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## FINAL NOTICE

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To: Credit Suisse First Boston International  
(formerly Credit Suisse Financial Products)

Of: One Cabot Square  
London  
E14 4QJ

Date: 11 December 2002

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

### THE PENALTY

The FSA gave you a decision notice on 11 December 2002 which notified you that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty against you in the amount of £4,000,000.

You have agreed not to refer the matter to the Financial Services and Markets Tribunal under section 208 of the Act.

Accordingly, for the reasons set out below and having taken into account the settlement reached, the FSA imposes a financial penalty on you in the amount of £4,000,000 ("Penalty").

### REASONS FOR THE PENALTY

#### Summary

1. Between April 1995 and December 1998, Credit Suisse Financial Products (now known as Credit Suisse First Boston International) ("CSFP"/"the Company") engaged in conduct designed deliberately to mislead the Japanese regulatory and tax authorities as to the scope of the business being conducted by it, or on its behalf, in Japan and failed to organise and control its activities in Japan in a responsible manner. The FSA considers the Company's conduct to have been an extremely serious breach of the regulatory responsibilities under which it operated. CSFP admits to these matters and has agreed to pay a financial penalty of £4,000,000.

2. It is not part of the FSA's case that the Company was at any time conducting business in Japan for which it did not have regulatory authorisation.
3. In determining the action, the FSA has taken account of subsequent changes in CSFP's senior management, including the departure of relevant personnel. The Company's new senior management has implemented extensive organisational, personnel and structural changes in order to ensure that far higher standards of ethics and professionalism are maintained throughout the organisation. These changes have led to a much higher priority being given to regulatory compliance and have resulted in significant improvements in the Company's compliance culture generally. The FSA welcomes the commitment of CSFP's new senior management to maintaining a higher degree of openness and co-operation with its regulators.

### **Relevant Statutory Provisions**

4. The FSA is authorised by the Act to exercise the powers contained in section 206 of the Act, which includes the following terms:

***"206. Financial penalties***

*If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate".*

5. CSFP is currently an Authorised Person within the meaning of the Act.
6. When exercising its powers, the FSA seeks to act in a way it considers most appropriate for the purpose of meeting its regulatory objectives, which are set out in section 2(2) of the Act. The FSA considers that taking this action meets the regulatory objective of maintaining market confidence, that is, maintaining confidence in the financial system.
7. At all material times, CSFP was authorised by the Securities and Futures Authority ("SFA"), a self-regulating organisation. Article 8 of the Financial Services and Markets Act 2000 (Transitional Provisions and Savings)(Civil Remedies, Discipline, Criminal Offences etc.)(No.2) Order 2001 ("Pre-N2 Misconduct Order") authorises the FSA to exercise the powers contained in section 206 of the Act in respect of breaches of SFA's Rules which occurred before 1 December 2001.

### **Relevant rules**

8. SFA's Rules included the FSA's former Statements of Principle ("Former Principles"). Under Rule 7-23A(3) of SFA's Rules, an act of misconduct included a breach of SFA's Rules.
9. Where the SFA Enforcement Committee considered that an SFA-authorized firm (such as CSFP) had committed an act of misconduct, it could institute disciplinary proceedings and serve a Notice on the Firm setting out the acts of misconduct. The Notice was accompanied by details of such penalties, which could include a fine, as the SFA Enforcement Committee considered appropriate (Rules 7-24A(1) and 7-30(2) of SFA's Rules).

10. Former Principle 9 provided that:

***"Internal Organisation***

*A firm should organise and control its internal affairs in a responsible manner, keeping proper records, and where the firm employs staff or is responsible for the conduct of investment business by others, should have adequate arrangements to ensure that they are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures".*

11. In addition, Appendix 38 of SFA's Rules set out standards for compliance with regulatory requirements.

12. Former Principle 10 provided that:

***"Relations with Regulators***

*A firm should deal with its regulator in an open and co-operative manner and keep the regulator promptly informed of anything concerning the firm which might reasonably be expected to be disclosed to it".*

13. The FSA considers that, for the reasons set out herein, CSFP breached Former Principles 9 and 10 and has thereby committed an act of misconduct within the meaning of Rule 7-23A(3) of SFA's Rules.

**Relevant guidance**

14. In deciding to take this action, the FSA has had regard to the guidance set out in Chapter 1.3 of the FSA's Enforcement manual, which is part of the FSA's Handbook, and to SFA's policy on the taking of disciplinary action and the imposition, and amount, of penalties.
15. In particular, the principles underlying the FSA's approach to the exercise of its enforcement powers are set out in *ENF 1.3.1* of the FSA's Enforcement manual. The FSA considers this action to be a proportionate exercise of its enforcement powers and consistent with its publicly stated policies.
16. SFA Board Notice 497 ("BN497") dated 21 October 1998 (and effective 2 November 1998) sets out SFA's penalty policies and procedures relating to disciplinary action, the application of which is considered in detail in paragraphs 32 to 36 below. In light of that guidance, the FSA considers the conduct of CSFP described herein to be a very serious breach of Former Principles 9 and 10 and the action to be appropriate in all the circumstances.

**Facts and matters relied on**

17. At all material times, CSFP was a company within the Credit Suisse Group with its headquarters and senior management located in London and was regulated by SFA for the conduct of investment business. It dealt in a range of derivative products with a wholesale and institutional client base including counterparties based in Japan.

18. In 1990 the Company wished to establish a presence in Japan to facilitate the marketing of its products to Japanese clients. It was advised by its external Japanese lawyers and believed that:
- (1) financial institutions in Japan could be authorised to conduct either banking or securities business but would not be authorised to conduct both;
  - (2) CSFP was at that time unlikely to be granted a licence to open a Japanese branch for either banking or securities business;
  - (3) it would however be possible for it to be represented in Japan by a so-called 'Limited Agent' without it being required to have its own licence; and
  - (4) there were restrictions on the types of activity that could be performed on its behalf by a Limited Agent. However, the precise extent of these restrictions was unclear.
19. In or about July 1990, CSFP therefore appointed CS First Boston (Japan) Limited ("CSFB JL"), a company within the Credit Suisse Group which held a Japanese securities licence, as its Limited Agent in Japan. CSFP delegated to CSFB JL the authority to agree to transactions with Japanese counterparties on its behalf. Thereafter and until 15 April 1997, activities on behalf of CSFP were undertaken by a division within CSFB JL known as the Structured Products Group ("SPG"). Although it was part of CSFB JL, the SPG was widely regarded within both the Company and CSFB JL as CSFP's business unit in Japan and the Company had direct responsibility for much of its management.

*Preparation for 1996 regulatory inspection of CSFB JL*

20. In early 1995, CSFP was informed that CSFB JL was likely to be subject to a regulatory inspection by the Japanese Securities Exchange Surveillance Commission ("SESC"). By this time, following clarification of the regulatory position by the Japanese Ministry of Finance ("MoF"), the Company recognised that:
- (1) there was a risk that the SESC would regard certain of the activities being undertaken for the Company by the SPG as exceeding those permitted under the relevant Japanese regulations. In particular, CSFP was concerned that the SESC might regard some of the transactions agreed to by the SPG on the Company's behalf as banking business, which was outside the scope of CSFB JL's securities licence ; and
  - (2) in the event of such a finding, it was possible that CSFP might be required to move part of the business it conducted through the SPG away from CSFB JL, although it was not expected that any fine or similar penalty would be imposed. This would have been highly disruptive for CSFP from a business point of view.
21. In April 1995, in preparation for the anticipated SESC inspection and with the intention of ensuring that the nature and extent of the business being conducted on behalf of the Company would not be apparent to the SESC and with the Company's knowledge, members of the SPG's staff:

- (1) suggested the removal from the SPG's files of certain documents which contained evidence of SPG traders agreeing to transactions on behalf of CSFP and archiving documents off-site so that they would not be seen by the inspectors; and
  - (2) suggested that the SPG traders would inform the SESC inspectors, if questioned by them, that they only monitored CSFP's positions in Japan, whereas in fact they played an active role in arranging transactions for CSFP. In the event, the SESC inspection did not commence until April 1996 and the inspectors did not interview any of the SPG's traders.
22. In July 1995, also in anticipation of the SESC inspection, at the SPG's request and contrary to the Company's normal practice, CSFP made arrangements to ensure that copies of its monthly management accounts, weekly product control reports, market risk reports and trading revenue estimates would not be sent to SPG staff in Tokyo for the period during which the SESC inspectors were to be in CSFB JL's offices.

*Conduct of 1996/97 audit of CSFB JL by National Tax Administration Agency*

23. In September 1996, CSFP was informed that the Japanese National Tax Administration Agency ("NTA") proposed to conduct a tax audit of CSFB JL. CSFP recognised that the nature and extent of the business which had been conducted on its behalf by the SPG gave rise to a significant risk that the SPG would be deemed by the NTA to be a permanent establishment of CSFP in Japan. Were this to happen, the Company believed that it would be likely to be subject to retrospective assessment for Japanese tax on the profits generated by the SPG's activities.
24. Both prior to and during the course of the audit, in order to reduce the risk of the SPG being deemed a permanent establishment, CSFP employees and members of the SPG's staff acting on the Company's behalf took steps to conceal from the NTA the relationship between CSFP and the SPG and the nature and extent of the business being carried out by the SPG. These steps included:
- (1) arranging to provide the NTA with information which the Company knew to be misleading in relation to the SPG's activities and which incorrectly indicated that the SPG:
    - (a) acted on the Company's behalf in an administrative or liaison capacity only;
    - (b) had no power to agree to any transaction on behalf of any Credit Suisse Group company and that transactions for CSFP were undertaken by the SPG's traders only after consideration and approval by CSFP traders based in Hong Kong. In fact, the CSFP traders in Hong Kong merely signed the deal tickets relating to the SPG's transactions and they did not consider the transactions or review the tickets before doing so; and
    - (c) department heads did not report to CSFP managers in London;
  - (2) removing copies of daily transaction logs and P&L reports which had been attached to documents that were to be inspected by the NTA and removing other documents from CSFB JL's offices for all or part of the duration of the NTA inspection;

- (3) purchasing a shredder for the destruction of documents which it was intended should not be seen by the NTA inspectors (although there is no evidence that any documents were actually destroyed);
  - (4) arranging to provide the NTA with a version of the SPG's weekly transaction log which omitted details of transactions which would have indicated the nature and extent of the SPG's activities on the Company's behalf; and
  - (5) agreeing that the NTA incorrectly be informed that no record existed of the deals facilitated by the SPG on behalf of CSFP.
25. In the event, in July 1997 the NTA determined that the SPG was an agent of CSFP in Japan with authority to conclude contracts on its behalf. However, the NTA was unable to determine from the information provided to it by CSFP and the SPG what was the income attributable to the SPG for the purposes of assessing any liability on the Company's part to Japanese tax. As a result, no additional liability was imposed on the Company by the NTA at that time. In 2000, following the provision of additional information by CSFP, the Company paid tax in respect of the activities undertaken by the SPG on CSFP's behalf in 1996-1997.

*Activities of CSFP Tokyo Branch*

26. On 15 April 1997, following a change in licensing policy by the Japanese regulatory authorities and following approval by the MoF of its application for a banking licence, the Company opened Credit Suisse Financial Products Tokyo Branch ("CSFP TB / the Tokyo Branch"). At all material times thereafter, the Company's activities in Japan were undertaken by CSFP TB.
27. A significant element of the Company's business in Japan involved the sale to Japanese clients of structured notes, which the Company believed were probably characterised as securities under the relevant Japanese regulations. Prior to the Tokyo Branch opening, the Company was advised that:
- (1) under the terms of CSFP TB's banking licence it would not be permitted to conduct securities business in Japan; and
  - (2) as a result, whilst CSFP TB staff were free to discuss the overall economic effect of a transaction with a customer, they would be required to refer customers wishing to purchase structured notes to a company which held a Japanese securities licence (such as CSFB JL), which would take over the marketing of the notes and, where appropriate, complete the transaction.
28. In April 1997, Tokyo Branch marketing staff were instructed that:
- (1) although they could discuss structured notes with clients orally, they must not send written details of such notes to customers in CSFP TB's name;
  - (2) any written material relating to structured notes was to be faxed to customers by a nominated CSFB JL member of staff from a fax machine purchased by CSFP for this purpose but located in CSFB JL's office and registered in CSFB JL's name;

- (3) written material relating to structured notes should be prepared by CSFP TB but was to be sent in the name of CSFB JL and should not include reference to CSFP TB or the names of CSFP TB staff involved in the transaction;
  - (4) copies of documents relating to structured note transactions in which CSFP TB was involved should be kept separately and should be shredded after use.
29. As CSFP knew, material relating to structured note transactions was often faxed to customers by CSFP TB staff in the name of CSFB JL. CSFB JL had no active involvement in those transactions, the terms of which continued to be negotiated by CSFP TB staff after they became aware that the clients had made it clear that they wished to purchase structured notes.
30. To reduce the risk that its involvement in structured note transactions would become known to the regulatory authorities, the Company implemented a filing system under which documents relating to structured note transactions were stored separately from those relating to other transactions. In addition, in November 1997, the structured note related documents were moved to a storage room outside the CSFP TB dealing room, where it was believed they were unlikely to be, and intended that they would not be, discovered in the event of a regulatory inspection.
31. The procedures referred to in paragraphs 27 to 29 above remained in operation at all material times thereafter and were adopted in order to:
  - (1) give the impression that CSFP TB was not involved in the marketing or sale of structured notes to Japanese clients; and
  - (2) reduce the risk that CSFP TB's involvement in the marketing or sale of structured notes to Japanese clients would be discovered in the event of regulatory inspection.

#### *Compliance arrangements*

32. Between April 1997 and August 1998, there was no full-time resident compliance officer within the Tokyo Branch, despite the Company's extensive efforts to recruit one, and for much of that period there was no dedicated compliance presence at all. Instead, the Company relied for advice on compliance issues on both its internal and external lawyers and from compliance personnel based in London and, from April 1998, on a secondee from the Company's London compliance department. Between April 1997 and December 1998, the Company failed to ensure that:
  - (1) active compliance monitoring was conducted of CSFP TB's activities; and
  - (2) CSFP TB was in practice operating in accordance with advice the Company had received concerning the restrictions imposed by its banking licence.

#### **Application of relevant guidance**

##### *Disciplinary action*

33. In determining whether disciplinary action should be taken, BN497 indicates that SFA gave credit to a Firm which disclosed an issue to SFA. SFA disciplinary action was much less likely where a Firm with adequate controls discovered an issue in a timely

way and promptly informed SFA, giving the full facts together with a proposed course of remedial action. Discovery of issues by SFA, and issues revealing systemic weaknesses in a Firm, increased the likelihood that SFA would have taken disciplinary action.

34. The FSA considers that material parts of the conduct of CSFP described herein were discovered during the course of the investigation and not disclosed promptly to SFA in the manner envisaged by BN497.
35. The FSA is of the view that CSFP lacked adequate controls over its business in Japan. The FSA also considers that CSFP's conduct revealed systemic weaknesses within the Company at the material times in that it occurred in both Tokyo and London, involved a significant number of employees and took place over a number of years. On the other hand, the FSA acknowledges that CSFP has subsequently taken remedial action to improve significantly its compliance controls and culture.
36. Consequently, in light of the FSA's own regulatory objectives and SFA's policy in determining whether disciplinary action should be taken, the FSA considers that taking disciplinary action against CSFP is appropriate.

#### *Penalty*

37. BN497 also sets out the main factors which SFA took into account in arriving at a penalty. The relevant factors and the FSA's view in relation to their application in the present case are set out below:
  - (1) the gravity of the offence: the FSA considers CSFP's breaches of Former Principles 9 and 10 to be extremely serious;
  - (2) the seriousness of the offence in the context of CSFP's compliance record: the FSA is of the view that CSFP's past regulatory failings were considerably less serious than, and different in subject matter to, the conduct described herein and that they therefore do not have a significant bearing on the appropriate level of penalty;
  - (3) whether the offences indicate a lack of proper compliance procedures/systems of supervision within CSFP: the FSA considers that CSFP's conduct at the material times demonstrated a lack of proper compliance and supervision in relation to the Company's business in Japan;
  - (4) whether the offences were deliberate or committed through inadvertence: the FSA is of the view that the majority of CSFP's conduct was deliberate;
  - (5) the length of time during which the breaches occurred: the breaches occurred between April 1995 and December 1998;
  - (6) whether the offences indicate widespread wrongdoing throughout CSFP or are primarily actions of an individual: the FSA considers that the conduct complained of took place not only in Tokyo but also in London and involved a significant number of employees. The FSA is firmly of the view that this conduct did not arise primarily from the actions of one individual;



- (7) whether CSFP drew the offences to SFA's attention: as mentioned above, the FSA is of the view that material parts of the conduct of CSFP described herein, which breached Former Principles 9 and 10, and the extent of those breaches, were discovered by SFA (and the FSA) during the course of the investigation;
- (8) the extent to which CSFP derived benefit or stood to benefit from its misconduct: the FSA considers that CSFP stood to benefit from its actions because they were intended to avoid the risk that it would be required to move part of the business it conducted through the SPG away from CSFB JL or would be exposed to a significant liability to Japanese tax;
- (9) SFA penalties imposed or agreed in similar cases: in view of the nature of the conduct, its deliberate commission and the period of time over which it took place, the FSA considers that there are no similar SFA cases or relevant precedents;
- (10) CSFP's means, including its size and the size of any group of which it is part: CSFP is part of a multinational organisation with substantial means.

## **Conclusion**

38. The FSA is of the view that the facts and matters set out above demonstrate that between April 1995 and December 1998 CSFP engaged in conduct designed deliberately to mislead the Japanese regulatory and tax authorities as to the scope of the business being conducted by it, or on its behalf, in Japan and failed to organise and control its activities in Japan in a responsible manner. CSFP has admitted those facts and matters and agrees to settlement on that basis. In the circumstances, the FSA considers it appropriate to impose a financial penalty of £4,000,000.

## **MANNER OF PAYMENT**

The Penalty must be paid to the FSA in full.

## **TIME FOR PAYMENT**

The Penalty must be paid to the FSA no later than 31 December 2002, being not less than 14 days beginning with the date on which this notice is given to you.

## **IF PENALTY NOT PAID**

If all or any of the Penalty is outstanding on 1 January 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

## **IMPORTANT**

The Final Notice given to you in accordance with section 390 of the Act.

## **Publicity**

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notices relates. Under those provisions, the FSA must publish such information about the matter to which this notices 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 you or prejudicial to the interests of consumers.

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

**FSA Contacts**

For more information concerning this matter generally, you should contact Ian Brown (direct line 020 7676 1366/fax: 020 7676 1367) or Pam Cross (direct line: 020 7676 1216/fax: 020 7676 1217) of the FSA.

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Martyn Hopper  
Head of Market Integrity  
FSA Enforcement Division