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**FINAL NOTICE**

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To: **BNP Paribas Private Bank SA London Branch (“BNPP Private Bank”)**

Of: 10 Harewood Avenue  
London NW1 6AA

Date: 10 May 2007

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) gives you final notice about a requirement to pay a financial penalty.**

**1. ACTION**

- 1.1. The FSA gave BNPP Private Bank a Decision Notice on 3 May 2007 which notified BNPP Private Bank that for the reasons listed below and pursuant to Section 206 of the Financial Services and Markets Act 2000 (“the Act”) the FSA has decided to take the following action, namely to impose a financial penalty of £350,000 on BNPP Private Bank in respect of a breach of Principle 3 of the FSA's Principles for Businesses (“the Principles”) which occurred between 1 September 2002 and 28 July 2006 (“the relevant period”). As BNPP Private Bank has confirmed that it will not be referring this matter to the Financial Services and Markets Tribunal, the FSA imposes the financial penalty for the reasons set out below.
- 1.2. BNPP Private Bank agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures.

## 2. REASONS FOR THE ACTION

- 2.1. In the relevant period, BNPP Private Bank breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 2.2. BNPP Private Bank did not take reasonable care to ensure that it had effective systems and controls to manage the risks relating to fraud (Principle 3).
- 2.3. The period in which these issues arose began before BNPP Private Bank was authorised and continued within the relevant period. The FSA acknowledges that the issues described below had been corrected by the end of the relevant period, which is the date at which a skilled person report pursuant to section 166 was prepared in July 2006. The FSA also acknowledges that events prior to 1 December 2001 are outside the scope of its jurisdiction, and has not imposed a penalty in respect of any failings prior to December 2001.
- 2.4. The weaknesses in question facilitated a series of fraudulent transactions by a senior BNPP Private Bank employee. Between February 2002 and March 2005, by a series of 13 transactions, the employee defrauded BNPP Private Bank of around £1.4 million. The relevant transactions involved the dishonest debiting of clients' accounts without authority. Many of the transactions involved forged clients' instructions and signatures and false requests for changes of correspondence address. Most of the later transactions appear to have been designed to conceal earlier ones, with the total movement of funds in these transactions being £2.6 million. The net loss was of the order of £1.4 million, which was borne by BNPP Private Bank.
- 2.5. When BNPP Private Bank was authorised on 1 September 2002 it was on notice of the FSA's recommendation that procedures for the monitoring of large transactions could be improved. The FSA's recommendation stated that "*in some cases the transaction details submitted were very basic, [and] this lack of detail could hinder the effectiveness of [large transaction reports] in identifying*

*unusual/suspicious transactions*” as a result of an August 2002 FSA Supervision visit in relation to money laundering systems and controls. Certain subsequent internal reviews which identified potential weaknesses in controls were not acted upon in a timely and efficient manner.

2.6. Defects in the systems and controls for the checking of instructions and in the risk-based before and/or after-the-event review enabled an employee to transfer funds away from the bank dishonestly.

2.7. Particular failings include:

- in the case of large transactions, some form of independent risk based review or challenge process should have been in place either before and/or after the transaction has taken place;
- there was no independent before-the-event check on significant transfers of money from client accounts. Under the system put in place within BNPP Private Bank, the Relationship Manager initiating the transaction could have sole responsibility for initiating and reviewing that transfer (albeit subject to a further check and approval by Middle Office in respect of external transfers);
- as local procedures were not explicit on senior review requirements a number of the fraudulent transactions were not independently reviewed by senior management prior to payment and the forged instructions were only signed by the dishonest employee;
- basic authorisation and signatory checks were not conducted by Middle Office in respect of internal transfers (ie transfers of cash between the accounts of two customers at the same branch of the Bank). Due to a design flaw in BNPP Private Bank’s IT systems it was possible to bypass the checking process conducted by Middle Office. This failing was identified in November 2003 and although steps were taken to remedy it, it was only partially remedied at the time; and

- the information provided in the report to support the after-the-event reviews of substantial transactions should have contained a fuller explanation of the relevant transactions in order to enhance the effectiveness of the report in identifying unusual or suspicious transactions.

2.8. The FSA considers these failings to be serious because:

- the control failures in question facilitated actual and significant fraud against the bank as a result of the unauthorised deductions made from clients' accounts;
- the original fraud which was committed in February 2002, and the subsequent transfers apparently arranged to prevent its detection, were not discovered for a significant period of time;
- the systems and controls failures continued over a significant period of time;
- certain failings were identified as needing remedial action and such action was not undertaken in a timely manner;
- the firm failed to enhance its procedures to an adequate standard during this period of heightened FSA and industry awareness of fraud and client money risks (for example in December 2003, the FSA issued its discussion paper DP26 "Developing our Policy on Fraud and Dishonesty"); and
- the cumulative impact of the failings represented a risk to the FSA objective of reducing the extent to which it is possible for regulated firms to be used for a purpose connected with financial crime.

2.9. BNPP Private Bank's failures therefore merit the imposition of a financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognises that the fraudulent transactions were undertaken by a senior employee and that the forgeries were sophisticated. BNPP Private Bank had taken measures to improve its systems and controls before the discovery of the fraud and also has taken

further steps to correct the failings subsequently. The review undertaken by a skilled person pursuant to section 166 of the Act confirmed that there were now no significant weaknesses in BNPP Private Bank's anti-fraud systems and controls environment. In addition no customers suffered loss. Further BNPP Private Bank informed the FSA that the frauds had occurred and has co-operated fully throughout the investigation. These steps serve to mitigate the seriousness of the defects identified.

- 2.10. BNPP Private Bank has received full credit for settlement of the disciplinary case at an early stage; it has received a 30% discount for settling the case at stage one.

### **3. RELEVANT STATUTORY PROVISIONS**

- 3.1. Under section 206(1) of the Act, if the FSA considers that an authorised person has contravened a requirement imposed by or under the Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

- 3.2. Section 2(2) of the Act includes as a regulatory objective the reduction of financial crime. This is defined by Section 6(1) of the Act in the following way:

“Reducing the extent to which it is possible for a business carried on by a regulated person ... to be used for a purpose connected with financial crime”.

- 3.3. Principle 3 of the Principles provides:

“A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”.

- 3.4. The Principles constitute requirements imposed on authorised persons under the Act.

- 3.5. The Principles apply to an EEA incoming firm in so far as they cover areas not reserved by European Community instrument to the firm's Home State regulator.

3.6. The rule in Senior Management Arrangements, Systems and Controls module of the FSA's Handbook ,SYSC 3.1.1R provides:

"A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business"

The areas to be covered by these systems and controls are set out in SYSC 3.2.

3.7. SYSC 3.2.6 R provides:

"A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime."

#### **4. FACTS AND MATTERS RELIED ON**

##### **Background**

4.1. BNPP Private Bank is wholly owned by BNPP SA France (together with its subsidiaries "the BNPP Group"). BNPP Private Bank is an EEA passported firm. From its authorisation on 1 September 2002 BNPP Private Bank employed about 20 staff. However it contracted various functions to other parts of the BNPP Group under Service Level Agreements. As at 31 May 2006, it managed a total of 586 accounts for clients with c£500m of assets under its management.

4.2. BNPP Private Bank took over the private banking business of BNP Paribas Private Bank plc ("the plc") on 1 September 2002.

4.3. In 2005 BNPP Private Bank conducted two investigations into allegations that a senior employee had defrauded the bank by dishonestly debiting clients' accounts of a minimum of £1.4 million between March 2002 and March 2005.

4.4. This Final Notice covers the period between 1 September 2002 (when BNPP Private Bank was first authorised) and 28 July 2006, when the FSA received

notification in a report from a skilled person which concluded that overall there were now no significant weaknesses in BNPP Private Bank's anti-fraud control environment.

- 4.5. The fraud that occurred was the trigger for the FSA's examination of the relevant financial crime controls. The FSA considers that the fact that the control failures facilitated an actual fraud is an aggravating feature of this case, but is not the sole reason for imposing the penalty. The defects in procedures are alone a cause of significant concern.

### **Review of Transactions**

- 4.6. In order to reduce the extent to which it is possible for the firm to be used for purposes in connection with financial crime, BNPP Private Bank had policies in place that required independent checks and approval prior to significant transfers of money between or out of client accounts being made. The detail of these policies changed from time to time, but the principle of independent oversight was to remain.

### General Procedures

- 4.7. BNPP Private Bank had in place a system of independent review, checking and approval of payment instructions received from customers via the Front Office Relationship Manager. This was conducted by the Middle Office. This control included review of the client instructions, including the reasons given for the transaction, checking of signatures against the mandate, review of the beneficiary details for the payment, and ensuring there was sufficient cash in the account to cover the transaction. Once those checks were complete, the payment would be passed to the back office for processing.

#### Procedures for large transactions

- 4.8. In addition, prior to around September 2002, there was in place a process of additional independent senior management sign-off for large transactions (at that stage defined as payments over £100,000). This sign-off was delegated to another company, which acted as the bank's agent. During this time, notwithstanding the involvement of a third party, BNPP Private Bank remained responsible for the veracity of client instructions. This arrangement continued until Autumn 2002 when the Middle Office function was moved to London.
- 4.9. In around September 2002, new authorisation procedures including those for significant transactions (contained within BNPP Private Bank Procedure Manual) were prepared by the BNPP Group's central risk management function and were intended to be implemented in local sites by the New Year (although in fact they remained 'on validation', i.e. requiring a further process of consultation and consideration in light of local law and local circumstances in each site before they were finally implemented in the relevant site). These new procedures contained a requirement for the General Manager of BNPP Private Bank or the London Private Bank Compliance Officer to provide signed approval prior to the making of large transfers of client funds; and for Middle Office to ensure that appropriate approval signatures were in place. Although the procedures considered a 'large transaction' as one over EUR 150,000, the London Offices' translation of the procedures contained the considerably lower figure of £10,000.
- 4.10. However BNPP Private Bank brought in its own approval system, which derogated from the procedures set by the global policy, in that they did not explicitly require independent oversight by senior management in respect of large transactions. At this time BNPP Private Bank considered that these procedures would be impractical, given its local circumstances. In the circumstances, BNPP Private Bank arranged to derogate from central procedures in order to reflect or accommodate these local conditions.
- 4.11. This derogation was done with the knowledge and approval of the Project Team



who were co-ordinating the migration of the private banking business from the plc to the London Branch of BNPP Private Bank in Autumn 2002. Part of the project included the harmonisation of procedures and controls within the Private Bank between London and other sites. The derogation was therefore considered and approved in this context. However it was intended only as a short term measure pending a more long term solution.

- 4.12. In fact, the issue of the appropriateness of the above derogation was never revisited by BNPP Private Bank. Instead the derogation continued until the discovery of the fraud in July 2005, a period of almost three years. This was despite the issue being identified in a Key Surveillance Point report dated November 2003, at which point the appropriateness of the derogation should have been reconsidered.

#### The fraudulent transactions

- 4.13. The initial fraud and the first subsequent transfer took place in February 2002 and 18 March 2002 respectively at a time when the independent checking process via a third party was still in place. Accordingly, the relevant documents in connection with these transfers (a transfer of the USD equivalent of £1.4 million to an account in Singapore and a transfer of the USD equivalent of £949,700 to a solicitor's firm in London) was reviewed and approved prior to payment by a third party.
- 4.14. However, following implementation of the derogated sign-off procedures in September 2002 none of the subsequent fraudulent transactions were independently reviewed by senior management prior to payment, and were therefore signed only by the Relationship Manager initiating the transaction within Front Office. An internal report in August 2005 relating to the alleged frauds recorded that there was a *“lack of second signature for approval (Head of Private Banking or Compliance Officer) due to large transactions”*.
- 4.15. In addition, although further checks were required to be carried out by Middle

Office by both BNPP Private Bank Procedures Manual and the derogated procedures, these checks were not effective for all internal account transfers (i.e. transactions between two different customers of the same branch). This was due to a defect in BNPP Private Bank's IT architecture which enabled Middle Office to be bypassed by the Relationship Manager in the case of certain internal transfers. This defect was identified in November 2003, but was only partially corrected.

- 4.16. Further, even where Middle Office should have checked the authorisation approvals for external transfers, this was not always completed, or adequately completed. For example on one occasion the Middle Office did identify a discrepancy concerning a client's signature but failed to escalate this to senior management.
- 4.17. An after-the-event review was also carried out on significant transactions (at that time also set at the level of above £10,000) – however the manner in which this was carried out and the information provided to senior management was such that this did not amount to an adequate control. At the time senior management were presented with a list of all transactions of £10,000 and above, but with only limited explanatory material and no means of identifying whether or not a particular transaction was anomalous on a particular client account. At that time, no supporting documentation was requested for entries on the large transaction report, even on an ad hoc basis. The FSA expects that sufficient management information should be given to enable those reviewing such transactions to adopt a risk-based approach to monitoring transactions.
- 4.18. The FSA considers that in the case of large transactions, some form of independent risk based review or challenge process should have been in place either before and/or after the transaction has taken place. Further, BNPP Private Bank's IT systems should have been configured so as to ensure it was not possible to circumvent the Middle Office approval process in the case of internal transfers. In failing to have in place any such processes and procedures after September 2002, BNPP Private Bank did not have in place an effective system and control

for countering the risk that the bank might be used to further financial crime.

### **Hold Mail**

- 4.19. BNPP Private Bank operated a system whereby mail could be held for certain categories of clients (“hold mail”). Throughout the relevant period certain of the systems and controls in relation to hold mail were inadequate; in the present case the inadequacy of the systems and controls was such that it possibly enabled an internal perpetrator of fraud to avoid detection for a significant period of time.
- 4.20. Until 2004 BNPP Private Bank had no central schedule of clients that were provided with a hold mail service. Further, although there was put in place a process to ensure that clients who did not collect their mail on at least an annual basis were identified, there was no mechanism to ensure that clients were contacted to ensure they were aware of the mail and of their obligation to collect their mail on a regular and timely basis.
- 4.21. In the event, the senior employee selected an account for executing his fraud which was a hold mail account in relation to which the customer rarely visited the UK and did not pick up mail regularly. The lack of checks to ensure contact was made with this customer in relation to collection of mail may have contributed to the concealment of the fraud by the senior employee for such a long period.
- 4.22. The FSA considers that BNPP's hold mail system carried a higher than usual risk of being used for the purposes of facilitating financial crime.

### **Failure to Correct Defects**

#### Lack of second signatories

- 4.23. The lack of second authorisation signatories on large transfers had been noted in an audit of the Branch in November 2003 (“the November 2003 KSP audit”) stating that “*Payments >£20k must be signed off [by] the Compliance Officer in line with procedure.*” Six fraudulent transfers occurred after the date of this report. In no case was there evidence that this authorisation had been obtained.

- 4.24. Having identified a potential weakness in management oversight in November 2003, this was not addressed. The last fraudulent transfer of USD 20,000 occurred on 4 March 2005. This was reported in the Inspection Generale Special Mission Report into the fraud dated 2 January 2006 (“the GI report”) as not having the requisite second authorisation signature. This transfer took place 16 months after the issue was identified in the November 2003 KSP audit.
- 4.25. The fact that the absence of this significant control was not identified for such a period of time is considered particularly serious by the FSA.

Lack of checks on internal transfers

- 4.26. One level of transaction controls was the requirement that Middle Office check the integrity of the documentation: however as discussed above, the IT architecture allowed Middle Office to be circumvented for internal inter-account transfers. The November 2003 KSP audit identified that “*No Middle Office 4 eyes [that is independent] control for internal payment instructions – Transfer between 2 accounts held in BNP Paribas London – this should be implemented.*” Shortly thereafter modifications were made to the IT architecture to ensure that Middle Office controls were applied whether the transfer was external or internal. However the instructions for the IT department were defective and still allowed Front Office to bypass the Middle Office controls in certain circumstances. This later defect was only discovered and corrected after the GI report had recommended that BNPP Private Bank “[t]ake the measures to modify the IT treatment of the internal transfers to ensure a systematic notification to the Middle Office for controls.”

Lack of detailed after-the-event information

- 4.27. Further, the lack of after-the-event management information in respect of significant transactions, as discussed above at paragraph 4.17 was identified during a FSA supervisory visit to BNPP Group in London in August 2002, and amongst other things recommended improvement in anti-money laundering

controls, stating *“the Private Bank relies on a large transactions report... In some cases the details submitted were very basic. The lack of detail could hinder the effectiveness of the report in identifying unusual/suspicious transactions.”* However the GI Report was still recommending corrective action in January 2006.

#### Hold mail

4.28. A series of internal audits had identified failings in the hold mail system. In September 2000 there was a hold mail audit which identified areas for improvement; in May 2001 an internal audit of one of the desks in that part of the plc that became the Branch (and the desk at which the fraud took place) made three specific recommendations in respect of hold mail, the first of which was *“Remind to the London compliance officer to implement recommendations of the previous hold-mail audit.”* The recommendations were that a list of hold mail clients needed to be established, and that procedures need to be defined for ex-Paribas hold mail clients as, amongst other things *“there is no trail on a register that the clients received their mail at least once a year.”* All three recommendations were identified internally as high risk.

#### **Principle 3 Breach - Systems and Controls**

4.29. By reason of the facts and matters set out above the FSA considers that BNPP breached the requirements of Principle 3 to take reasonable care to establish effective systems and controls for countering the risk that it might be used to further financial crime, as required by SYSC 3.1.1R and SYSC 3.2.6R, namely:

- BNPP Private Bank's systems and controls relating to processing of large transactions were deficient in that they contained no requirement for an independent review before entering the approval process within Middle Office;
- the IT system in use allowed internal transfers to bypass the required

Middle Office checking procedures and on a number of occasions the Middle Office was so bypassed (see paragraph 4.15 above);

- further, the after-the-event review was a purely mechanical check and did not provide sufficient information to enable suspicious activity to be reviewed, assessed, and where appropriate, investigated (see paragraph 4.17 above);
- there were deficiencies in BNPP Private Bank's hold mail system in relation to procedures for ensuring that customers who did not collect hold mail regularly were contacted; and which
- was aggravated by the fact that during the relevant period a number of high level issues were raised in various internal reports and audits regarding aspects of the transaction approval process, namely concerns regarding the less onerous derogated signature approval procedures, lack of checks on internal transfers, and lack of a schedule for uncollected hold mail.

## **5. FACTORS RELEVANT TO DETERMINING THE ACTION**

### **Relevant Guidance on Sanction**

- 5.1. The FSA has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.
- 5.2. The FSA's policy on the imposition of financial penalties is set out in Chapter 13

of the Enforcement Manual (ENF 13) which forms part of the FSA Handbook. Section 13.3 of the Enforcement Manual sets out some of the factors that may be of particular relevance in determining the appropriate level of financial penalty. These have been taken into account by the FSA in determining the appropriate level of penalty in this case. Chapter 13 of the Enforcement Manual at paragraph 13.3.4 states that the criteria listed in the Manual are not exhaustive and all relevant circumstances of the case will be taken into consideration. In determining whether a financial penalty is appropriate and its level, the FSA is required therefore to consider all the relevant circumstances of the case.

- 5.3. The FSA has had regard to the seriousness of BNPP Private Bank's contraventions, including the nature of the requirements breached, the number and duration of the breaches and the fact that actual frauds occurred. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. Details of the breaches identified in this case are set out above. It is the responsibility of regulated firms to ensure that appropriate systems and controls are in place to control their business and ensure compliance with regulatory requirements.
- 5.4. Reducing the extent to which it is possible for a firm to be used for a purpose connected with financial crime is one of the FSA's four statutory objectives. The profile of fraud and client money risks has increased significantly in recent years. FSA has issued several publications drawing public attention to these risks since December 2003. There have also been numerous high profile articles in the national and trade press, FSA speeches and papers as well as guidance from government and industry organisations. The FSA considers it particularly serious that the firm failed to enhance its procedures to an adequate standard during this period of heightened FSA and industry awareness of fraud and client money risks.
- 5.5. The FSA has had regard to the size, financial resources and other circumstances of BNPP Private Bank, including the fact that BNPP Private Bank was small. However this is mitigated by the fact that it was part of a very large group with substantial resources.

- 5.6 The FSA has also had regard to the nature of the fraud which involved sophisticated forgeries of client instructions by a senior employee. The FSA acknowledges that it is not always possible for firms to prevent a committed fraudster, particularly if he is in a supervisory role within the firm. However the FSA's risk based approach requires firms to assess the risk of fraud and where necessary implement necessary systems and controls to mitigate the risk.
- 5.7 BNPP Private Bank's systems and controls have improved significantly over the period in question, both before the discovery of the fraud and afterwards. The section 166 skilled person's report in July 2006 concluded that there were no significant weaknesses in BNPP Private Bank's anti-fraud control environment at the time of their review between March and May 2006. The FSA has also taken into account the fact that there was no actual client loss and the relevant accounting entries on client accounts were corrected immediately by BNPP Private Bank, once discovered. The FSA recognises that the BNPP Private Bank itself was defrauded, and that BNPP Private Bank incurred a loss of £1.4 million as a result.
- 5.8 Throughout the FSA's investigation BNPP Private Bank has co-operated fully and worked with the FSA. BNPP Private Bank has also co-operated with the Police enquiry into the underlying fraud. BNPP Private Bank has also pursued civil remedies for the recovery of funds at its own expense.
- 5.9 The FSA has had regard to previous cases involving breaches of system and control requirements that threaten the FSA's financial crime objective. BNPP Private Bank has not been the subject of Enforcement action previously.

## **6. DECISION MAKER**

- 6.1. The decision which gave rise to the obligation to give this Final Notice was made by the Executive Settlement Decision Makers on behalf of the FSA.



## **7. IMPORTANT**

7.1. This Final Notice is given to BNPP Private Bank in accordance with section 390 of the Act. The following statutory rights are important.

### **Manner of and time for Payment**

7.2. The financial penalty must be paid in full by BNPP Private Bank to the FSA by no later than 24 May 2007, 14 days from the date of the Final Notice.

### **If the financial penalty is not paid**

7.3. If all or any of the financial penalty is outstanding on 25 May 2007, the FSA may recover the outstanding amount as a debt owed by BNPP Private Bank and due to the FSA.

### **Publicity**

7.4. 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 FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to BNPP Private Bank or prejudicial to the interests of consumers.

7.5. The FSA intends to publish this Final Notice and such information about the matter to which this Final Notice relates as it considers appropriate.

**FSA contacts**

7.6. For more information concerning this matter generally, you should contact Ken O'Donnell at the FSA (direct line: 020 7066 1374 /fax: 020 7066 1375).

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**Tom Spender**  
**Head of Department**  
**FSA Enforcement Division**