12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

FINAL NOTICE

To: **H2O AM LLP**

Reference Number: **529105**

Address: **33 Cavendish Square**
London
W1G 0PW

Date: **2 August 2024**

1. ACTION

1.1. For the reasons given in this Notice, the Authority hereby imposes on H2O AM LLP ("H2O LLP" or "the Firm") a public censure pursuant to section 205 of the Act.

1.2. H2O LLP has agreed to resolve this matter on the following terms:

- the H2O Group has voluntarily secured the sum of €250 million that will be paid to the current unitholders in the Side-pocketed Funds ("Current SP Unitholders");

- in addition to the sum of €250 million, further realised monies may also be returned to the Current SP Unitholders at a later date (as described further at paragraph 2.19 below);

- the H2O Group has formally waived its rights to fees and investments totalling €320 million for the benefit of unitholders in the Side-pocketed Funds; and

- H2O LLP will voluntarily apply to cancel its UK regulatory permissions under Part 4A of the Act by 31 December 2024.

1.3. This settlement reflects significant voluntary contributions and support, without admission of liability, from the H2O Group and its shareholders and, accordingly, will result in payments to Current SP Unitholders significantly above what would be available from H2O LLP alone.

1.4. The public censure takes the form of this Final Notice, which will be published on the Authority's website.

2. SUMMARY OF REASONS

2.1. Asset managers act as agents for their customers, making investment decisions in financial markets on their behalf. Confidence that asset managers will conduct themselves in accordance with regulatory requirements when acting on behalf of customers is central to the relationship of trust between the industry and its customers. When making investment decisions on behalf of the funds they manage, asset managers are expected to ensure a high level of due diligence in deciding which assets such funds invest in and have in place written policies, procedures and effective arrangements to assess and manage risks associated with their investment decisions. Asset managers are also required to identify and manage effectively any conflicts of interest to ensure they do not interfere with their obligations to customers.

2.2. Between April 2015 and November 2019 (the "Relevant Period"), H2O LLP failed:

1) to conduct its business with due skill, care and diligence, in contravention of Principle 2 of the Authority's Principles for Businesses ("Principle 2") and to ensure a high level of diligence in the selection of scheme property and to act in the best interests of the scheme and its unitholders as required by the rules set out in the Authority's Handbook relating to Collective Investment Schemes ("COLL");

2) to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, in contravention of Principle 3 of the Authority's Principles for Businesses ("Principle 3"); and

3) to deal with the Authority in an open and cooperative manner, in contravention of Principle 11 of the Authority's Principles for Businesses ("Principle 11").

2.3. During the Relevant Period, H2O LLP's business included acting as authorised fund manager ("AFM") for a number of funds including seven French UCITS funds, referred to in this Notice as "the H2O Funds". Between 2015 and 2019, H2O LLP made a series of investments through the funds it managed into 24 entities controlled or introduced by Lars Windhorst (the "Investments"). The estimated value of the Investments in August 2020 totalled €1.643 billion.

2.4. The Investments were generally private placement debt instruments and equity shares in entities which H2O LLP recognised as early stage or turnaround businesses. Most of the Investments were therefore highly illiquid. The nature of the Investments differed significantly from the vast majority of investments made by the H2O Funds which were open-ended, daily-dealing funds (meaning that investors could withdraw their money on a daily basis).

2.5. On 18 June 2019, the Financial Times ("FT") published an article focusing on the exposure of the H2O Funds to the Investments and the close relationship between H2O LLP's CEO, Mr Crastes, and Mr Windhorst (the "2019 FT Article"). This prompted significant investor redemptions across the funds managed by H2O LLP. By mid-July 2019, €8 billion of the €34 billion assets under management at the start of June 2019 had been redeemed by investors.

2.6. Since publication of the 2019 FT Article, the Authority and the AMF, the French financial services regulator, have taken various steps in relation to the H2O Funds' exposure to the Investments. Following a sharp drop in valuations across the H2O Funds in the first half of 2020 and a resulting increase in the percentage of illiquid holdings, on 28 August 2020, H2O LLP announced that the AMF had required H2O LLP to suspend all subscriptions and redemptions to three of the H2O Funds (H2O Allegro, H2O MultiBonds and H2O MultiStrategies) due to their significant exposures to and valuation uncertainties in the Investments. H2O LLP voluntarily suspended all subscriptions and redemptions to the four other H2O Funds (H2O Adagio, H2O Moderato, H2O MultiEquities and H2O Vivace) which were also exposed to the Investments. In September and October 2020, the Investments held by each of the H2O Funds were contained in side-pockets closed to subscriptions and redemptions ("the Side-pocketed Funds") and all other assets were moved to open funds.

2.7. The Authority also agreed requirements with H2O LLP. The first of these, in April 2020, prevented further investment in entities owned by or associated with Mr Windhorst. The second, in October 2020, prevented Mr Crastes from having any involvement in dealing with the Investments held by the H2O Funds and required the appointment of an independent person by H2O LLP to advise H2O LLP on dealing with them.

2.8. The estimated value of the assets subsequently contained in the Side-pocketed Funds totalled €1.643 billion in August 2020.

2.9. The deficiencies in H2O LLP's record keeping, in particular, its trading data records, are so significant that the Authority has been unable to determine with certainty the precise exposure of the H2O Funds to the Investments throughout the Relevant Period. When the side-pocketing took place, the value of side-pocketed assets was approximately €1.643 billion. As at the date of this Notice, H2O LLP has already written off the vast majority of the value of the Side-pocketed Funds and they remain suspended such that investors are unable to release any value from their investments held within the Side-pocketed Funds.

Breach of Principle 2 and COLL

2.10. In making the Investments, H2O LLP failed to perform its responsibilities as AFM with due skill, care and diligence, often failing to conduct sufficient, and sometimes basic, due diligence. In particular, H2O LLP:

1) Failed to obtain sufficient (or in some cases any) due diligence information to enable it to evaluate adequately the merits, risks and valuations of the Investments: the Authority's investigation found that the information H2O LLP obtained, albeit inconsistently, was typically limited to: debt term sheets / terms and conditions; side letter or other agreements; investor presentations prepared by the underlying entity; financial statements; and, on a single occasion, a third-party research report;

2) Failed to conduct adequate (or in some cases any) due diligence analysis to support its decisions to enter into each of the Investments. By way of example: only seven of the Investments had any business analysis conducted; only two had any form of financial analysis conducted. Further, H2O LLP gave inadequate consideration to the risks arising from their common control and/or introduction by Mr Windhorst;

3) Failed to conduct sufficient (or in some cases any) ongoing due diligence on the merits, risks and valuations of the Investments, particularly when deciding to make further investments into entities controlled or introduced by Mr Windhorst;

4) Failed to comply with its own policies and procedures relating to gifts and hospitality, conflicts of interest, due diligence and record keeping.

2.11. As a result of these failings, H2O LLP entered into the Investments, which were higher-risk, predominantly unlisted and less easily sold (i.e. less liquid) than investments in its core strategies, without having appropriately considered their merits and risks, often without having a reasonable basis for establishing their valuations.

Breach of Principle 3

2.12. H2O LLP failed to take reasonable care to organise and control its affairs responsibly and effectively and to have in place adequate risk management systems in relation to the Investments. In particular, H2O LLP:

1) Failed to have in place appropriate written policies and procedures, and systems and controls regarding investment decision-making in relation to the Investments: what and how due diligence should be performed; the rationale for investment decisions; or the basis for their valuations;

2) Failed to institute and maintain appropriate governance arrangements to review and scrutinise investment decisions in relation to the Investments; and

3) Failed to ensure adequate oversight, challenge or monitoring by the Risk and Compliance functions of the investment decision-making process which led to the Investments being made.

2.13. In addition, H2O LLP failed to have in place appropriate conflicts of interest policies and procedures. H2O LLP failed to undertake sufficient monitoring of staff and failed to identify, challenge or mitigate potential conflicts which arose from the relationships H2O LLP's Investment Decision-Makers had with Mr Windhorst. H2O LLP also failed to record gifts and hospitality provided by Mr Windhorst to H2O LLP staff and their family members either at all or in sufficient detail, which meant that activities that could have acted as an inducement to continue making investments with Mr Windhorst, were not properly overseen or challenged. This failure occurred despite the receipt of hospitality and occasionally gifts being well known within H2O LLP.

Breach of Principle 11

2.14. H2O LLP failed to be open and cooperative with the Authority. In response to information requests made in August, October and November 2019 by the Authority, H2O LLP:

1) Made multiple false and misleading statements in correspondence to the Authority regarding the levels of due diligence it had conducted on the Investments and when it had conducted this due diligence;

2) Created multiple records and minutes of governance and oversight committee meetings, many of which had not taken place at all, and knowingly provided these false documents to the Authority;

3) Provided numerous misleading due diligence reports relating to the Investments which purported to evidence contemporaneous analysis of initial investment decisions but which had been prepared subsequently; and

4) Failed to disclose and provided misleading information as to the close relationship and receipt of hospitality between Mr Crastes and Mr Windhorst when asked by the Authority to explain their relationship. H2O LLP also failed to disclose fully the receipt of hospitality from Mr Windhorst by certain other members of H2O LLP staff.

2.15. It appears to the Authority that H2O LLP's objective in providing misleading information to the Authority was to conceal certain matters and (i) to create a false impression of the level and quality of analysis it had conducted in relation to the Investments (it had conducted little or no such due diligence); and (ii) to hide the inadequacy of H2O LLP's record keeping.

2.16. H2O LLP's misconduct included an extensive effort to create documents and provide misleading information to the Authority in an attempt to hide the severity of its due diligence and systems and controls failings. This misconduct extended over a five-month period in 2019 and was led by a member of H2O LLP's senior management ("Senior Manager A") (who was suspended when these matters were identified by H2O LLP and its external lawyers and is no longer with H2O LLP) and involved individuals within its Risk and Compliance functions acting under his direction. Accordingly, the Authority views H2O LLP's breach of Principle 11 as extremely serious.

2.17. In making these findings, the Authority does not find that H2O LLP's senior management all knew, or ought to have known, that the information provided to the Authority was false or misleading.

2.18. Since the Relevant Period, H2O LLP has taken measures to significantly enhance its governance, systems and controls to ensure that similar misconduct will not occur in future. This includes implementing a new governance model with changes to senior management roles and responsibilities and undertaking a culture review and change programme, as well as enhancements to its policies and procedures.

2.19. €229 million has already been returned to unitholders in the Side-pocketed Funds since the H2O Funds were suspended in August 2020 and the side-pocketing subsequently took place. The H2O Group has voluntarily secured the further sum of €250 million that is ring-fenced for the sole purpose of making payments to Current SP Unitholders. In the first instance, the €250 million will be utilised in an offer to the Current SP Unitholders to purchase their units in the Side-pocketed Funds. Current SP Unitholders will have the option of whether or not to

participate in this offer. All of the €250 million will ultimately be distributed to the Current SP Unitholders whether or not they participate in the offer. Those who participate in the offer will receive an enhanced and earlier payment in return for relinquishing their right to pursue claims in respect of the Investments. Payment to non-participating unitholders may take up to six years. To the extent the H2O Group is able to realise value in the side-pocketed assets or recover any monies paid in fines, such additional sums will also be paid to Current SP Unitholders.

2.20. Having assessed H2O LLP's available resources, the Authority is satisfied that it is preferable for H2O LLP to make funds available to Current SP Unitholders, rather than to pay a financial penalty to the Authority as this would then reduce the funds available to such unitholders. In addition, the Authority has taken into account that the AMF has imposed a financial penalty on H2O LLP relating to the Investments (currently subject to appeal by H2O LLP).

2.21. In addition to the above payments, the H2O Group has formally waived its rights to fees and investments totalling €320 million to the benefit of the unitholders in the Side-pocketed Funds.

2.22. H2O LLP has agreed that by 31 December 2024 it will voluntarily apply to cancel all of its Part 4A permissions under the Act and no longer conduct regulated activities within the UK.

3. DEFINITIONS

3.1. The definitions below are used in this Notice:

"2019 FT Article" means the article published by the FT on 18 June 2019, which was the first in a series of subsequent articles by the FT, examining the Investments

"the 2019 Responses" mean the false statements and misleading documents provided to the Authority by H2O LLP in response to the Authority's enquiries regarding due diligence conducted on the Investments

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

"AFM" means an authorised fund manager

"AIF" means alternative investment fund

"the AMF" means the Autorité des marchés financiers, the financial services regulator of France

“the Authority” means the Financial Conduct Authority

“COLL” means the regulatory provisions published in the Authority’s Handbook relating to Collective Investment Schemes

“Current SP Unitholders” means unitholders in the Side-pocketed Funds as at the date of this Notice

“Deep Value Overlay” means investments which differed from H2O LLP’s core investments in terms of sector, type, cashflow and maturity

“Deep Value Procedures” means H2O LLP’s written description of the due diligence to be applied when investing in Deep Value Overlay assets

“DEPP” means the Authority’s Decision Procedure and Penalties Manual

“FT” means the Financial Times

“H2O LLP” means H2O AM LLP

“the H2O Funds” means the seven French funds which were exposed to the vast majority of the Investments and were subjected to the exercise to side-pocket those Investments in 2020, namely: H2O Adagio; H2O Allegro; H2O Moderato; H2O MultiBonds; H2O MultiEquities; H2O MultiStrategies; and H2O Vivace

“Investment Decision Makers” means the individuals principally responsible for deciding to enter into the Investments, being Bruno Crastes and Vincent Chailley

“Investments” means the investments made by H2O LLP via the H2O Funds into 24 instruments or entities either controlled or introduced by Mr Windhorst during the Relevant Period

“Notice” means this Warning Notice together with its Appendices

“Relevant Period” means the period between April 2015 and November 2019

“Risk and Compliance Committee” means H2O LLP’s Risk and Compliance Committee, which in 2019 became H2O LLP’s Legal, Risk and Compliance Committee

"Senior Manager A" means the member of H2O LLP's senior management who led the creation of false and misleading documents and provided false and misleading information to the Authority (who was suspended when these matters were identified by H2O LLP and its external lawyers and is no longer with H2O LLP)

"Side-pocketed Funds" means the funds which hold the Investments and are closed to subscriptions and redemptions

"Tennor" means Tennor Holding B.V., a global investment holding company whose ultimate beneficial owner is Mr Windhorst

"the Tennor Group" means Tennor and its subsidiaries

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber)

"UCITS" means Undertakings for Collective Investment in Transferable Securities

"UCITS Directive" means Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009

4. FACTS AND MATTERS

Background to H2O LLP and investment strategy

4.1. H2O LLP is a portfolio management company which was founded as a limited liability partnership in 2010. In addition to its main office in London, H2O LLP also operated offices during the Relevant Period in Paris, Monaco, and Singapore. H2O LLP primarily specialises in global macro investment strategies serving institutional, corporate and (indirectly) individual investors through a range of absolute and total return UCITS, actively managed across global debt, currency and equity markets. During the Relevant Period, 50.01% of H2O LLP was controlled by Natixis Investment Management (NIM) with the remainder owned by H2O LLP's partners.

4.2. During the Relevant Period, H2O LLP wholly owned 3 foreign subsidiaries – H2O AM Europe, H2O AM Asia and H2O Monaco. At its peak in 2019, H2O LLP's assets under management (AuM) exceeded €34 billion.

4.3. H2O LLP's core investment strategies (which typically accounted for 90-95% of the risk taken by H2O LLP-managed funds) generally comprised highly liquid, mainstream investments (for example sovereign debt).

4.4. H2O LLP also invested a small proportion of the H2O Funds' assets in what it described as a "Deep Value Overlay" of investments which differed from its core investments in terms of sector, type, cashflow and maturity. Such "Deep Value" investments fell into categories including government bonds and corporate debt in emerging markets, distressed sovereign debt, and private debt. The rationale behind the Deep Value Overlay was that returns to investors could be improved by investing a small proportion of the H2O Funds' assets into higher risk assets (which accordingly were expected to pay a higher return). This approach is typically referred to in the fund management industry as a "core plus" strategy.

4.5. Operating a core plus strategy can be a legitimate way for an AFM to increase returns to investors and can therefore be in investors' best interests. It is permitted within certain parameters by the UCITS Directive and other relevant regulatory rules. However, in adopting such a strategy, an AFM must ensure it conducts a high level of due diligence and has in place appropriate written policies and procedures, and systems and controls to manage the greater risks associated with such investments and to ensure the funds it manages continue to comply with regulatory requirements.

4.6. During the Relevant Period, the Investments formed around half of this Deep Value Overlay and all of the private debt element in the H2O Funds. However, H2O LLP's approach to the private debt element of the Deep Value Overlay during the Relevant Period was unusual for a core plus strategy as it ultimately focused on investing almost exclusively in companies controlled or introduced by Mr Windhorst. No other comparable investments (e.g. in private placements, illiquid corporate debt, equity shares in early stage or distressed businesses) were made by any of the H2O Funds.

The Investments

4.7. Mr Windhorst is the founder and ultimate beneficial owner of Tennor Holding B.V. ("Tennor"). Tennor is a global investment holding company; its portfolio is described as being diversified across technology, industrials, natural resources, media, entertainment, sports, retail and real estate (the "Tennor Group").

4.8. During the Relevant Period, H2O LLP made investments into 20 private debt / equity offerings which were issued by the Tennor Group of companies. Also during the Relevant Period, H2O LLP made investments into a further 4 private debt / equity offerings which were introduced

to H2O LLP by Mr Windhorst and for which Mr Windhorst acted as intermediary. Collectively these investments are the "Investments" for the purposes of this Notice.

4.9. The Investments were largely allocated across seven UCITS funds incorporated in France which were managed by H2O LLP on a cross-border basis pursuant to the UCITS Directive (the "H2O Funds"). The AMF is the designated regulator in respect of the H2O Funds and the Authority is the designated regulator of H2O LLP.

4.10. Consistent with the purpose of the Deep Value Overlay, the Investments were much higher-risk, less-liquid products than H2O LLP's core investment strategies: for example, the Investments were in private placements, illiquid corporate debt, and / or equity stakes in early stage or distressed businesses. H2O LLP made the Investments across a range of industry and geographic sectors and types of business.

4.11. Following an initial investment into a Tennor Group company in 2013, H2O LLP considered various investments as part of its Deep Value Overlay strategy. From April 2015 onwards, H2O LLP began making increasing investments into Tennor Group companies and entities introduced to it by Mr Windhorst.

4.12. In August 2017, H2O LLP took a strategic decision to strengthen the relationship with the Tennor Group and make it H2O LLP's single partner in the private debt and equity markets. H2O LLP considered that taking this step would be beneficial to its funds and enable it to obtain quicker access to information and greater transparency in relation to the companies it had invested in. In June 2018, due to concerns following several missed payments by Tennor Group companies, H2O LLP reviewed the relationship again and decided to continue working with Mr Windhorst with the intention of reducing its exposure to the Investments. In a number of instances this took the form of re-investing into other Tennor Group companies alongside the receipt of collateral (albeit this collateral was in the form of shares in companies within the Tennor Group). The final investments made by H2O LLP into the Investments were made in 2019.

The 2019 FT Article and subsequent events

4.13. On 18 June 2019, the FT published an article, which was the first in a series of subsequent articles by the FT, examining the Investments (the "2019 FT Article"). The 2019 FT Article focused on the concentration of the H2O Funds in the Investments and their "highly illiquid" nature. The FT included a number of adverse allegations against Mr Windhorst.

4.14. Following the 2019 FT Article, H2O LLP experienced substantial investor redemptions across the funds it managed.

Buy and Sell-Back Transactions

4.15. A further unusual feature of the Investments was H2O LLP's specific approach to buy and sell-back transactions from mid-2019 onwards.

4.16. Ordinarily, buy and sell-back transactions are intended as relatively short-term arrangements to generate additional returns to investors from surplus funds by temporarily loaning funds in exchange for high quality collateral. However, in H2O LLP's case, it repeatedly "rolled over" its exposure to certain of the Investments by rolling forward the settlement date for repurchases from the H2O Funds. The reasoning for this, according to H2O LLP, was that following the 2019 FT Article, whilst there was a desire within H2O LLP to reduce its exposure to entities linked to Mr Windhorst, certain of the companies linked to the Investments suffered reduced liquidity as a result of the 2019 FT Article. H2O LLP understood that additional liquidity would become available to the Tennor Group in due course and that allowing the relevant companies more time would lead to a better outcome for investors than allowing the companies to default on their financial obligations to H2O LLP. When rolling forward the buy and sell-back transactions, H2O LLP sought additional cash premia and collateral (albeit only in the form of shares in companies within the Tennor Group to which the H2O Funds were already exposed) to improve the H2O Funds' position.

4.17. Accordingly, H2O LLP's position is that it rolled certain buy and sell-back transactions to avoid crystalising losses in the Investments in anticipation that the situation may improve given time. However, this decision did not ultimately assist in H2O LLP exiting from these Investments and therefore resulted in a more open-ended exposure of the H2O Funds to the Tennor Group.

4.18. The approach described above reflected the fact that H2O LLP's exposure to entities linked to Mr Windhorst had grown so large that it felt unable to cease funding any particular investment without negatively impacting the Investments overall. These actions continued the substantial, higher risk and illiquid exposures to the Tennor Group by investors in the H2O Funds.

H2O LLP's systems and controls relating to the Investments

Policies and procedures

4.19. During the Relevant Period, H2O LLP had in place various policies, procedures and governance fora relevant to its investment management decision-making. For the purposes of this Notice, the Authority has focused on those relevant to the Investments (noting that this framework differed somewhat from that used for H2O LLP's core investment strategy).

4.20. The policies and procedures primarily relevant to due diligence and the Investments were the Deep Value Procedures, the Valuation Policy, the Conflicts of Interest Policy and the Gifts and Entertainment Policy.

4.21. During the Relevant Period H2O LLP had a written description of the due diligence to be applied when investing in Deep Value Overlay assets (the "Deep Value Procedures"). This document is undated and therefore it is not known when it was produced. The Deep Value Procedures describe at a relatively high level a due diligence process involving deep micro-economic analysis of the opportunity, analysis to determine credit and liquidity risk and pricing and meetings with the management team of that business before H2O LLP would decide to make an investment in illiquid assets.

4.22. The Deep Value Procedures set out that investment decisions were to be made by Mr Crastes and Mr Chailley in their capacities as the CEO and CIO of H2O LLP respectively ("the Investment Decision Makers"). Whilst a number of the H2O Funds had different designated portfolio managers, in practice, the Investment Decision Makers made all decisions to invest in the Investments, even in respect of H2O Funds for which they were not the designated portfolio managers.

4.23. The Valuation Policy set out at a high level the approach to be conducted when valuing illiquid assets (such as the Investments). The principles for valuation set out in the Valuation Policy were broadly reasonable. However, it contained little guidance on or procedures for the techniques to be employed when valuing illiquid or otherwise hard to value assets. A supplemental document providing further detail on the valuation methodology was subsequently created after June 2019. The actual basis on which the Firm sourced valuations for the Investments appears to have differed from that set out in the Valuation Policy during the Relevant Period. Further, the Valuation Policy provided limited guidance on or procedures for valuing buy and sell-back transactions despite these being a significant departure from H2O LLP's normal investment strategy.

4.24. H2O LLP's Conflicts of Interest Policy was a high level document which often directed readers to other, more specific policies such as the Gifts and Entertainment Policy. It did not include details of mitigating controls and was not supported by additional detailed procedural documentation. The Conflicts of Interest Policy did not refer to or describe any governance framework or committee with responsibility for managing conflicts (although H2O LLP's Compliance function was intended to have day-to-day management of conflicts issues with oversight provided by H2O LLP's Executive Committee).

4.25. The Conflicts of Interest Policy did require the maintenance of a Conflicts Register to record all identified conflicts of interest and mitigating measures. H2O LLP was only able to provide the Authority with a version of the Conflicts Register dating from 2019 (i.e. at the end of the Relevant Period). The Conflicts Register provided was a high level document and failed in the majority of instances to include information on when a given conflict arose or details of why a potential issue was considered to be a conflict. Instead, it generally only documented the rationale as to why H2O LLP considered that a given issue was not a conflict and did not describe any controls or procedures to mitigate potential conflicts.

4.26. The Conflicts of Interest Policy also described monitoring arrangements such as "back-testing" which were to be conducted to identify any conflicts which were missed. However, it provided no further detail on these arrangements and H2O LLP did not undertake any such back-testing during the Relevant Period.

Relevant committees / governance fora

4.27. The senior decision-making committee within H2O LLP was the Executive Committee. The Executive Committee had day-to-day responsibility for the management of H2O LLP and all matters concerned with the conduct of its business. Both of the Investment Decision Makers were members of the Executive Committee.

4.28. During the Relevant Period, H2O LLP did not operate a formal Investment Committee to review and scrutinise investment decisions. Instead, H2O LLP held regular investment meetings. However, these investment meetings did not perform an oversight role nor were they involved in the investment decision-making itself. Documentation of these meetings was limited and it appears that no meaningful analysis of the Investments took place at them. As a result, there was no formal committee whereby decisions of the Investment Decision Makers could be scrutinised and challenged.

4.29. H2O LLP had a Valuation Committee during the Relevant Period. The purpose of this committee was to review and examine the valuations of investments made by the H2O Funds. Where the Valuation Committee considered that the pricing of an investment did not properly reflect all factors (such as market liquidity) then it could adjust the valuation given to a particular investment.

4.30. Moreover, as set out in more detail below, between at least January and June 2019, there was little, if any, formal governance through the Valuation Committee.

4.31. Finally, H2O LLP's Valuation Committee was a sub-committee of H2O LLP's Risk and Compliance Committee, which in 2019 became H2O LLP's Legal, Risk and Compliance

Committee (the "Risk and Compliance Committee"). The Risk and Compliance Committee was intended to be a forum for members of H2O LLP's Risk, Compliance and Legal functions. The purpose of the Risk and Compliance Committee included considering matters relating to compliance controls and procedural and policy updates across the business, risk and regulatory reporting and developments in the field of regulation, the scheduling of audits and follow-up points and the implementation and delivery of training.

4.32. In the first half of 2019, the Risk and Compliance Committee met infrequently even though it was intended to meet fortnightly.

4.33. Further, in respect of the Risk and Compliance Committee meetings which did take place, there was limited consideration or scrutiny of any of the Investments. H2O LLP employees who attended the Risk and Compliance Committee did not recall any discussions relating to risks of the Investments taking place and several members of the Risk and Compliance Committee had never heard of Mr Windhorst nor heard of any concerns relating to the Tennor Group prior to the 2019 FT Article. This was despite the Investments being substantially higher-risk and more illiquid than H2O LLP's normal investments.

H2O LLP's investment decision-making and due diligence in relation to the Investments

4.34. Whilst H2O LLP's Deep Value Procedures set out at a high level the due diligence to be conducted when making the Investments, H2O LLP did not follow these procedures or the standards of due diligence to be expected from an AFM undertaking investments of this sort.

4.35. In particular, for all of the Investments, H2O LLP sourced limited due diligence information at the time of making the initial investment decision. As such it lacked sufficient due diligence material that would ordinarily be obtained by an AFM undertaking investments of this sort.

4.36. For some of the Investments, H2O LLP had gathered no material diligence information to support the initial investment decision. The types of information H2O LLP, albeit inconsistently, obtained were typically limited to: debt term sheets / terms and conditions; side letter or other agreements; investor presentations prepared by the underlying entity; financial statements and, on a single occasion, a third-party research report. This information fell far short of the information which H2O LLP's own Deep Value Procedures required to be gathered.

4.37. This flawed approach to investing was particularly stark given that in respect of debt placements forming part of the Investments, the H2O Funds were in many cases the largest investor.

4.38. H2O LLP's Deep Value Procedures called for: (i) a governance analysis of the proposed investment: this was to consist of analysis of management capability including experience, strengths, credibility of an issuer's senior leadership team and the robustness of their governance structures; (ii) a microeconomic analysis: this was to include an analysis of balance sheets, expected cash flows, prospective business plans and financing plans; and (iii) a financial / credit analysis: this was to include analysis of the valuation and performance potential and prospective cash flows under expected and stressed conditions.

4.39. For half of the Investments, H2O LLP had no records of any due diligence analysis being conducted at the time of making the Investments.

4.40. For ten of the Investments, H2O LLP prepared an "Investment Decision Note". These notes typically set out in bullet point form macroeconomic and microeconomic considerations; governance analysis; valuation and performance potential; and a timeline of H2O LLP's involvement. There was minimal evidence in these notes regarding any work undertaken to understand the risks and to independently value the investment.

4.41. In the case of seven of these Investments, H2O LLP also prepared a longer "Investment Summary". These documents described at greater length the underlying business and the terms of the relevant debt instrument. However, these summaries were largely narratives which repeated content from investor presentations and financial forecasts without commentary or analysis. In six of these seven papers, there was no analysis of the risks of the investment and no indication that any independent valuation or financial analysis had been performed by H2O LLP. Further, for five Investments, the "Investment Decision Notes" and the "Investment Summaries" were amongst the documents which H2O LLP provided as part of its attempts to mislead the Authority and as such it is unlikely that there was any contemporaneous due diligence analysis for these Investments.

4.42. For only two of the Investments was there any record of basic financial analysis being conducted on the investment. However, these documents simply adopted the revenue and expenditure figures provided by the issuers without challenge and did not attempt to analyse how any risks identified in respect of the investment might impact the value of the investment.

4.43. In respect of all of the Investments, there was no analysis (such as benchmarking or comparisons) made against other investment opportunities which might meet the criteria for H2O LLP's Deep Value Overlay strategy nor consideration as to whether alternative investments might offer a better risk / return profile than the Investments. There was no attempt by H2O LLP to analyse the risks arising from their common link to Mr Windhorst.

4.44. Finally, in addition to the very limited due diligence around the time of the initial investment decisions, H2O LLP did not conduct ongoing due diligence on the Investments prior to the 2019 FT Article. There was insufficient ongoing due diligence activity, which could have informed H2O LLP of the business activities of these Investments, including the likelihood of repayment. Furthermore, standard investment lifecycle events, such as the time and schedule of coupon payments or bond redemptions, also did not trigger further due diligence activities by H2O LLP over the Investments. The lack of initial or ongoing due diligence meant investors in the H2O Funds were being exposed to levels of risk in relation to the Investments that were not properly analysed and managed.

Suspension of the H2O Funds and subsequent events

4.45. The Authority and the AMF exercised various regulatory powers to protect investors in the H2O Funds. In August 2020, the AMF required H2O LLP to suspend certain of the H2O Funds due to their exposure to and valuation uncertainties in the Investments. H2O LLP voluntarily suspended the remaining H2O Funds. The Authority maintained close supervisory engagement with H2O LLP throughout the period following the 2019 FT Article. The Authority also agreed two requirements with H2O LLP. The first of these, in April 2020, prevented further investment in entities linked to Mr Windhorst. The second, in October 2020, prevented Mr Crastes from involvement in dealing with the Investments and required the appointment of an independent person to advise H2O LLP on dealing with them.

Communications between H2O LLP and the Authority regarding conflicts of interest

4.46. Following the 2019 FT Article, there was additional press coverage of the close relationship between Mr Crastes and Mr Windhorst. In particular, a Wall Street Journal article dated 11 September 2019 alleged that Mr Crastes had spent time on Mr Windhorst's yacht and private jet. The Authority requested H2O LLP to provide information in respect of potential conflicts of interest relating to Mr Windhorst.

4.47. On 30 September 2019, the Authority wrote to H2O LLP compelling certain information in this regard. The Authority requested information relating to gifts and hospitality in respect of a particular company linked to Mr Windhorst which had entered into a number of buy and sell-back trades with H2O LLP and any of the issuers of the Investments. H2O LLP responded on 7 October 2019 stating:

> *[…] According to our Gifts and Entertainment register, nothing was given or received from these entities.*

4.48. Following receipt of H2O LLP's 7 October 2019 response, the Authority sought further information from H2O LLP on 7 November 2019 which specifically asked (amongst other things) for:

> *A schedule of all business trips H2O staff has undertaken with Lars Windhorst and staff at LW associated companies, including (but not exclusively) meetings on yachts, airplanes and private properties*

4.49. H2O LLP responded to the Authority on 8 November 2019. The response noted that business meetings had been held between H2O LLP's senior management with Mr Windhorst or his staff since 2016, with most of them taking place at the Tennor Group's London office. Details were also given of two specific overseas trips by more junior H2O LLP staff to visit two Tennor Group companies which had issued certain of the Investments.

4.50. However, this response omitted key information regarding meetings held between Mr Windhorst and H2O LLP's senior management which occurred on Mr Windhorst's private jet, helicopter and superyacht. These instances were known personally to H2O LLP's senior management who were involved in preparing the response to the Authority dated 8 November, some of whom had themselves been the recipients of the hospitality from Mr Windhorst. The 8 November response from H2O LLP was also incomplete as there had been numerous further instances of H2O LLP staff, and on occasion their families, receiving hospitality, and occasionally gifts, from Mr Windhorst (see below).

4.51. In December 2019, the Authority required H2O LLP to commission a Skilled Person to conduct an independent review and report on a number of issues including the effectiveness of H2O LLP's due diligence process and management of conflicts of interest in relation to investments linked to Mr Windhorst.

4.52. During the Skilled Person's review of H2O LLP's systems and controls, the Skilled Person alerted the Authority to multiple instances of hospitality and occasionally gifts which had been accepted by H2O LLP staff, but which had not been recorded on the relevant registers for gifts and hospitality or conflicts of interest nor in compliance declarations. In particular, hospitality received by H2O LLP from Mr Windhorst included the following:

1) Mr Crastes being hosted at a wine tasting event held by the Minister of State of Monaco at the request of Mr Windhorst;

2) Mr Crastes, Mr Chailley, and occasionally their families, being hosted on Mr Windhorst's superyacht on more than one occasion;

3) Mr Crastes requesting use of Mr Windhorst's private jet and also being flown by private helicopter arranged by Mr Windhorst; and

4) Other H2O LLP staff and their relatives being hosted at the 2019 Monaco Grand Prix and hosted on Mr Windhorst's superyacht.

4.53. The Authority instructed H2O LLP to complete targeted searches to look for any additional instances of the receipt of hospitality from Mr Windhorst or his companies by H2O LLP's staff.

4.54. H2O LLP subsequently provided the Authority with details of instances, additional to those identified by the Skilled Person, where staff of H2O LLP had either been provided with gifts or hospitality by Mr Windhorst or where gifts or hospitality had been offered by Mr Windhorst, but there was no record of whether they had been accepted and received by the H2O LLP employee.

4.55. These additional details showed more than 50 instances of H2O LLP staff receiving hospitality (and occasionally gifts) from Mr Windhorst between April 2015 and June 2019. These were broadly similar to the instances described above and included:

1) Numerous members of H2O LLP staff receiving dinner invitations, on occasion including family members, hosted at restaurants, a private members club and also on Mr Windhorst's superyacht;

2) Mr Chailley and his family being flown by helicopter to attend a 2015 Grand Prix at Silverstone;

3) Mr Crastes and his family being flown between the UK, France, the USA and Saint Martin on commercial flights and Mr Windhorst's private jet as part of a 2018/19 New Year's trip; and

4) Mr Crastes being flown to Barbados to play golf with Mr Windhorst.

4.56. H2O LLP also listed another 18 instances between 2015 and 2018 where hospitality had been offered by Mr Windhorst, but there was no confirmation of its acceptance or receipt. The type of hospitality potentially received from Mr Windhorst included further examples of flights being provided for H2O LLP staff, dinner invitations, wine tasting events, and invitations to Grand Prix.

4.57. The value of the hospitality received generally far exceeded the de minimis values required for disclosure to be made under H2O LLP's Gifts and Entertainment and Conflicts of Interest Policies.

Relationship between Mr Crastes and Mr Windhorst

4.58. The Authority also asked H2O LLP in its request dated 7 November 2019:

> *Whether there is any other interaction that the FCA should be made aware of, such as whether any personal relationships (such as friendships) exist between H2O staff and staff of entities associated with Lars Windhorst.*

4.59. H2O LLP's 8 November 2019 response stated that no such relationship existed.

4.60. However, there was in fact a close personal relationship between Mr Crastes and Mr Windhorst, in contrast to the purely professional relationship characterised to the Authority. This was reflected in the above provision of hospitality to Mr Crastes and his family by Mr Windhorst. By way of example, in January 2019, Mr Crastes wrote Mr Windhorst an email entitled "*Thank you my friend"*. This email, written in English (which is not Mr Crastes' first language), thanked Mr Windhorst for hosting Mr Crastes and his family in the Caribbean over New Year, stating:

> *We are about to leave St Martin and I would like to sincerely thank you for that week of dream that we so much enjoyed on the boat. Everything was so exclusive and so friendly […] We feel like having a new family with […] you and it goes straight to our heart.*

4.61. Mr Windhorst replied to Mr Crastes the same day stating:

> *Dear Bruno.*
>
> *Just tried to call you.*
>
> *Thank you so much for this very kind message! I feel exactly the same it´s more than just close friendship between us it does feel like extended family for me also!*

4.62. H2O LLP's approach to conflicts of interest, gifts and hospitality meant that no gifts or hospitality were recorded as being received from Mr Windhorst throughout the Relevant Period and they were not subject to any form of scrutiny by H2O LLP, despite the very significant exposures to the Investments.

4.63. It was not until 2021 that H2O LLP identified to the Authority the full extent of what gifts and hospitality had actually been received from Mr Windhorst.

Provision of false and misleading documents and information to the Authority

4.64. Between July and November 2019, a member of H2O LLP's senior management (Senior Manager A) made numerous false statements and provided misleading documents to the Authority in response to the Authority's enquiries regarding due diligence conducted on the Investments (the "2019 Responses").

4.65. During the course of its investigation, the Authority became suspicious that certain due diligence on the Investments may not have been conducted contemporaneously with the investment decisions. In 2021, the Authority therefore compelled H2O LLP to produce internal correspondence relating to how it had prepared the 2019 Responses.

4.66. The internal correspondence provided by H2O LLP in response to the Authority's request revealed that extensive work had been undertaken within H2O LLP to prepare for provision to the Authority "evidence" of due diligence analysis and records of meetings which had not in fact taken place at the time of making the Investments. H2O LLP ultimately acknowledged that certain materials had been prepared retrospectively and that certain statements made to the Authority were misleading. In 2021, H2O LLP suspended Senior Manager A who had led the preparation of the 2019 Responses and he is no longer with H2O LLP.

Misleading minutes

4.67. In July 2019, the Authority requested that H2O LLP provide information relating to the Investments including internal correspondence which led to the valuation of the Investments. In response, H2O LLP provided minutes of meetings of its Valuation Committee and Risk and Compliance Committee. In providing its response, H2O LLP provided misleading documentation, in particular:

1) Senior Manager A provided 23 documents purporting to be contemporaneous minutes of meetings of its Valuation Committee between January and July 2019: although no meetings of the Valuation Committee had taken place. H2O LLP provided these documents to the Authority on 1 August 2019.

2) Senior Manager A also provided the following 12 misleading records:

   (i) four documents purporting to be minutes of its Risk and Compliance Committee when no such meetings had taken place;

(ii) four minutes of Risk and Compliance Committee meetings which had taken place but were not recorded at the time and were retrospectively created; and

(iii) minutes of four further Risk and Compliance Committee meetings which had been created contemporaneously, but which were retrospectively amended to include additional evidence of due diligence copied from the minutes for the Valuation Committee (which had not taken place).

Misleading due diligence materials and related communications with the Authority

4.68. Furthermore, on three occasions during 2019, in response to questions from the Authority, H2O LLP misleadingly provided documents to the Authority on the basis that they had been prepared at the time of the initial investments as part of H2O LLP's due diligence process. In particular, Senior Manager A provided to the Authority:

1) Investment Summaries, which were also referred to as "Due Diligence Reports", on 1 and 8 August 2019;

2) Investment Decision Notes on 31 October 2019; and

3) Credit Notes, which were largely identical in content to the Investment Summaries / Due Diligence Reports on 14 November 2019.

4.69. The Authority's investigation identified that all of these documents had, in fact, been prepared retrospectively from June 2019 onwards – either directly in response to the Authority's requests or as part of a general 're-papering' exercise to create and document due diligence materials on the Investments following the 2019 FT Article.

4.70. In response to a direct request by the Authority that H2O LLP confirm when the due diligence materials were written, Senior Manager A responded:

To confirm:

The due diligence reports are written at the time of the investments and they are updated afterwards by the portfolio managers in charge of the related investments. This is a permanent process and is on going…

4.71. This statement was misleading in two respects: no due diligence reports had been written at the time of the Investments and there had been no ongoing process for updating of the reports.

4.72. On 31 October 2019, Senior Manager A continued to mislead the Authority as to the timing of the due diligence materials. In response to a further request by the Authority that H2O LLP provide all due diligence documentation performed "*in advance of and in preparation*" for each Investment, he provided the Authority with the misleading Investment Decision Notes and stated:

> *[…] What we can add is the final investment decision made by our CIO for each bond bought... All documents were elaborated at the time of the investments, as all investments need to be documented*.

4.73. This statement was made despite the fact that, for the previous few months, Senior Manager A had led and been copied on correspondence within H2O LLP regarding the creation of due diligence materials, including the Investment Decision Notes to respond to the Authority's requests.

4.74. Finally, on 6 November 2019, Senior Manager A misleadingly stated in correspondence to the Authority: "*The investment notes are documents which were put together by Vincent Chailley the CIO of H2O, at the time of the investments".*

4.75. At interview, Mr Chailley informed the Authority that, in fact, the Investment Decision Notes had only been created in July 2019 and that he had written most of the analysis they contained in September and October 2019.

4.76. At no point in its extensive correspondence with the Authority throughout 2019 did H2O LLP disclose that these due diligence materials had been created retrospectively.

4.77. Finally, in November 2019, H2O LLP made a submission to the Authority explaining how the Firm had met the rules relating to collective investment schemes. In support of this, H2O LLP provided five 'Credit Notes' relating to certain of the Investments. These were nearly identical to the Investment Summaries provided to the Authority in August 2019. H2O LLP misled the FCA by suggesting that these reports had been written contemporaneously to the investments when in fact they had been prepared from the summer of 2019 onwards.

H2O LLP's control functions

4.78. The only significant work undertaken by the Compliance function in respect of the Investments identified by the Authority's investigation was a report prepared in June 2019 (i.e. after the Investments had been made). The report indicates, for the first time in the Relevant Period, due diligence checks and analysis being conducted in respect of Mr Windhorst and the underlying issuers of the Investments by H2O LLP's Compliance function.

4.79. Correspondence at the time of the report also indicated that the Compliance function appeared to have no records as to the dates of on-site visits to Tennor Group companies or documentation relating to those visits and that, in respect of five of the underlying issuers of the Investments, the Compliance function was unable to find any information on those companies within H2O LLP.

4.80. Some members of H2O LLP's Compliance function had never heard of Mr Windhorst or the Tennor Group prior to the 2019 FT Article. Further, the Compliance function had no role in conducting due diligence on the Investments more generally.

4.81. There was also limited, if any, oversight or challenge by H2O LLP's Compliance function in respect of gifts, hospitality and conflicts of interest. By way of example, conflicts of interest only became a standing item on the Risk and Compliance Committee from mid-2019 and during the period from the start of 2018 to the end of the Relevant Period, only three instances of conflicts of interest matters being briefly discussed were recorded, none of which related to the Investments.

4.82. H2O LLP's Conflicts of Interest Policy stated that H2O LLP's senior management was ultimately responsible for the implementation of appropriate procedures to ensure that potential conflicts were identified and managed with any concerns to be referred to Compliance. In addition to the Conflicts of Interest Policy's requirements for approval and registering gifts and hospitality, the Policy also stated that a Gifts and Entertainment Register was maintained by Compliance.

4.83. However, during the Relevant Period, no issues relating to the receipt of gifts and hospitality from Mr Windhorst were identified or referred to Compliance. This was despite the obvious risk that the close personal relationship between the Investment Decision Makers and Mr Windhorst could raise potential conflicts of interest and, accordingly, needed to be appropriately managed. H2O LLP's own Compliance Manual highlighted this risk stating:

> *"The receipt or giving of gifts or entertainment from individuals […] having business dealings with H2O creates the potential for conflicts of interest*".

4.84. H2O LLP's Code of Ethics also stated:

> "*Investment personnel shall not accept any gift or other thing of more than de minimis value from any person or entity that does business with or on behalf of any Portfolio*."

4.85. As noted above, H2O LLP's Investment Decision Makers regularly accepted hospitality above this value from Mr Windhorst.

4.86. Whilst H2O LLP's Investment Decision Makers failed to disclose to the Compliance function the receipt of, predominantly, hospitality from Mr Windhorst, the Firm's Gifts and Entertainment Registers do provide examples of other, typically more junior, staff adhering to the requirements to report the receipt of items such as tickets to sporting events, dining and wine. Therefore, there was an awareness of these requirements within H2O LLP generally, but amongst senior management these requirements were often not complied with.

4.87. The receipt of hospitality by H2O LLP senior management from Mr Windhorst was well known within H2O LLP (even if such instances were not declared or referred to Compliance). Despite the receipt of hospitality being well-known within H2O LLP, no challenge was made by Compliance of the failure to declare or record it.

5. FAILINGS

5.1. The regulatory provisions relevant to this Notice are referred to in Annex A.

Breaches of Principle 2 and COLL

5.2. Principle 2 requires a firm to act with due skill, care and diligence. COLL 6.6A.4 (R) (1) requires an AFM to ensure a high level of diligence in the selection and ongoing monitoring of scheme property, in the best interests of the scheme and the integrity of the market. COLL 6.6A.4 (R) (2) requires an AFM to ensure it has adequate knowledge and understanding of the assets in which any scheme it manages is invested.

5.3. During the Relevant Period, H2O LLP failed to act with the skill, care and diligence to be expected of an AFM in relation to the Investments. In particular, H2O LLP:

1) Failed to obtain sufficient (or in some cases any) due diligence information to enable it to evaluate adequately the merits, risks and valuations of the Investments.

2) Failed to conduct adequate (or in some cases any) due diligence analysis to support its decisions to enter into each of the Investments.

3) Failed to conduct sufficient (or in some cases any) ongoing due diligence on the merits, risks and valuations of the Investments.

5.4. The need to conduct a high standard of due diligence was particularly important in relation to the Investments given that H2O LLP was investing in assets fundamentally different to its normal investment strategy and which were higher risk and illiquid in nature. In this context,

the fundamental lack of investment analysis conducted for many of the Investments fell short of basic standards of due diligence. H2O LLP compounded this failure by failing to conduct ongoing due diligence and continuing to reinvest and make further investments in companies related to Mr Windhorst, exposing investors in the H2O Funds to levels of risk in relation to the Investments that were not properly analysed and managed.

Breach of Principle 3

5.5. Principle 3 requires that a firm take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. During the Relevant Period, H2O LLP breached Principle 3 in that in relation to the Investments it:

1) Failed to have in place appropriate written policies and procedures, and / or systems and controls regarding investment decision-making: what and how due diligence should be performed; the rationale for investment decisions; or the basis for their valuations;

2) Failed to institute and / or maintain appropriate governance arrangements to review and scrutinise investment decisions; and

3) Failed to conduct adequate oversight, challenge or monitoring by its Risk and Compliance functions of the investment decision-making process which led to the Investments being made. In addition, H2O LLP's control functions failed to ensure compliance with H2O LLP's policies relating to gifts, hospitality, record keeping and conflicts of interest.

5.6. H2O LLP's policies and procedures relating to investment decision-making were insufficiently detailed. There also was a significant lack of appropriate governance fora to challenge and scrutinise the decisions of the Investment Decision Makers. H2O LLP has been forced (in the period between the side-pocketing and the date of this Notice) to substantially reduce the valuations of many of the Investments.

5.7. H2O LLP's control function failings were also systemic: during the Relevant Period, the role of the Risk and Compliance functions in providing oversight of or monitoring the investment decision-making process around the Investments was almost non-existent. H2O LLP's control functions also failed to identify or challenge numerous breaches of H2O LLP's policies and procedures relating to conflicts of interest and gifts and hospitality and failed to take any meaningful steps to address the increasing risk posed by the H2O Funds' exposure to the Investments.

5.8. In addition, H2O LLP failed to have in place appropriate conflicts of interest policies and procedures.

5.9. The risk of a potential conflict of interest should have been obvious to H2O LLP given the extensive receipt of hospitality and occasionally gifts by members of H2O LLP staff. There was a failure to have in place an appropriate framework to identify and mitigate such risks and to follow the limited systems and controls which H2O LLP did have in place in relation to conflicts of interest, gifts and hospitality. These failures meant that activities that could have acted as an inducement to continue making investments with Mr Windhorst were not properly overseen or challenged.

Breach of Principle 11

5.10. Principle 11 requires a firm to deal with the Authority in an open and cooperative way and to disclose to the Authority appropriately anything relating to the firm of which the Authority would reasonably expect notice.

5.11. H2O LLP provided documents and information to the FCA on a false and / or misleading basis on multiple occasions, thereby failing to comply with its duties under Principle 11.

5.12. In particular, H2O LLP:

1) Made multiple false and misleading statements in correspondence to the Authority regarding the levels of due diligence it had conducted on the Investments and when it had conducted this due diligence;

2) Created multiple records and minutes of governance and oversight committee meetings many of which had not, in fact, taken place at all and knowingly provided these falsified documents to the Authority;

3) Provided numerous misleading due diligence reports relating to the Investments which purported to evidence contemporaneous analysis of initial investment decisions but which had, in fact, been prepared subsequently. H2O LLP then took more than a year to admit that these due diligence materials had in fact been created retrospectively; and

4) Failed to disclose and provided misleading information as to the close relationship and receipt of hospitality between Mr Crastes and Mr Windhorst when it was asked by the Authority to explain their relationship and failed to disclose the receipt of hospitality from Mr Windhorst by certain other members of H2O LLP staff.

5.13. The Authority considers that H2O LLP intended by these actions to conceal certain matters from the Authority including:

1) the inadequate level and quality of research and analysis carried out by H2O LLP into the Investments; and

2) the inadequacy of the Firm's record keeping.

5.14. H2O LLP's misconduct in relation to Principle 11 was extremely serious for the following reasons:

1) There was extensive discussion within H2O LLP regarding the retrospective creation of documents and minutes which were known to be provided to the Authority. This was led by Senior Manager A and involved members of H2O LLP's Compliance function. Consideration was given by one H2O LLP employee (who has since left H2O LLP) as to how best to conceal the retrospective creation of documents and minutes from the Authority with, at one point, that former employee suggesting the use of specialist software to amend metadata on documents to be provided to the Authority (although such software ultimately does not appear to have been used).

2) Detailed instructions were provided to more junior H2O LLP employees on how best to retroactively create due diligence materials. Certain H2O LLP employees were plainly aware that this conduct was wrongful: one H2O LLP employee even noted: "*If the FCA has a way of finding out that we have changed these dates, the risk is obviously considerable*". However, the Authority has not seen any evidence that any member of H2O LLP staff ever sought to challenge or question this activity.

3) Senior Manager A knowingly made the false statements and provided the falsified documents to the Authority.

4) The repeated provision of false or misleading information to the Authority meant that for a significant period, the Authority was unable to determine fully whether the Firm was complying with the requirements and standards of the regulatory system. The conduct was indicative of a firm which was not ready, willing and able to comply with Principle 11 during the Relevant Period.

5.15. The extent of this misconduct was such that significant investigative resources and time had to be used to establish the true level of due diligence and analysis conducted on the Investments.

5.16. Since the Relevant Period, H2O LLP has taken measures to significantly enhance its governance, systems and controls to ensure that similar misconduct will not occur in future. This includes implementing a new governance model with changes to senior management roles and responsibilities and undertaking a culture review and change programme, as well as enhancements to its policies and procedures.

6. SANCTION

6.1. The Authority has had regard to the provisions of Chapter 6 of DEPP in relation to penalty, together with Chapter 7 of the Enforcement Guide. DEPP 6.4.1G states that the Authority will consider all the relevant circumstances of the case when deciding whether to impose a penalty or issue a public censure.

6.2. In the particular circumstances of this case, the Authority does not consider it would be appropriate to impose a financial penalty given the H2O Group volunteered to secure the sum of €250 million to be held for the sole purpose of making payments to Current SP Unitholders. Furthermore, H2O LLP has agreed to voluntarily cancel its regulatory permissions.

6.3. The Authority believes that its objectives may appropriately be achieved by means of a public censure. In reaching this conclusion, the Authority has had regard to the following matters:

a) For the reasons set out above, H2O LLP's conduct was extremely serious and a significant financial penalty would ordinarily be justified.

b) The H2O Group has voluntarily secured the sum of €250 million that is ring-fenced for the sole purpose of making payments to Current SP Unitholders. Current SP Unitholders will have the option whether or not to participate in an offer by H2O LLP to purchase their units in the Side-pocketed Funds; those who choose to participate will relinquish their rights to bring claims in respect of the Investments and receive an enhanced and earlier payment in return for doing so. In addition, the H2O Group has formally waived its rights to fees and investments totalling €320 million to the benefit of all unitholders in the Side-pocketed Funds.

c) To the extent the H2O Group is able to realise value from the side-pocketed assets or recover any monies paid in fines, such additional sums will also be paid to Current SP Unitholders;

d) If the Authority had imposed a financial penalty, this would have reduced the amount available to make payment to Current SP Unitholders.

e) H2O LLP has agreed to voluntarily apply to cancel its regulatory permissions and cease to conduct regulated activities within the UK by 31 December 2024.

f) Whilst currently the subject of appeal, the existence of a significant penalty imposed by the AMF on H2O LLP in respect of alleged misconduct relating to the same investments to which this Notice relates.

6.4. Accordingly, pursuant to section 205 of the Act, the Authority intends to publish a statement to the effect that H2O LLP breached regulatory requirements as outlined above.

7. PROCEDURAL MATTERS

7.1. This Notice is given to H2O LLP under section 205 and in accordance with the section 390 of the Act.

7.2. The following statutory rights are important.

Decision maker

7.3. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

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 Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

Authority contacts

For more information concerning this matter generally, contact Richard Bovan (direct line: 020 7066 6448/email: richard.bovan@fca.org.uk) and Kevin Oh (direct line: 020 7066 4312/email: kevin.oh2@fca.org.uk) at the Authority.

Allegra Bell

Interim Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1. RELEVANT STATUTORY PROVISIONS

Financial Services and Markets Act 2000

1.1. The Authority's statutory objectives, set out in section 1B(3) of the Act, include the consumer protection objective (section 1C FSMA) and the integrity objective (section 1D FSMA).

1.2. Section 205 of the Act provides:

> "If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may publish a statement to that effect."

1.3. H2O AM LLP is an authorised person for the purposes of section 205 of the Act.

2. RELEVANT REGULATORY PROVISIONS AND GUIDANCE

Relevant Regulatory Provisions

2.1. In exercising its powers to impose a financial penalty, the Authority has had regard to the relevant regulatory provisions published in the Authority's handbook. The main provisions that the Authority considers relevant are set out below.

Principles for Businesses

2.2. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant principles are as follows:

2.3. Principle 2 states: "A firm must conduct its business with due skill, care and diligence."

2.4. Principle 3 states: "A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

2.5. Principle 11 states: "A firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice."

Collective Investment Schemes (COLL)

2.6. COLL 6.6A.2R (Duties of AFMs of UCITS schemes to act in the best interests of the scheme and its unitholder) provides:

> "An authorised fund manager of a UCITS scheme must:
>
> (1) ensure that the unitholders of any such scheme it manages are treated fairly;
>
> (2) refrain from placing the interests of any group of unitholders above the interests of any other group of unitholders;
>
> (3) apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market;
>
> (4)
>
> (a) ensure that fair, correct and transparent pricing models and valuation systems are used for each scheme it manages, in order to comply with the duty to act in the best interests of the unitholders; and
>
> (b) be able to demonstrate that the investment portfolio of each such scheme it manages is accurately valued;
>
> (5) act in such a way as to prevent undue costs being charged to any such scheme it manages and its unitholders; and
>
> (6) in carrying out its functions act:
>
> (a) honestly, fairly, professionally and independently; and
>
> (b) solely in the interests of the UCITS scheme and its unitholders."

2.7. COLL 6.6A.4R (Due diligence requirements of AFMs of UCITS schemes) provides:

> "An authorised fund manager of a UCITS scheme must:
>
> (1) ensure a high level of diligence in the selection and ongoing monitoring of scheme property, in the best interests of the scheme and the integrity of the market;
>
> (2) ensure it has adequate knowledge and understanding of the assets in which any scheme it manages is invested;

(3) establish written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of any UCITS scheme it manages are carried out in compliance with the objectives and the investment strategy and risk limit system of the scheme;

(4) when implementing its risk management policy, and where it is appropriate after taking into account the nature of a proposed investment:

(a) formulate forecasts and analyse the investment's impact on the portfolio composition, liquidity and risk and reward profile of the scheme before carrying out the investment; and

(b) carry out the analysis in (a) only on the basis of reliable and up-to-date information, both in quantitative and qualitative terms;

(5) exercise due skill, care and diligence when entering into, managing or terminating any arrangement with third parties in relation to the performance of risk management activities; and

(6) before entering into any arrangements of the type referred to in (5):

(a) take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally and effectively; and

(b) establish methods for the ongoing assessment of the standard of performance of the third party."

Relevant Regulatory Guidance

DEPP

2.8. Chapter 6 of DEPP, which forms part of the Authority's Handbook, sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act.

The Enforcement Guide

2.9. The Enforcement Guide sets out the Authority's approach to exercising its main enforcement powers under the Act.

2.10. Chapter 7 of the Enforcement Guide sets out the Authority's approach to exercising its power to impose a financial penalty