
FINAL NOTICE

To: Arch Financial Products LLP
Firm
Reference
Number: 417495
Address: Suite LP22733, Lower Ground Floor, 145-157 St John Street, London,
EC1V 4PW
Date: 27 March 2015

1. ACTION

- 1.1. For the reasons given in this notice, the Authority hereby publishes, pursuant to section 205 of the Financial Services and Markets Act 2000 (the "Act"), a statement that Arch Financial Products LLP ("AFP") has contravened regulatory requirements.
- 1.2. This action is in respect of breaches of Principles 1, 3 and 8 of the Authority's Principles for Businesses ("the Principles") and breaches of rules relating to Senior Management Arrangements, Systems and Controls ("SYSC") and Conduct of Business ("COB").
- 1.3. Were it not for AFP's financial position the Authority would have imposed on AFP a financial penalty of £9 million.
- 1.4. A public censure will be issued and takes the form of this Final Notice, which will be published on the Authority's website.

2. REASONS

- 2.1. On 14 September 2012 the Authority gave AFP a Decision Notice that it had decided to publish a statement to the effect that AFP had contravened regulatory

requirements in respect of breaches of Principles 1, 2, 3 and 8 and breaches of rules relating to SYSC and COB pursuant to section 205 of the Act which occurred between July 2006 and March 2009 (the "Relevant Period").

- 2.2. The Decision Notice stated that were it not for AFP's financial position, the Authority would have decided to impose on AFP a financial penalty of £9 million.
- 2.3. On 12 October 2012, AFP referred this decision to the Upper Tribunal (the "Tribunal"). The Tribunal, in a written decision dated 19 January 2015, <http://www.tribunals.gov.uk/financeandtax/Documents/decisions/Arch-v-FCA.pdf>, determined that the Authority should publish a statement to the effect that AFP had contravened Principles 1, 3 and 8 (and in the latter two cases related SYSC and COB Rules) and, but for the financial position, a financial penalty of £9 million would have been imposed in respect of such contraventions.
- 2.4. The Tribunal's written decision sets out fully the Tribunal's reasons and should therefore be read in full. Those reasons are incorporated herein by reference.

Systems and controls in relation to management of conflicts

- 2.5. The Tribunal found that AFP had failed, in breach of Principle 8 and associated SYSC and COB Rules in force at the relevant times, to have in place appropriate policies and procedures to manage conflicts fairly and to record them (paragraph 191).
- 2.6. At paragraph 134 of its decision, the Tribunal set out a number of general principles as to how to approach the management of conflicts – these relate to: identification of and understanding the conflict; mitigating factors; disclosure and consent; and record-keeping. The Tribunal found that:

"a record of the steps taken to manage a conflict establishes an audit trail and gives a "corporate memory" so that the firm can see how to handle conflicts in a particular situation...records do not have to be in any particular form and can be in a series of different documents, although their value will be much diminished if they are not easily accessible, coherent and comprehensible and made soon after the event. They also need to be accurate. If they are made much later they are less likely to be accurate."

- 2.7. The Tribunal's conclusions in relation to AFP included the following at paragraph 189:

"...conflicts were managed and recorded on an ad hoc basis and decisions were not made and recorded within a tailored framework of systems and controls as required by the relevant regulatory provisions."

Lack of integrity in approach to managing specific conflicts

- 2.8. The Tribunal upheld the Authority's findings that the firm failed in breach of Principle 1 to act with integrity in managing the conflicts arising in respect of the AGL Transaction, the Cru Transaction, the Lonscale Transaction and the Nice Transaction ("the Four Transactions").
- 2.9. The Tribunal found that there was an unacceptable risk that the conflicts arising in respect of the Four Transactions would not be managed fairly (paragraphs 262, 309, 336 and 371). Further, it found that AFP had failed to take adequate steps to manage the conflicts arising, despite the risk being obvious to them (paragraphs 263, 264, 310, 311, 312, 337 and 373).
- 2.10. The Tribunal found that, given the serious nature of the conflicts in the Four Transactions and in light of the failings as found by the Tribunal to manage the conflicts of interest, in failing to decline to enter into the Four Transactions, AFP had failed to act with integrity in breach of Principle 1 (paragraphs 267, 313, 338 and 374).
- 2.11. Specifically, in relation to the Lonscale Transaction the Tribunal held at paragraph 336 to 338 that:

"The conflict arising in this case was as serious as could be imagined, involving the payment of a substantial fee to AFP where that fee would only be payable if the transaction completed and where AFP procured that the Guernsey Cells make the necessary investment to enable the transaction to proceed at a time when no other alternative sources were available... In these circumstances, and there being no serious attempt to manage the conflict, there was in our view an unacceptable risk that the Guernsey Cells and the UK Funds would be disadvantaged by the Lonscale Transaction and accordingly that the risk had not been managed fairly.

...In these circumstances in our view the only right course of action to take in the absence of any other meaningful steps to manage the conflict would be to decline to enter into the transaction."

Failure to have a formal compliance monitoring programme in place

2.12. The Tribunal further found that AFP had failed during the Relevant Period to implement an adequate, formal and independent compliance monitoring programme (paragraph 389). Accordingly, in breach of Principle 3 and associated SYSC rules, AFP had failed to take reasonable care to organise and control its affairs responsibly and effectively.

2.13. The Tribunal held at paragraph 388 that:

"a formal compliance monitoring programme provides discipline to the frequency, depth, breadth and reporting of compliance monitoring and is especially important in firms with complex or novel business models or which are growing over time, all of which applied to AFP. Regular reporting to a firm's governing body is also a good discipline as it will prompt the compliance officer to consider whether the firm's systems and controls need review regardless of whether there is anything specific to report."

Inadequate systems for segregating and controlling non-public information

2.14. The Tribunal found that AFP had failed from February 2007 to ensure that there were adequate systems for segregating and controlling access to non-public information about the Guernsey Cells and to recognise and manage fairly the conflicts of interest between the interests of the Guernsey Cells, their shareholders and the UK Funds resulting from the risk of use by AFP of such non-public information (paragraph 404). Accordingly, in breach of Principle 3, AFP had failed to take reasonable care to organise its affairs responsibly and effectively.

2.15. The Tribunal held at paragraph 403 that:

"...there was no reason in theory or practice why in February 2007 AFP could not have taken the following steps:

(1) Established separate and distinct investment committees;

(2) Placed controls over the provision of indicative prices to Winterflood [i.e. the market-maker in the Guernsey Cells' shares] so that persons responsible for providing those prices did not have access to material non-public information; and

(3) Restricted access to AFP's servers and records management systems to ensure that those involved in decision making for the UK Funds did not have access to material non-public information.

Inevitably, such arrangements may have involved some duplication of staff beyond what was necessary for an integrated structure thereby having costs implications but we see no reason why a firm should be allowed to compromise on the necessary standards simply on the grounds of cost."

Findings on the Authority's assertions as to liquidity risk management

- 2.16. The Tribunal did not uphold the Authority's finding in the Decision Notice that AFP had failed to meet the requisite standard required under Principle 2, with regard to its management of the liquidity of the property of the UK Funds (paragraph 449).

3. DEFINITIONS

The definitions below are used in this Final Notice:

"the Act" means the Financial Services and Markets Act 2000

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority

"AFP" (or the "Firm") means Arch Financial Products LLP

"AGL Transaction" means the transaction whereby in February and March 2007 certain Guernsey Cells invested in Arch Group (UK) Limited

"COB" that part of the Authority's Handbook in force prior to 1 November 2007 relating to the conduct of business by persons regulated by the Authority

"Cru Transaction" means the transaction whereby between February 2007 and March 2009 certain Guernsey Cells made investments in Cru Investment Management Ltd

"Diversified Funds" means CF Arch cru Diversified Funds, an OEIC in respect of which AFP was the investment manager

"Guernsey Cells" means the 22 cells incorporated by Arch Guernsey ICC Limited

“Investment Funds” means CF Arch cru Investment Funds, an OEIC in respect of which AFP was the investment manager

“Lonscale Transaction” means the loans made by certain Guernsey Cells in order to facilitate the acquisition of the Clubeasy group of companies by Lonscale Limited

“Nice Transaction” means the transaction in respect of which debt and equity investments were made by certain Guernsey Cells in Nice Group Limited and Nice Capital LLP

“Principles” means the Authority’s Principles for Businesses

“Relevant Period” means July 2006 to March 2009 inclusive

“SYSC” means that part of the Authority’s Handbook setting out its rules relating to Senior Management Arrangements, Systems and Controls

“the Four Transactions” means the AGL Transaction, the Cru Transaction, the Lonscale Transaction and the Nice Transaction

“Tribunal” means the Upper Tribunal (Tax and Chancery Chamber)

“UK Funds” means the “Investment Funds” and the “Diversified Funds” together.

4. PROCEDURAL MATTERS

4.1. This Final Notice is given under, and in accordance with, section 390 of the Act.

Publicity

4.2. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to AFP or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

4.3. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contacts

- 4.4. For more information concerning this matter generally, contact Stephen Robinson (direct line: 020 7066 1338 / fax: 020 7066 1339) of the Enforcement and Market Oversight Division of the Authority.

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Anthony Monaghan

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division