities between the United Kingdom funds and the Jersey funds and, most important of all, that at December 1984 the gilt-edged securities and cash held for the Jersey funds were at least some £3.65m less than the funds' obligations to investors.) But I think it highly unlikely that Mr Clowes could have found any means of ensuring that investigation of the matters in question was averted, while at the same time satisfying the Department that his operations could properly be licensed. To my mind, therefore, it is a virtual certainty that the partnership's operations would have been brought to an end, in one way or another, within a relatively short time after the meeting of 18 December 1984.

The legitimising licence 8.7 I found (4.99) that the Department were at fault in concluding that they could properly grant the partnership a legitimising licence in advance of receiving, through Spicers, the verification which they saw as being necessary. It is true, of course, that this never occurred, because solution of the Banking Act problem took longer than Spicers' report. But I have to consider how matters would have stood in March–April 1985 if it had been seen that a legitimising licence was not a proper way forward. That, it seems to me, would have left the Department with the choice between peremptory action to bring the partnership's operations to a halt, at least as regard taking in new money, and proceeding with the original proposal that a decision on the licence application should be deferred until Spicers had reported (4.34). However, the latter course had at the time been seen as unacceptable—indeed it had been for that reason that the route of a legitimising licence was proposed. Yet the Department could claim, at least with hindsight, that such a course would have been justified, having regard to Spicers' report. As to peremptory action, there was certainly room for a view that that was the proper course. In particular, the situation had been changed, as compared with December 1984, by the revelation of the very unsatisfactory state of affairs which existed within the partnership. And, from the standpoint of investors, obstacles to peremptory action arising from the advice the Department had earlier given would themselves be the consequence of maladministration. The evidence indicates that, as it was, there were those who were calling for stern action. All in all, it seemed to me that on the footing of there being no obstacle of the kind to which I have referred, there is a very distinct possibility that the decision would have gone in favour of peremptory action.

Erosion of capital 8.8 I found that the Department were at fault in failing to appreciate that the instructions given to Spicers to carry out an audit of the partnership's client accounts would not, at least as regards some important Barlow Clowes portfolios, have enabled any reassurance to be gained on the score of the concern that the partnership could not make the payments of income they had guaranteed without eroding clients' capital (4.105 to 4.108). The portfolios which gave rise to this problem were those under which, besides guaranteed income payments, there was a guarantee that a stated sum would be repaid to the investor at the future maturity date of his chosen stock, but no guarantee that any particular sum would be repaid if the investor withdrew before that future maturity date. The audit of client accounts would not, I found, involve enquiring into the question whether the stock and cash standing to the credit of the investor at the audit date would prove sufficient to meet both the guaranteed income and the guaranteed repayment on maturity.

8.9 The question to which I have just referred was almost certainly one to which an exact answer could not have been given. Moreover any assessment on the subject would, it seemed to me, have required more than just accountancy skills.

Indeed the view which Mr Pearson expressed to me was that it would have been, to a considerable extent, a matter for experts in the investment field, rather than for accountants. However, despite such difficulties, I felt that it should have been possible to obtain a broad picture, sufficient to show whether there was cause for real doubt about the capacity of the funds to meet future contractual commitments to investors in those funds. To the extent that any cause for doubt was shown, attention would have had to be turned, of course, to the assets of the partnership and the partners. As to what would have been revealed if enquiries had been made on these lines, as at 28 December 1984, the facts which have subsequently emerged provide ground for suspecting that an unfavourable picture would have been revealed. One cannot say more than that. There is therefore no more than a possibility that proper action would have led to the partnership's operations being halted.

The 1987 licence

8.10 Here I found two elements of significant maladministration. The first was the delay in taking a decision following the receipt of information from the Stock Exchange (6.54). The second was the failure to perceive, and give urgent consideration to, the additional option for action which Touche Ross's request for further time for the submission of the monitoring return had opened up. As to the first, the consequences for investors would appear, at first sight, to be reasonably readily ascertainable. On the footing of the decision which was actually made (a section 105 investigation) the investigation would have started earlier and—I see no reason to doubt—would have finished earlier, leading to an earlier liquidation both of BCGM and of BCI. As a result, those who invested during the “wasted” weeks preceding the collapse, who it would seem were all investors in BCI (see paragraph 8 of the Introduction), could say that they would never have invested at all and claim that the maladministration had been the cause of their loss. But at that point at least one complication occurs, because it seems that these investors, or some of them, are or may be able to avoid the whole or part of their losses by “tracing” their investments into funds or property. If those investors are able to do that, it might be necessary to consider whether their places could be taken by an earlier set of late investors, who could argue that with an earlier collapse they would have had tracing claims. And none of this takes account of any outflows of funds which would not have occurred if the collapse had been earlier. I have said enough, I think, to indicate the complications.

8.11 As to the other element of maladministration which I found under this head, that consisted of the failure to perceive, and give urgent consideration to, the possibility of requiring a verified monitoring return before the expiration of the current licence, with a warning that revocation would have to be considered in default. As I have indicated (6.57) I saw no reason why such a course could not have been taken in parallel with continued preparations for a section 105 investigation. I also found it difficult to see what harm could have come from such an approach, given that there would have been no commitment to revocation if the verified monitoring return had not been forthcoming. However, I think it is a reasonable assumption that it would not have been forthcoming, at which point one moves into the realm of speculation, since it is only if a decision would then have been made in favour of revocation that subsequent investors could claim to have suffered loss in consequence of the maladministration. If the assumed deadline had not been met, the Department would have had to give consideration to a number of factors. One might well have been an assessment of the risks of judicial review if the decision were to go in favour of revocation. Another would have been the availability of legal processes to take control of the funds out of the hands of the company. Yet another, about which it is difficult to speculate, would have been the nature of any explanations given for the non-production of the verified monitoring return. Taking these factors into account, I do not think it is possible to say that the decision, assuming no maladministration, must have been to proceed with revocation. Again, therefore, I am left with the position that, if the maladministration had not occurred, it is possible, but not certain, that losses to subsequent investors would have been averted.

Summary 8.12 Three of the instances of maladministration which I found related to the 1984–85 licensing process. (Another—the early licensing failures—can be said to have had an impact on that process.) As to two of those three instances, I have been unable to say more than that there was a possibility that, if matters had been handled properly, the operations of Barlow Clowes, both here and overseas, would have been brought to a halt, sparing investors (or most of them) the losses they have suffered. However in the case of the third instance—the failures in relation to the Jersey partnership—I could only conclude that if things had gone as they should, the upshot would have been the halting of the Barlow Clowes operations. That being so, it seemed to me unnecessary to dwell further on the later maladministration in relation to the 1987 licence—there was, to my mind, a strong case for compensation for those investors who had suffered as a result of Barlow Clowes being allowed to continue in business beyond the early part of 1985.

8.13 Before addressing the matter of compensation in detail, it is right that I should say something about what might be represented as the harshness of a conclusion that compensation should be paid on account of, it might be said, some minor oversights. For my part, however, I would not look at the matter in that way. A regulatory agency—which is what the Department were, at the time, in relation to the protection of investors—ought, to my mind, by definition to adopt a rigorous and enquiring approach as regards material coming into its possession concerning an undertaking about which suspicions have been aroused, and also as regards representations made to it on the part of the undertaking in question. And it was, in my view, the lack of a sufficiently rigorous and enquiring approach which led not only to the failure to appreciate that there was a Jersey partnership but also to some others of the faults I have identified.

Compensation 8.14 Generally, it seemed to me that no distinction of principle should be drawn between investors in the onshore funds and investors in the offshore funds. If action had been taken which had brought the operation of the onshore partnership to an end it would also in the circumstances have brought the offshore operations to an end. As to possible distinctions by reference to the date when investments had been made, it seemed that, *prima facie*, a distinction would need to be drawn between investments made *after* the date on which, if matters had been handled properly in the 1984–85 licensing process, the operations of Barlow Clowes would have been brought to an end, and investments made *before* that date. As to those early investors, the possibility that, if the early licensing errors had not been made (see 8.2 to 8.4 above), their lot would have been improved on that account was, to my mind, so remote that it had to be discounted. On the other hand there was the possibility that, if action had been taken in 1984–85, the early investors would have suffered less from a collapse at that date than they suffered, in the event, from the collapse in 1988. There would, of course, be considerable difficulties about determining whether, and to what extent, that would have been the case; but that did not seem to me a sufficient basis for excluding the early investors entirely from the compensation process.

8.15 Another matter which it seemed to me would need to be taken into account, in some manner or other, was the possible blameworthiness of others besides the Department. I have pointed out in the Introduction that it is no part of my function to consider questions of blameworthiness of persons or organisations other than the governmental organisations to which my jurisdiction extends. On the other hand I could not ignore the fact that accusations had been levelled by investors at others besides the Department, to the effect that those others should in some sense or another bear part of the blame for what occurred in the Barlow Clowes affair and for the losses suffered by investors. Indeed it was evident to me that thought has been given by investors and those representing them to the possibility of legal proceedings in various directions with a view to recouping the losses which investors have suffered, or some part of them. In that connection, it had been represented to me on behalf of investors that if I were to find that a case for compensation by the Department had been made out, the solution to the problem of compensation would be for the Department, in effect, to bear the cost of compensating investors in full, while being “subrogated to”, and taking the benefit

of, any claims which investors, and the receivers and liquidators (including the liquidators of James Ferguson Holdings plc), might have against third parties. It had been acknowledged, however, that such a scheme would require further detailed consideration before it was put into practice.

8.16 It seemed to me, certainly, that matters ought to be arranged in a manner which, while securing a just result for investors, enabled recoupment action to be taken against any persons who might have been at fault. It also seemed to me that, while fairness required that the investors affected should be left, at the end of the day, in the position of having had the great bulk of their losses made good to them, it would not be unfair or inappropriate if, bearing in mind the inherent risks of high-return investments, the ultimate settlement left them a modest way short of being compensated in full.

8.17 When I put to the Principal Officer of the Department my recommendation that the injustice which I had found investors to have suffered as a result of the Department's administrative failings ought to be remedied by the payment of compensation on a basis which took account of the considerations set out above, he indicated to me that the Government disagreed with a number of my specific findings and proposed to set out its views on those matters in a separate document to be published at the same time as my report. The Principal Officer also indicated that in the Government's view my report raised a number of important issues about the responsibilities of regulators, and said that the Government proposed to set out its views on these issues in the same document. However, the Principal Officer told me that the Government recognised that this case had created very great hardship, and involved a unique combination of unusual features. In the light of that the Government was, in the exceptional circumstances, and without admission of fault or liability, prepared to make a substantial payment to investors who had suffered loss. This payment would be made to investors in both Barlow Clowes Gilt Managers Limited and Barlow Clowes International Limited, in return for their assigning to the Secretary of State their rights, in the liquidation and against third parties, and giving an undertaking to provide reasonable assistance in the pursuit of those rights. The payments would not distinguish between early and late investors.

8.18 The Principal Officer provided me with a draft of the detailed proposals for calculating the amount of the payments to be made, indicating that in certain specified respects it had not yet been possible to finalise the proposed terms. He told me however that these aspects would shortly be finalised and that he would furnish me with a copy of the finalised terms in advance of the date set for the publication of this report. The finalised terms would be published at the same time as this report.

8.19 The Principal Officer summarised the basis for calculating the payments to investors as follows:

“First, a calculation would be made of the basic claim attributable to each investor at the date of the liquidation of the relevant company. This calculation would take into account not only the amount originally invested but also interest which would have been earned had the amount invested been deposited and earned compound interest in a long-term UK deposit account.

The amounts thus calculated would then be abated on the following basis. Where the basic claim as calculated was not greater than £50,000 it would be abated by 10%. Where the basic claim was greater than £50,000 but not greater than £100,000 the first £50,000 would be abated by 10% and the remainder would be abated by 20%. Where the basic claim was over £100,000 the first £50,000 would be abated by 10%, the next £50,000 by 20% and the remainder by 40%. Where an investor had more than one account his or her accounts would be aggregated for this purpose.

The amount to be paid would then be calculated by applying compound interest (up to the end of 1989) at an appropriate rate to the abated sum thus calculated, taking account of the interest which investors could have earned

on sums which have already been paid in the liquidation or by third parties. This would give a gross figure, from which would be deducted the amounts already paid to investors in the liquidation or by third parties to give the total amount to be paid.”

8.20 The Principal Officer explained to me the reasons why the Government proposed that claims should be abated in this way. First, he said, the Government considered it important for investors to understand that no investment is entirely free of all risk, and that investors must be expected to bear part of the risk themselves. Secondly, investors who have large sums at their disposal might also be expected to be better placed to take proper care before committing their funds, and should accept a greater degree of responsibility for the consequences of their own decisions; the payment to them should reflect this. The Principal Officer also proposed that the Government should have the discretion to withhold payment from any person who appeared to have contributed to, or to have benefited directly or indirectly from, the circumstances leading up to the collapse. The Principal Officer told me that he expected that a formal offer could be sent to investors in mid-January, with a view to making payments on accepted claims by the end of February. (He added that if the Department were unable to make its offer by that date there would, of course, be a corresponding extension of the date to which interest would run.)

8.21 I was, of course, disappointed that the Government was not willing to give its unreserved acceptance to the findings I had made as the result of my investigation. Such indications as I had seen of the grounds for questioning my findings had left me altogether unconvinced. The Government had however—with whatever reservations—proposed making substantial payments to Barlow Clowes investors, without distinguishing between the offshore and onshore funds and without reference to the dates of their investments. In that I saw ground for satisfaction. It remained, however, for me to consider whether the quantum of the proposed payments would be such as to enable me to say, in the terms of the Parliamentary Commissioner Act, that the injustice which I had found that investors had suffered in consequence of the Department’s maladministration would be remedied by the payments. As to that, it seemed to me not unsatisfactory that those with investments of £50,000 or less would end up having received 90 per cent—and those with investments of up to £100,000 at least 85 per cent—of their capital and, in addition, compensation in the form of interest for loss of income on that amount since the collapse. These investors, with £100,000 or less invested, constitute, I understand, over 99.5 per cent of the number of investors involved. As to the larger investors, they would certainly be left with a greater percentage loss. On the other hand it seemed to me that the distinctions suggested by the Principal Officer were not without foundation. In the result I concluded that I could not say, in all the circumstances, that the Government’s proposals would not constitute a fair remedy for the injustice which had been suffered.

HMSO publications are available from:

HMSO Publications Centre

(Mail and telephone orders only)

PO Box 276, London SW8 5DT

Telephone orders 01-873 9090

General enquiries 01-873 0011

(queuing system in operation for both numbers)

HMSO Bookshops

49 High Holborn, London, WC1V 6HB 01-873 0011 (Counter service only)

258 Broad Street, Birmingham, B1 2HE 021-643 3740

Southey House, 33 Wine Street, Bristol, BS1 2BQ (0272) 264306

9-21 Princess Street, Manchester, M60 8AS 061-834 7201

80 Chichester Street, Belfast, BT1 4JY (0232) 238451

71 Lothian Road, Edinburgh, EH3 9AZ 031-228 4181

HMSO's Accredited Agents

(see Yellow Pages)

and through good booksellers