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**FINAL NOTICE**

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**To: David Pascall Andrew McGrath**

**Of: 132 Livingstone Road  
Gravesend  
Kent  
DA12 5DY**

**IRN: DPM01141**

**Date: 9 May 2011**

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (the “FSA”) gives David Pascall Andrew McGrath final notice about the imposition of a financial penalty and prohibition from performing the compliance oversight controlled function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm**

**1. THE ACTION**

1.1. The FSA gave David Pascall Andrew McGrath (“Mr McGrath”) a Decision Notice on 9 May 2011 which notified Mr McGrath that the FSA had decided to:

- (1) impose a financial penalty of £3,000, pursuant to section 66 of the Financial Services and Markets Act 2000 (the “Act”), for failing to comply with Statement of Principle 7 of the Statements of Principle for Approved Persons; and
- (2) make an order, pursuant to section 56 of the Act, prohibiting him from performing the compliance oversight controlled function (CF10) in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm (the “Prohibition Order”).

1.2. Mr McGrath confirmed on 19 April 2011 that he would not be referring the matter to the Upper Tribunal (Tax and Chancery Chamber). Accordingly, for the reasons set

out below, the FSA imposes a financial penalty of £3,000 and the Prohibition Order. The Prohibition Order takes effect from 9 May 2011.

- 1.3. Mr McGrath agreed to settle at an early stage of the FSA's investigation and qualified for a 30% (Stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £20,000.
- 1.4. However, Mr McGrath has provided verifiable evidence that imposing such a financial penalty would cause him serious financial hardship. Under these exceptional circumstances, the FSA has reduced the financial penalty to £3,000.

## **2. REASONS FOR THE ACTION**

2.1. On the basis of the facts and matters described below, the FSA considers that Mr McGrath's conduct, as a person approved to perform the compliance oversight controlled function (CF10) with specific responsibility for client money at ActivTrades Plc ("ActivTrades") during the period between 14 April 2009 and 30 April 2010 (the "relevant period"), failed to comply with Statement of Principle 7.

2.2. Mr McGrath failed to take reasonable steps to ensure that ActivTrades complied with the relevant requirements and standards of the regulatory system. Specifically, he failed to:

- (1) ensure that ActivTrades accounted and treated client money properly in accordance with the FSA Rules set out in the Client Assets sourcebook (the "CASS Rules"). In particular, he failed to ensure that ActivTrades segregated client money appropriately, performed client money calculations and reconciliations correctly and made clear the circumstances in which it would retain interest received on client money or cease to treat this money as client money;
- (2) implement adequate risk management systems at ActivTrades to ensure the protection of client money. In particular, he failed to put in place adequate policies and procedures relating to client money processes or provide ActivTrades' Board with regular management information to monitor and assess the adequacy of ActivTrades' client money arrangements; and
- (3) demonstrate an appropriate knowledge of the CASS Rules to perform his compliance oversight controlled function adequately.

2.3. The FSA views Mr McGrath's failings as serious because:

- (1) the FSA places great importance on the responsibilities of compliance officers as they are responsible for ensuring that the businesses that they oversee comply with regulatory requirements and standards;
- (2) deficiencies were found throughout ActivTrades' client money processes, indicating that its client money regime was fundamentally flawed;
- (3) the failings placed some client money at risk (although none of ActivTrades' clients suffered any losses as a result);

- (4) ActivTrades' client money deficiencies were not identified through his own compliance monitoring but by third parties;
  - (5) Mr McGrath did not take reasonable steps to monitor ActivTrades' client money processes to ensure that they complied with regulatory obligations;
  - (6) whilst Mr McGrath relied on an external consultant for guidance with regard to client money matters, he did not consider the adequacy of this advice or whether it was reasonable for him to rely on it; and
  - (7) his conduct fell far below the standard which would have been reasonable in all the circumstances.
- 2.4. The FSA has taken into account the following factors which have served to mitigate the seriousness of Mr McGrath's failings:
- (1) the FSA does not consider that he deliberately caused ActivTrades to breach regulatory requirements and standards during the relevant period;
  - (2) he accepted at an early stage that he had not discharged his responsibility for client money to an adequate standard; and
  - (3) he has co-operated fully with the FSA's investigation.
- 2.5. The FSA has concluded that the nature of the breaches outlined above warrants a financial penalty. The FSA therefore imposes a financial penalty of £3,000 on Mr McGrath.
- 2.6. In addition, the FSA has concluded that, as a result of the seriousness, nature and extent of Mr McGrath's misconduct, he fails to meet the minimum regulatory standards required in terms of competence and capability, and is not fit and proper to perform the compliance oversight controlled function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm. Accordingly the FSA makes the Prohibition Order against Mr McGrath.
- 2.7. This action supports the FSA's regulatory objective of the protection of consumers.

### **3. STATUTORY PROVISIONS, REGULATORY GUIDANCE AND POLICY**

- 3.1. The relevant statutory provisions, regulatory guidance and policy are set out in the Annex to this Final Notice.

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

#### **Background**

- 4.1. Mr McGrath was approved by the FSA from 23 October 2008 until 30 April 2010 to perform the compliance oversight (CF10) and money laundering reporting (CF11) controlled functions at ActivTrades.
- 4.2. ActivTrades is a broker specialising in foreign exchange, contracts for difference and futures, which operates in London. ActivTrades has been authorised and regulated by

the FSA since 27 October 2005 and is permitted to hold client money. In the course of its business, ActivTrades received money on behalf of its clients for the provision of its brokerage services. The money ActivTrades received on behalf of its clients was “client money” and was subject to the relevant requirement and standards set out in the CASS Rules.

### **Client assets and money thematic project**

- 4.3. The FSA has been conducting a thematic project into the management of client assets and money held by firms. The project’s aim was to assess whether client assets and money held by firms are safe and would be returned within a reasonable time in the event a firm became insolvent. It also aimed to make firms take seriously their responsibilities with regards to client assets and money and have appropriate controls in place to mitigate any risks.
- 4.4. In March 2009, the FSA issued a “Dear Compliance Officer” letter notifying firms to make adequate arrangements to protect client money and assets. The letter highlighted issues for firms to consider and warned firms of visits in 2009.
- 4.5. In January 2010, the FSA issued a “Dear Chief Executive Officer” letter and published a “Client Money and Asset Report” notifying firms of failings identified during work conducted by the FSA in 2009. The letter warned firms that visits would continue throughout 2010.
- 4.6. Following these letters, the FSA visited ActivTrades in June 2010 to review its client money arrangements. The FSA identified a number of weaknesses with ActivTrades’ client money processes and was concerned that it did not have in place adequate risk management systems to protect client money.
- 4.7. In September 2010, the FSA issued ActivTrades with a skilled person requirement notice pursuant to section 166 of the Act. The requirement notice required ActivTrades to engage a skilled person to review its client money arrangements in light of the concerns identified during the FSA’s visit. The skilled person produced his report in November 2010 (the “skilled person report”), which detailed a number of deficiencies with ActivTrades’ client money processes during the relevant period while Mr McGrath was acting as its compliance officer with specific responsibility for client money.
- 4.8. As ActivTrades’ compliance officer, Mr McGrath was responsible for ensuring its compliance with regulatory requirements and standards. However, the FSA found that he failed to ensure ActivTrades’ proper accounting and treatment of client money, failed to implement adequate risk management systems over ActivTrades’ business, and failed to demonstrate an appropriate knowledge of the CASS Rules.

### **Failing to ensure proper accounting and treatment of client money**

- 4.9. During the relevant period, Mr McGrath failed to ensure that ActivTrades conducted adequate due diligence in respect of the institutions with which it deposited client money, segregated client money appropriately, performed client money calculations and reconciliations correctly and made clear the circumstances in which it would

retain interest received on client money or cease to treat this money as client money in accordance with the CASS Rules.

### ***Due Diligence***

- 4.10. Mr McGrath failed to take reasonable steps in selecting, appointing and reviewing the institutions where ActivTrades deposited client money. Although ActivTrades held client money at well recognised financial institutions, he relied solely on the credit rating of the institutions that ActivTrades used, and information reported by the media. He did not consider factors such as the need to diversify risks, the financial and legal standing of the institution and the market practices of the institution connected to its investment and loan activities.
- 4.11. In addition, he did not demonstrate the appropriateness of the institution selected by making sufficient records of the due diligence undertaken, the factors considered and the rationale for choosing the institution. In particular, the skilled person report highlighted that ActivTrades did not appear to have performed any due diligence on one institution with which it placed client money relating to its futures business.
- 4.12. Consequently, by failing to ensure that ActivTrades conducted adequate due diligence and maintained sufficient records documenting its rationale for selecting particular institutions, ActivTrades could not demonstrate the suitability of the institutions that it deposited client money with.

### ***Co-mingling of client and corporate money***

- 4.13. Mr McGrath did not take the necessary steps to ensure that ActivTrades held client money in accounts that could be identified separately from any accounts that it used to hold its own funds. In particular, the skilled person report highlighted that on several dates between October 2009 and February 2010, client money received in respect of ActivTrades' futures business was co-mingled in an account used to hold its own funds.
- 4.14. Consequently, by failing to ensure that ActivTrades segregated client money appropriately, these funds were at risk of being combined with ActivTrades' own funds in the event that it became insolvent. In these circumstances, client money would not have been ring-fenced but would have been pooled with ActivTrades' money with the effect that clients would have been classed as general creditors in ActivTrades' insolvency process rather than having the right to claim from a pool of protected client money. The likelihood of such clients recovering their money in the event of ActivTrades' insolvency would have been reduced.

### ***Calculating client money***

- 4.15. Mr McGrath failed to ensure that ActivTrades performed client money calculations and reconciliations correctly or in a timely manner.

### **Internal and external reconciliations**

- 4.16. Mr McGrath did not ensure that ActivTrades performed its client money reconciliations and transfers on a daily basis. The FSA considers ActivTrades'

approach during the relevant period of reconciling client money on a monthly basis to be insufficient given the nature, volume and complexity of its business. To maintain accurate records, the FSA would have expected ActivTrades to undertake daily reconciliations because ActivTrades was undertaking daily transactions.

- 4.17. The skilled person report also highlighted that during the relevant period, ActivTrades' client money calculations were performed at various times during the day, rather than at midnight on the previous working day, which was when the reconciliations were done.
- 4.18. Further, Mr McGrath did not ensure that ActivTrades conducted adequate reconciliations of its internal accounts and records against those of third parties who held client money. During the relevant period, ActivTrades' trading system did not show a bank account level breakdown of client money balances so reconciliations were conducted against client transactions recorded in its client cashbook. ActivTrades' external reconciliations were aimed at calculating the amount that needed to be adjusted on the trading system to bring it in line with balances recorded on client bank statements. The skilled person report highlighted that such reconciliations and adjustments were performed incorrectly. The skilled person report also noted that due to incorrect adjustments being made, the opening cashbook and bank statements did not agree.
- 4.19. Consequently, by failing to ensure that ActivTrades performed correct and timely reconciliations, its records and accounts were neither accurate nor up-to-date and could not distinguish at any time and without delay client money held for one client from money held for any other client and from its own funds.

#### Incorrect client money calculations

- 4.20. Mr McGrath did not ensure that ActivTrades performed its client money calculations correctly. This failure led to an under segregation of client money and potentially placed client money at risk. The skilled person highlighted the following failings with ActivTrades' client money calculations during the relevant period:
  - (1) bank charges were added to client money calculations (during the relevant period up until August 2009);
  - (2) client cash balances rather than equity balances were used to calculate client money (during the relevant period up until January 2010);
  - (3) client money that had been received but not allocated to specific clients was excluded from client money calculations;
  - (4) negative balances were included in client money calculations (although the total of these balances was not material when compared to the amount of client money held); and
  - (5) client money that had been received in connection with its futures business was excluded from client money calculations.

- 4.21. Consequently, by failing to ensure that ActivTrades calculated its client money correctly, its accounts and records did not correspond to client money held for clients and ActivTrades would not have been able to perform an accurate top up or transfer of client money excesses or shortfalls from its client bank accounts. In addition, including negative balances in the client money calculation effectively meant that money belonging to one client was being used to pay the debts of another client.

***Paying interest received on client money***

- 4.22. Mr McGrath did not ensure that ActivTrades paid interest received on client money to clients. ActivTrades did not explicitly state in its client agreement, as in force during the relevant period, that interest would not be paid unless clients held a pre-agreed balance. In any event, ActivTrades did not obtain permission from each client to retain interest paid on money held in client banks accounts.
- 4.23. The skilled person report highlighted that, except for one client, ActivTrades did not pay interest received on client money to clients, contrary to the terms of its client agreement. The skilled person report calculated that ActivTrades owed interest of £50 or more, totalling £16,553.11, to 141 clients, and interest of less than £50, totalling £26,177.21, to 8,308 clients.
- 4.24. Consequently, by failing to ensure that ActivTrades paid interest received on client money, ActivTrades effectively benefitted in its capacity as trustee.

***Treatment of unclaimed client money***

- 4.25. Mr McGrath did not ensure that ActivTrades' client agreement reflected CASS Rules in respect of the treatment of unclaimed client money. Under CASS Rules, firms are permitted to cease treating as client money any unclaimed client money if they can demonstrate that they have taken reasonable steps to trace the client concerned and return the balance. The FSA considers reasonable steps to include entering into a written agreement in which the client consents to the firm ceasing to treat any client money balances held for that client from client bank accounts after a specified period of time, and taking action to contact the client in question if there has been no movement on the client's balance for a period of time.
- 4.26. ActivTrades' client agreement, as in force during the relevant period, stated that client money would cease to be treated as client money if there was no movement on the balance after six years without any further evidence or steps being required.
- 4.27. Consequently, ActivTrades would not have been able to demonstrate that it had taken all reasonable steps to trace and return the balance to the client concerned before ceasing to treat such funds as client money.

### **Failing to implement adequate risk management systems**

- 4.28. Mr McGrath failed to establish adequate systems and controls at ActivTrades for ensuring the protection of client money. In particular, he failed to put in place adequate client money policies and procedures or provide ActivTrades' Board with sufficient information to monitor and assess ActivTrades' client money arrangements.

#### ***Client money procedures***

- 4.29. Mr McGrath did not put in place any specific procedures relating to the review, sign off and retention of records that supported client money calculations. In addition, he did not himself check any client money calculations or reconciliations.
- 4.30. The skilled person report highlighted that not checking client money calculations increased the risk that incorrect amounts could be transferred. It also stated that in the event that an error was identified during subsequent checks, it would be too late to correct the error.
- 4.31. Consequently, by failing to ensure that client money calculations and reconciliations were reviewed, ActivTrades was not in a position to identify errors in the computation of its client money requirement and resources. This placed client money at risk of loss in the event of insolvency.

#### ***Management information***

- 4.32. Mr McGrath did not provide ActivTrades' Board with sufficient information to monitor and assess the adequacy of ActivTrades' client money systems and controls. He did not produce any client money reports or report any client money issues to the Board on a regular basis. This was supported by the findings of the skilled person report which highlighted that Board minutes did not contain any points relating to client money.
- 4.33. Consequently, by failing to provide the Board with adequate client money information, it was not in a position to monitor and assess ActivTrades' client money arrangements.

### **Failing to demonstrate appropriate knowledge of CASS Rules**

- 4.34. As the compliance officer at ActivTrades, Mr McGrath was responsible for ensuring that its business complied with regulatory requirements and standards. However, the FSA found that he failed to take reasonable steps to ensure that ActivTrades complied with the CASS Rules, notwithstanding the fact that he had specific responsibility for client money.
- 4.35. Mr McGrath stated at an interview with the FSA that he had worked previously in the compliance department of another firm but that his duties had not encompassed handling client money matters. He also stated that before joining ActivTrades he had never worked as a compliance officer and that he did not have any formal compliance qualifications.



- 4.36. In relation to the handling of client money, he was aware that client money had to be segregated from ActivTrades' own funds, that trust letters had to be in place with the institutions at which ActivTrades deposited client money and that client money calculations and reconciliations had to be performed. He considered that his responsibilities consisted of ensuring that the relevant steps for protecting client money had been carried out but he could not and did not check whether these steps had been performed correctly since he was unaware of the specific requirements under the CASS Rules.
- 4.37. Instead, he relied on the services of an external consultant for guidance and support and to ensure that ActivTrades met its client money obligations. However, he did not consider the adequacy of his advice and whether it was reasonable for him to rely on it. He stated that he trusted the external consultant to provide reliable advice.
- 4.38. Despite Mr McGrath's lack of expertise, he did not take adequate steps to improve his regulatory knowledge in respect of client money issues in order to monitor the affairs of the business and to engage effectively with the external consultant.
- 4.39. The FSA takes the view that he could and should have identified some of the issues observed himself, independent of any guidance or support provided by the external consultant, but he did not do so. For example, he could have referred to the CASS Rules for information on the required client money processes and procedures. He was obliged and responsible in his role as the person approved to perform the compliance oversight function at ActivTrades, to keep informed of regulatory requirements so that he could implement appropriate systems and controls at ActivTrades but he failed to discharge that obligation.
- 4.40. By failing to take adequate steps to equip himself with the basic knowledge to assess effectively the advice given by the external consultant and to monitor the affairs of the business, he was not in a position to identify and control risks. Consequently, he failed to realise that ActivTrades breached the CASS Rules during the relevant period.

## **5. ANALYSIS OF THE MISCONDUCT**

- 5.1. Having regard to its regulatory objectives which include the protection of consumers, the FSA has concluded that Mr McGrath, as a person approved to perform the compliance oversight controlled function at ActivTrades, failed to:
- (1) ensure that ActivTrades was in a position to protect client money adequately. ActivTrades' approach to the accounting and treatment of client money meant that client money was not adequately segregated from its own funds, and exposed clients to the risk of loss in the event it became insolvent;
  - (2) take reasonable care to organise and control ActivTrades' affairs responsibly and effectively with adequate risk management systems. The effect of this failing meant that ActivTrades' Board was not in a position to monitor and assess the adequacy of ActivTrades' client money arrangements; and

- (3) to take reasonable steps to check whether ActivTrades complied with the CASS Rules. Consequently, he was not in a position to identify shortcomings relating to ActivTrades' client money processes during the relevant period.
- 5.2. The FSA therefore considers that Mr McGrath failed to comply with Statement of Principle 7, and that having regard to the facts and matters referred to at paragraphs 4.1 to 4.40, the FSA considers it appropriate and proportionate in all the circumstances to take disciplinary action against him for the breaches.

## **6. ANALYSIS OF THE SANCTIONS**

### **Imposition of financial penalty**

- 6.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP"), which forms part of the FSA Handbook. The relevant sections of DEPP are set out in more detail in the Annex.
- 6.2. Since the majority of Mr McGrath's failings started and occurred before the change in the regulatory provisions governing the determination of financial penalties on 6 March 2010, the FSA has applied the penalty regime that was in place before 6 March 2010. All references to DEPP in this section are references to the version that was in force prior to 6 March 2010.
- 6.3. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour. A financial penalty is a tool that the FSA may employ to help it achieve its regulatory objectives.
- 6.4. In determining whether a financial penalty is appropriate the FSA is required to consider all the relevant circumstances of a case. Applying the criteria set out in DEPP 6.2.1G (regarding whether or not to take action for a financial penalty or public censure) and 6.4.2G (regarding whether to impose a financial penalty or a public censure), the FSA considers that a financial penalty is an appropriate sanction, given the serious nature of the breaches.
- 6.5. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty. The FSA considers that the following factors are particularly relevant in this case.

#### *Deterrence (DEPP 6.5.2G(1))*

- 6.6. In determining whether to impose a financial penalty, the FSA has had regard to the need to ensure those who are approved persons exercising the compliance function act with appropriate levels of competence and capability and in accordance with regulatory requirements and standards. The FSA considers that a financial penalty should be imposed to demonstrate to Mr McGrath and others the seriousness with which the FSA regards such behaviour.

*The nature, seriousness and impact of the breach in question (DEPP 6.5.2G(2))*

- 6.7. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached and the duration of the breach.
- 6.8. The FSA has concluded that Mr McGrath exercised inadequate compliance oversight and control over the conduct of ActivTrades' business, which resulted in ActivTrades failing to comply with the CASS Rules during the relevant period. ActivTrades' breaches were not identified through his own compliance monitoring but by third parties and exposed some clients to a risk of financial loss in the event of its insolvency.

*The extent to which the breach was deliberate or reckless (DEPP 6.5.2G(3))*

- 6.9. The breaches were neither deliberate nor reckless.

*Whether the person on whom the penalty is to be imposed is an individual (DEPP 6.5.2G(4))*

- 6.10. The FSA recognises that the financial penalty imposed on Mr McGrath is likely to have a significant impact on him as an individual but it is considered to be proportionate in relation to the seriousness of the misconduct and given his former position as an approved person performing the compliance oversight controlled function at ActivTrades.

*The size, financial resources and other circumstances of the person on whom the penalty is to be imposed (DEPP 6.5.2G(5))*

- 6.11. The FSA considers that a financial penalty of the level proposed is appropriate, having taken account of all relevant factors, including the impact such a penalty might have on Mr McGrath's financial resources.

*Conduct following the breach (DEPP 6.5.2G(8))*

- 6.12. Mr McGrath has co-operated fully with the FSA's investigation and worked with the FSA to facilitate an early settlement of the matter. From the outset, he acknowledged his failure to ensure that ActivTrades complied with the CASS Rules.

*Other action taken by the FSA (DEPP 6.5.2(10))*

- 6.13. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other approved persons for similar behaviour. This was considered alongside the deterrent purpose for which the FSA imposes sanctions.

**Prohibition**

- 6.14. The FSA has had regard to the guidance in Chapter 9 of the Enforcement Guide ("EG") in imposing the Prohibition Order on Mr McGrath.

- 6.15. Given the nature and seriousness of the failures outlined above, the FSA has concluded that Mr McGrath's conduct demonstrated a lack of competence and capability and he is therefore not fit and proper to perform the compliance oversight controlled function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm.
- 6.16. It is therefore necessary and proportionate, in order for it to achieve its regulatory objectives, for the FSA to exercise its powers to make the Prohibition Order against Mr McGrath.

### **Conclusions**

- 6.17. On the basis of the facts and matters described above, the FSA concludes that Mr McGrath's conduct fell short of the minimum regulatory standards required of an approved person and that he has breached Statement of Principle 7.
- 6.18. The FSA, having regard to all the circumstances, therefore considers that it is appropriate and proportionate to impose a financial penalty of £3,000 and the Prohibition Order on Mr McGrath.

## **7. DECISION MAKERS**

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

## **8. IMPORTANT**

- 8.1. This Final Notice is given to Mr McGrath under section 390 of the Act.

### **Manner of and time of payment**

- 8.2. The financial penalty must be paid in full by Mr McGrath to the FSA by no later than 23 May 2011, 14 days from the date of the Final Notice.

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

- 8.3. If all or any part of the financial penalty is outstanding on 23 May 2011, the FSA may recover the outstanding amount as a debt owed by Mr McGrath and due to the FSA.

### **Publicity**

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

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

**FSA contact**

- 8.6. For more information concerning this matter generally Mr McGrath should contact Anna Hynes (direct line: 020 7066 9464 / fax: 020 7066 9465), Enforcement and Financial Crime Division at the FSA.

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**Tom Spender**  
**Head of Department**  
**FSA Enforcement and Financial Crime Division**

**STATUTORY PROVISIONS, REGULATORY GUIDANCE AND POLICY****1. STAUTORY PROVISIONS**

- 1.1. The FSA's statutory objectives are set out in section 2(2) of the Act and include the protection of consumers.
- 1.2. Section 56 of the Act states that the FSA may make a prohibition order if it appears to the FSA that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person. Such an order may relate to a specific regulated activity, an activity falling within a specified description or all regulated activities.
- 1.3. Section 66 of the Act states that the FSA may take action to impose a penalty on an individual of such amount as it considers appropriate where it appears to the FSA that the individual is guilty of misconduct and it is satisfied that it is appropriate in all the circumstances to take action. Misconduct includes failure, while an approved person, to comply with a statement of principle issued under section 64 of the Act or to have been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under the Act.

**2. REGULATORY PROVISIONS**

- 2.1. In exercising its power to impose a financial penalty, the FSA has had regard to the relevant regulatory provisions and policy published in the FSA Handbook. The main provisions that the FSA considers relevant to this case are set out below.

**Statements of Principle and the Code of Practice for Approved Persons ("APER")**

- 2.2. APER sets out the Statements of Principle as they relate to approved persons and descriptions of conduct which, in the opinion of the FSA, do not comply with a Statement of Principle. It further describes factors which, in the opinion of the FSA, are to be taken into account in determining whether or not an approved person's conduct complies with a Statement of Principle.
- 2.3. APER 3.1.3G provides that when establishing compliance with or a breach of a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour to be expected in that function.
- 2.4. APER 3.1.4G provides that an approved person will only be in breach of a Statement of Principle where he is personally culpable, that is in a situation where his conduct was deliberate or where his standard of conduct was below that which would be reasonable in all the circumstances.

- 2.5. APER 3.1.6G provides that APER (and in particular the specific examples of behaviour which may be in breach of a generic description of conduct in the code) is not exhaustive of the kind of conduct that may contravene the Statements of Principle.
- 2.6. Statement of Principle 7 which provides that an approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.
- 2.7. APER 3.3.1E provides that in determining whether or not the conduct of an approved person performing a significant influence function complies with Statements of Principle 5 to 7, the following are factors which, in the opinion of the FSA, are to be taken into account:
- (1) whether he exercised reasonable care when considering the information available to him;
  - (2) whether he reached a reasonable conclusion which he acted on;
  - (3) the nature, scale and complexity of the firm's business;
  - (4) his role and responsibility as an approved person performing a significant influence function; and
  - (5) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.
- 2.8. APER 4.7 lists types of conduct which, in the opinion of the FSA, do not comply with Statement of Principle 7.
- 2.9. APER 4.7.3E provides that failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the regulatory system in respect of its regulated activities is conduct that does not comply with Statement of Principle 7.
- 2.10. APER 4.7.4E provides that failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulated system in respect of its regulated activities is conduct that does not comply with Statement of Principle 7.

### **Fit and Proper Test for Approved Persons (“FIT”)**

- 2.11. The FSA has issued specific guidance on the fitness and propriety of individuals in FIT. The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function and FIT is also relevant in assessing the continuing fitness and propriety of approved persons.

- 2.12. FIT 1.3.1G provides that the FSA will have regard to a number of factors when assessing a person's fitness and propriety. One of the most important considerations will be a person's competence and capability.
- 2.13. FIT 1.3.3G provides that it would be impossible to produce a definitive list of all the matters which would be relevant to a determination of a particular person's fitness and propriety.
- 2.14. FIT 1.3.4G provides that if a matter comes to the FSA's attention which suggests that the person might not be fit and proper, the FSA will take into account how relevant and how important it is.
- 2.15. FIT 2.2.1G(2) provides that in determining a person's competence and capability, the FSA will have regard to all relevant matters including, but not limited to, whether the person has demonstrated by experience and training that the person is suitable to perform the controlled function.

### **3. Decision Procedure and Penalties Manual ("DEPP")**

- 3.1. The FSA's policy in relation to the imposition and amount of penalties that applied during the majority of the relevant period was set out in Chapter 6 of DEPP that was in force prior to 6 March 2010.
- 3.2. DEPP 6.1.2G provides that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour. Financial penalties are therefore tools that the FSA may employ to help it to achieve its regulatory objectives.
- 3.3. DEPP 6.5.1G(1) provides that the FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned.
- 3.4. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act. The following factors are relevant to this case:

*Deterrence: DEPP 6.5.2G(1)*

- 3.5. When determining the appropriate level of financial penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.



*The nature, seriousness and impact of the breach in question: DEPP 6.5.2G(2)*

- 3.6. The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached, which can include considerations such as the duration and frequency of the breach, whether the breach revealed serious or systemic weaknesses in the person's procedures or of the management systems or internal controls relating to all or part of a person's business and the loss or risk of loss caused to consumers, investors or other market users.

*The extent to which the breach was deliberate or reckless: DEPP 6.5.2G(3)*

- 3.7. The FSA will regard as more serious a breach which is deliberately or recklessly committed, giving consideration to factors such as whether the person has given no apparent consideration to the consequences of the behaviour that constitutes the breach. If the FSA decides that the breach was deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case.

*Whether the person on whom the penalty is to be imposed is an individual: DEPP 6.5.2G(4)*

- 3.8. When determining the amount of penalty to be imposed on an individual, the FSA will take into account that individuals will not always have the resources of a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than on a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individual are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level.

*The size, financial resources and other circumstances of the person on whom the penalty is to be imposed: DEPP 6.5.2G(5)*

- 3.9. The purpose of a penalty is not to render a person insolvent or to threaten a person's solvency. Where this would be a material consideration, the FSA will consider, having regard to all other factors, whether a lower penalty would be appropriate.

*The amount of benefit gained or loss avoided: DEPP 6.5.2G(6)*

- 3.10. The FSA may have regard to the amount of benefit gained or loss avoided as the result of the breach, for example the FSA will impose a penalty that is consistent with the principle that a person should not benefit from the breach, and the penalty should also act as an incentive to the person (and others) to comply with regulatory standards and required standards of market conduct.

*Conduct following the breach: DEPP 6.5.2G(8)*

- 3.11. The FSA may take into account the degree of co-operation the person showed during the investigation of the breach by the FSA.

*Other action taken by the FSA (or a previous regulator): DEPP 6.5.2G(10)*

- 3.12. The FSA seeks to apply a consistent approach to determining the appropriate level of penalty. The FSA may take into account previous decisions made in relation to similar misconduct.

### **Enforcement Guide (“EG”)**

- 3.13. The FSA’s approach to exercising its power to make a prohibition order under section 56 of the Act is set out in Chapter 9 of EG.
- 3.14. EG 9.1 provides that the FSA’s power under section 56 of the Act to prohibit individuals who are not fit and proper from carrying out controlled functions in relation to regulated activities helps the FSA to work towards achieving its regulatory objectives. The FSA may exercise this power to make a prohibition order where it considers that, to achieve any of those objectives, it is appropriate either to prevent an individual from performing any functions in relation to regulated activities, or to restrict the functions which he may perform.
- 3.15. EG 9.4 sets out the general scope of the FSA’s power in this respect. The FSA has the power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual’s lack of fitness and propriety is relevant.
- 3.16. EG 9.5 provides that the scope of the prohibition order will depend on the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk which he poses to consumers or the market generally.
- 3.17. EG 9.9 provides that when deciding whether to make a prohibition order against an approved person, the FSA will consider all the relevant circumstances of the case. These may include, but are not limited to, the following:
- (1) whether the individual is fit and proper to perform the functions in relation to regulated activities. The criteria for assessing the fitness and propriety of approved persons are set out in FIT 2.1 (honesty, integrity and reputation), FIT 2.2 (competence and capability) and FIT 2.3 (financial soundness) (EG 9.9(2));
  - (2) whether, and to what extent, the approved person has failed to comply with the Statements of Principle issued by the FSA with respect to the conduct of approved persons, or been knowingly involved in a contravention by the relevant firm of a requirement imposed on the firm by or under the Act (including the Principles and other rules (EG 9.9(3)(a) and (b)));
  - (3) the relevance and materiality of any matters indicating unfitness (EG 9.9(5));
  - (4) the length of time since the occurrence of any matters indicating unfitness (EG 9.9(6));

- (5) the particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates (EG 9.9(7)); and
  - (6) the severity of the risk which the individual poses to consumers and to confidence in the financial system (EG 9.9(8)).
- 3.18. EG 9.12 provides a number of examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order. The examples include:
- (1) serious lack of competence (EG 9.12(4)); and
  - (2) serious breaches of the Statements of Principle for approved persons (EG 9.12(5)).
- 3.19. Where the FSA is considering making a prohibition order against an individual who is not currently an approved person, the FSA will consider the severity of the risk posed by the individual, and may prohibit the individual where it considers this is appropriate to achieve its regulatory objectives.
- 3.20. When considering whether to exercise its power to make a prohibition order against such an individual, the FSA will consider all the relevant circumstances of the case. These may include, but are not limited to, where appropriate, the factors set out in EG 9.9.
- 3.21. EG 9.23 provides that in appropriate cases the FSA may take other action against an individual in addition to making a prohibition order, including the use of its power to impose a financial penalty.

#### **4. Senior Management Arrangements, Systems and Controls (“SYSC”)**

- 4.1. SYSC 3.2.8R(1) states that a firm which carries on designated investment business with or for retail clients or professional clients must allocate to a director or senior manager the function of having responsibility for the oversight of the firm’s compliance and reporting to the governing body in respect of that responsibility.
- 4.2. SYSC 3.2.8R(2)(c) states that “compliance” means compliance with the rules in CASS (Client Assets).
- 4.3. SYSC 3.2.9G(2) provides that the rules referred to in SYSC 3.2.8R(2) are the minimum area of focus of the firm’s compliance oversight function.

#### **5. Client Assets sourcebook (“CASS”)**

- 5.1. CASS 7.2.14R states that unless a firm notifies a retail client in writing whether or not interest is to be paid on client money and, if so, on what terms and at what frequency, it must pay that client all interest earned on that client money. Any interest due to a client will be client money.

- 5.2. CASS 7.2.19R states that a firm may cease to treat as client money any unclaimed client money balance if it can demonstrate that it has taken reasonable steps to trace the client concerned and to return the balance.
- 5.3. CASS 7.3.2R states that a firm must introduce adequate organisational arrangements to minimise the risk of the loss or the diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record keeping or negligence.
- 5.4. CASS 7.4.7R states that a firm that does not deposit client money with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or qualifying money market fund where the money is deposited and the arrangements for the holding of this money.
- 5.5. CASS 7.4.10R states that a firm must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of a credit institution, a bank or a qualifying money market fund. The firm must make the record on the date it makes the selection and must keep it from the date of such selection until five years after the firm ceases to use the third party to hold client money.
- 5.6. CASS 7.4.11R states that a firm must take the necessary steps to ensure that client money deposited in a central bank, a credit institution, a bank authorised in a third country or a qualifying money market fund is held in an account or accounts identified separately from any accounts used to hold money belonging to the firm.
- 5.7. CASS 7.6.1R states that a firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money.
- 5.8. CASS 7.6.2R states that a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients.
- 5.9. CASS 7.6.9R states that a firm must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom client money is held.