Financial Services Authority

FINAL NOTICE

To:	**Kaupthing Singer and Friedlander Limited (in administration)**
FSA Reference Number:	**140839**
Address:	**21 New Street London EC2M 4HR**
Date:	**18 June 2012**

TAKE NOTICE: the Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives final notice about the issuance of a public censure:

1. ACTION

1.1. For the reasons set out below the FSA has decided to take action against Kaupthing Singer and Friedlander Limited ("KSFL") pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act").

1.2. The FSA has investigated the liquidity management of the UK-based, FSA-regulated bank KSFL in the period prior to KSFL being put into administration on 8 October 2008. KSFL activated its liquidity contingency process on 29 September 2008 and notified the FSA that it had done so on 30 September 2008. Nevertheless, we have found that between 29 September 2008 and 2 October 2008 KSFL did not give proper consideration to or properly monitor a special financing arrangement with its parent company in Iceland under which it could draw up to £1bn at short notice if it needed to.

1.3. While the ultimate insolvency of KSFL cannot be attributed to the failure to monitor promptly and properly the Liquidity Transformation Arrangement, the FSA has decided to issue a public censure against KSFL for breaches of Principle 2 of the FSA’s Principles for Businesses ("the Principles") which occurred between 29 September 2008 and 2 October 2008 (“the Relevant Period”) in relation to KSFL’s management of the assessment and reporting of its liquidity position.

1.4. KSFL’s financing arrangement with its parent was an important element of the firm’s survival in times of crisis and this failure alone would have led the FSA to impose a significant financial penalty were it not for the fact that KSFL is in administration.

1.5. KSLF agreed to settle this matter.

2. REASONS FOR THE ACTION

2.1. Firms which accept deposits are required to exercise particular care over the management of their liquidity positions, and are required to comply at all times with liquidity guidelines set by the FSA.

2.2. KSFL moved to ‘code red’ in accordance with its liquidity contingency process on 29 September 2008 and notified the FSA that it had done so on 30 September 2008. The FSA nevertheless considers that KSFL’s conduct fell below the requirements and standards of the regulatory system in that it did not exercise due skill, care and diligence by failing to consider promptly and properly whether liquidity stresses in its Icelandic parent Kaupthing Bank Hf (“KBHf”) would have a detrimental effect on its own liquidity position, as a result of which it failed to keep the FSA updated in relation to concerns about KBHf’s liquidity. In particular in the Relevant Period it failed to consider promptly and properly whether the warning signs it was receiving about the liquidity of KBHf meant that £1bn transferred on a rolling overnight deposit with KBHf, referred to as a liquidity transformation arrangement (the "Liquidity Transformation Arrangement"), could reasonably be regarded as recoverable in full or in part either on the contractual basis (overnight) or within 0-8 days, being the basis on which it was being reported to the FSA and relied upon by KSFL. This was despite the materiality of the Liquidity Transformation Arrangement to KSFL's overall liquidity and in particular to its ability to meet the FSA's liquidity guidance. By 29 September 2008 KSFL should have realised that there was a risk that the £1bn value of the Liquidity Transformation Arrangement might not be recoverable in full on an overnight basis, or within 0-8 days.

2.3. KSFL only communicated to the FSA that it had concerns regarding the operability of the Liquidity Transformation Arrangement at a meeting with the FSA in the late evening of 2 October 2008. However, the FSA acknowledges that KSFL had previously informed the FSA on 30 September 2008 that it was implementing its liquidity contingency procedures.

2.4. By assuming that it could rely in full on the Liquidity Transformation Arrangement without testing that assumption, and not acting on and discussing its eventual concerns with the FSA on a timely basis once it had become concerned about the Liquidity Transformation Arrangement, KSFL breached Principle 2.

2.5. While the ultimate insolvency of KSFL cannot be attributed to the failure to monitor promptly and properly the Liquidity Transformation Arrangement, the FSA considers KSFL's failings to be serious in view of the following considerations:

(1) they occurred at a critical period for the financial markets, shortly after Lehman Brothers Holdings Inc had filed for bankruptcy, during which period KSFL should have been particularly sensitive to developments that might have an impact on its liquidity and should have been particularly concerned to ensure that its liquidity position was assessed as accurately as possible;

(2) KSFL held significant deposits from UK retail consumers through its Kaupthing Edge internet banking operation;

(3) they related to a key component of KSFL's ability to meet its liquidity obligations, as the Liquidity Transformation Arrangement formed approximately 18% of KSFL's cumulative asset position in the 0-8 day liquidity bucket based on its FSA liquidity mismatch ratio calculations for 26 September 2008; and

(4) they occurred at a time when the FSA was particularly concerned to ensure that it was fully informed about all banks' liquidity.

2.6. The FSA recognises the following factors which mitigate the seriousness of KSFL's failings:

(1) following the collapse of Glitnir Banki Hf ("Glitnir") on 29 September 2008, KSFL's senior management placed KSFL into its highest state of liquidity contingency planning, 'code red', and notified the FSA the following day of the steps that were being taken – although the Liquidity Transformation Arrangement was not mentioned specifically, the reasons for placing KSFL on 'code red' were due to KSFL's concerns over events in Iceland;

(2) the failings occurred at a time of significant turmoil and uncertainty in the financial markets when KSFL was tackling many issues and concerns, and were restricted to a limited period of time;

(3) KSFL did seek actively to manage its liquidity during the Relevant Period, including by initiating its liquidity contingency planning process and by seeking to obtain further liquidity;

(4) KSFL did not deliberately or recklessly mislead the FSA about the status of its liquidity or the Liquidity Transformation Arrangement during the Relevant Period;

(5) KSFL also kept the FSA informed of other aspects of its liquidity management throughout the Relevant Period and had previously informed the FSA about its Liquidity Transformation Arrangement; and

(6) KSFL cooperated with the FSA in its approach to the financial turmoil in September and October 2008, including voluntarily agreeing to a variation in its regulatory permission on 3 October 2008.

2.7. The serious nature of the breaches identified in this notice would have led the FSA to impose a significant financial penalty were it not for the fact that KSFL is in administration.

3. RELEVANT STATUTORY PROVISIONS AND GUIDANCE

3.1. Section 205 of the Act provides:

“*If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect.”*

3.2. KSFL is an authorised person for the purposes of section 205 of the Act. The Principles are requirements imposed under section 138 of the Act. They represent a general statement of the fundamental obligations of authorised firms under the regulatory system.

3.3. Principle 2 states:

“A firm must conduct its business with due skill, care and diligence.”

3.4. In deciding to take this action, the FSA has had regard to the guidance published in the FSA Handbook in the Decision Procedure and Penalties Manual (“DEPP”), which forms part of the FSA Handbook. In particular, the FSA has taken into account the general criteria for determining whether to take disciplinary action and the factors relevant to determining the imposition of a public censure set out in DEPP 6.2G and 6.4G.

4. FACTS AND MATTERS RELIED ON

Background to Firm

4.1. In August 2005 the UK investment bank Singer & Friedlander plc was acquired by Kaupthing Holdings UK Limited, a subsidiary of KBHf, the largest bank in Iceland and was re-named Kaupthing Singer & Friedlander Limited (KSFL).

4.2. KSFL had six core business areas comprising Investment Banking, Capital Markets, Treasury, Banking, Wealth Management and Asset Finance.

4.3. During the Relevant Period, KSFL held permission under Part IV of the Act to carry on various regulated activities including accepting deposits, advising on investments, arranging (bringing about) deals in investments, dealing in investments as principal and managing investments.

4.4. KSFL provided an internet based savings product to retail customers, Kaupthing Edge ("Edge"), which by 29 September 2008 held over £2.5bn of retail customer deposits.

4.5. In accordance with its normal business practices, KSFL undertook a significant number of transactions with KBHf and its sister companies and their clients. These included investment and commercial banking deals as well as engaging in reverse repo and contract for difference transactions which it would sometimes then hedge with market counterparties.

4.6. On 3 October 2008 KSFL voluntarily agreed to vary its Part IV permission, which variation restricted its ability to market new products and required it to gain FSA approval for material cashflow movements. On 8 October 2008 the FSA applied to court to appoint administrators to KSFL.

FSA liquidity regime

4.7. FSA Rules require a bank to maintain adequate liquidity appropriate to the nature and scale of its business. In particular, a bank should be able to meet its obligations as they fall due. During the Relevant Period the FSA's Rules in this regard were set out in the FSA's Interim Prudential Sourcebook for Banks ("IPRU-BANK") and General Prudential Sourcebook ("GENPRU").

4.8. The Liquidity Management Chapter of IPRU-BANK set out that the FSA would give banks liquidity guidance and assess a bank's liquidity by means of the net cumulative mismatch in the maturity of its assets and liabilities. In the case of KSFL, the FSA's guidance entailed amongst other things KSFL complying with individual ratios as set by the FSA from time to time in relation to the extent of mismatch allowed in the maturity of its assets and liabilities (the "Liquidity Mismatch Ratios"). A mismatch is the difference between a bank's maturities of inflows (assets) and outflows (liabilities).

4.9. The Liquidity Mismatch Ratios KSFL was required to comply with during the Relevant Period were a minimum 0-8 day ratio of 0% and a minimum 0-30 day ratio of -5%. In practice these would mean that, at any one time, KSFL's contractual liabilities maturing in the next 8 days should not exceed the assets maturing during that same period, and that its liabilities maturing in the next 30 days should not exceed its assets maturing in the same period by more than 5%.

4.10. KSFL was required to report its performance against these Liquidity Mismatch Ratios to the FSA on a quarterly basis. Internally KSFL assessed its performance against them daily. If at any stage KSFL thought it might breach the Liquidity Mismatch Ratios, the FSA would have expected KSFL to notify it of this. In addition, as with a number of other banks, by the Relevant Period KSFL was required to report to the FSA on a daily basis on the contractual maturity of its assets and liabilities over the next 90 days. The FSA had requested this frequency of reporting because it was concerned about KSFL's position given the then ongoing crisis in the banking sector. During the Relevant Period, the FSA would have expected KSFL to be monitoring the key components of its liquidity position extremely closely and to have advised the FSA of any significant threats to KSFL's liquidity position.

The Liquidity Transformation Arrangement

4.11. Throughout the Relevant Period the Liquidity Transformation Arrangement was in place between KSFL and KBHf. It was created by two separate transactions whereby KSFL borrowed monies from KBHf to be repaid up to three months later. KSFL then deposited these monies back to KBHf, with an overnight contractual maturity date (i.e. the monies were notionally due to be repaid in full by KBHf the next day). There was then a netting agreement between KSFL and KBHf which meant that, in credit terms, the two transactions were netted off. These two transactions comprising the Liquidity Transformation Arrangement were rolled over and, other than in respect of interest payments, no cash movements actually occurred on a daily basis.

4.12. The existence of the Liquidity Transformation Arrangement had previously been disclosed to the FSA and had been successfully used by KSFL in the past to call on funds from KBHf.

4.13. By the Relevant Period, the value of the Liquidity Transformation Arrangement was £1bn, 18% of KSFL's cumulative asset position in the 0-8 day liquidity bucket based on its Liquidity Mismatch Ratio calculations for 26 September 2008. The Liquidity Transformation Arrangement accordingly formed a significant part of KSFL's liquidity reserves.

4.14. Each of these transactions would be considered as both an asset and a liability on the books of KSFL and KBHf. For example, KSFL would record the £1bn that it owed KBHf as a liability maturing in 3 months' time; and the £1bn that it lent KBHf as an asset maturing the next day.

4.15. One effect of the Liquidity Transformation Arrangement was that KSFL's Liquidity Mismatch Ratios were improved by KSFL having a short-dated £1bn asset contained within the 0-8 day and 0-30 days liquidity buckets, but with no corresponding liability within those time periods. It had a material effect on KSFL's performance against its Liquidity Mismatch Ratios, and after 26 September 2008, if the Liquidity Transformation Arrangement had not been in place KSFL would have breached the Liquidity Mismatch Ratios.

4.16. KSFL's reporting of the Liquidity Transformation Arrangement as an overnight asset depended upon KBHf being able to repay to KSFL the £1bn within the time period of the relevant Liquidity Mismatch Ratios. Therefore the liquidity of KBHf was a material factor in KSFL being able to rely upon the Liquidity Transformation Arrangement when compiling its reports of its performance against the Liquidity Mismatch Ratios.

4.17. Throughout the Relevant Period, KSFL included the £1bn due on an overnight basis from KBHf under the Liquidity Transformation Arrangement in full among its assets for the purposes of its reporting to the FSA.

4.18. The £1bn asset should only have been included in KSFL's calculations for the purposes of the Liquidity Mismatch Ratios if KSFL believed on reasonable grounds that it could be repaid in full to the extent that it was relied upon. If there were sufficient reasons to doubt the ability of KBHf to repay the £1bn asset either on an overnight basis, or within 0-8 days (as it was relied upon) then KSFL should either have excluded the asset from its calculations, or only included so much of it as was reasonable following a proper assessment.

Indications of liquidity stresses from Icelandic Parent

4.19. On 15 September 2008 Lehman Brothers Holdings Inc filed for bankruptcy protection, which acutely aggravated the global financial crisis. From this date, KSFL received an increasing number of signals which suggested that KBHf was experiencing significant liquidity difficulties. These included KBHf wishing to accelerate certain transactions and negotiating the timing and method of payment of margin calls. These signals should have indicated that KBHf needed to improve its cash liquidity.

4.20. On the morning of 29 September 2008 news broke that Glitnir, Iceland's third largest bank, had been nationalised in an emergency rescue by the Icelandic government. This caused a crisis of confidence in Icelandic financial institutions generally. As a result of this KSFL moved its own liquidity status to 'code red' to reflect its alarm following Glitnir's failure and notified the FSA of its move to 'code red'. Of the crisis, KSFL recognised that this was "*affecting the whole global financial sector market with a strong colour from our relations to Iceland*". KSFL should have realised that its parent would also be affected by the loss of confidence.

4.21. Therefore, on or by 29 September 2008, when KSFL moved to 'code red', there were sufficient warning signals for KSFL to have serious concerns about the liquidity situation of KBHf. These concerns meant that KSFL should have realised that there was a serious risk that the £1bn value of the Liquidity Transformation Arrangement may not in fact be recoverable in full on an overnight basis, or within 0-8 days.

Reaction of KSFL to indications of liquidity stress

4.22. During the Relevant Period KSFL continued to rely on public announcements from KBHf that it had secured liquidity to last 360 days. It also assumed that there were back-up financing facilities in place at the KBHf level that could be relied on to ensure the operability of the Liquidity Transformation Arrangement.

4.23. During the Relevant Period, KSFL's own short term liquidity, excluding the Liquidity Transformation Arrangement, fell from £968m to £451m.

4.24. On and from 29 September KSFL did take some steps to manage KSFL's liquidity position and inform the FSA of this.

4.25. However, despite the indications of liquidity stress in KBHf, until 1 October 2008 there was no consideration given to whether the Liquidity Transformation Arrangement could reasonably be regarded as a recoverable asset. Then, from 1 October to the evening of 2 October 2008 KSFL did not act upon or report to the FSA the increasing risk to the performance of the Liquidity Transformation Arrangement, even when KSFL had been receiving warning signs that KBHf's liquidity position was very strained on or by 29 September. This was despite the importance of this for KSFL to maintain its adherence to the Liquidity Mismatch Ratios, and its liquidity generally. Only when KSFL met the FSA on the evening of 2 October 2008 did it communicate its specific concerns about the operability of the Liquidity Transformation Arrangement.

5. ANALYSIS OF BREACHES AND SANCTION

Breach of Principle 2

5.1. On the basis of the facts and matters set out at paragraphs 4.1 to 4.25, KSFL breached Principle 2 during the Relevant Period in that it did not exercise due skill, care and diligence by failing to consider promptly and properly in the Relevant Period whether £1bn it was owed by KBHf pursuant to the Liquidity Transformation Arrangement could be regarded as recoverable in full or in part either overnight or within 0-8 days, as a result of which it failed to keep the FSA updated in relation to concerns about KBHf's liquidity. This was despite the materiality of the Liquidity Transformation

Arrangement to KSFL's overall liquidity and in particular to its ability to meet the FSA's liquidity guidance. By 29 September 2008 KSFL should have realised that there was a serious risk that the £1bn value of the Liquidity Transformation Arrangement might not be recoverable in full on an overnight basis, or within 0-8 days. By simply continuing to assume that it could rely in full on the Liquidity Transformation Arrangement without testing that assumption (between 29 September and 1 October) and not acting on and discussing its eventual concerns with the FSA until the late evening on 2 October, KSFL breached Principle 2.

6. ANALYSIS OF SANCTION

6.1. The FSA's policy on the imposition of public censures is set out in Chapter 6 of DEPP, which forms part of the FSA Handbook and came into force on 28 August 2007. This manual sets out the factors that may be of relevance in determining whether to take action and if so what action to take. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

6.2. The FSA considers that the following factors are particularly relevant in this case.

The nature, seriousness and impact of the breach

6.3. In determining the appropriate sanction, the FSA has had regard to the seriousness of the contraventions, including the nature of the breaches, the number and duration of the breaches, and the number of clients who were exposed to risk of loss. For reasons set out at paragraph 2.5 above the FSA considers that the breaches identified in this case are of a serious nature. While the ultimate insolvency of KSFL cannot be attributed to the failure to monitor promptly and properly the Liquidity Transformation Arrangement, KSFL nevertheless fell below the requirements and standards of the regulatory system.

6.4. It was important for the FSA to have access to accurate information to enable it to make appropriate decisions in a period of financial crisis. However, the FSA also recognises the mitigating factors set out in paragraph 2.6.

The extent to which the breach was deliberate or reckless

6.5. The FSA has considered the extent to which KSFL's actions were reckless or deliberate. The FSA has determined that KSFL has not deliberately or recklessly contravened regulatory requirements.

The size, financial resources and other circumstances of the Firm

6.6. In determining the imposition of a public censure, the FSA has been mindful of the size and financial resources of KSFL. The Firm is currently in administration.

Conduct following the breach

6.7. KSFL cooperated with the FSA in other aspects of its approach to the financial turmoil in September and October 2008, including voluntarily agreeing to variations in its regulatory permissions.

Disciplinary record and compliance history

6.8. KSFL has not previously been the subject of disciplinary action by the FSA.

Other action taken by the FSA

6.9. In determining whether to impose a public censure, the FSA has taken into account action taken by the FSA on other authorised persons for similar behaviour.

7. CONCLUSIONS

7.1. In light of the matters set out above, the FSA has concluded that KSFL breached Principle 2 in relation to the way it failed to consider promptly and properly, and act appropriately upon warnings signs in relation to KBHf's liquidity position. The FSA would have imposed a significant financial penalty on KSFL, were it not for the fact that KSFL is in administration. In those circumstances, the FSA has decided to issue a public censure. The public censure will be issued on 25 June 2012 and will take the form of this Final Notice, which will be published on the FSA's website.

8. DECISION MAKERS

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

9. PUBLICITY

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

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

10. FSA CONTACTS

10.1. For more information concerning this matter generally you should contact Stephen Robinson at the FSA (direct line: 020 7066 1338 /fax: 020 7066 1339).

Georgina Philippou

Project Sponsor

FSA Enforcement and Financial Crime Division