Financial Conduct Authority

FCA
FINANCIAL CONDUCT AUTHORITY

# FINAL NOTICE

To: **Invesco Asset Management Limited**
**Invesco Fund Managers Limited**

Reference Number: Invesco Asset Management Limited – 122674
Invesco Fund Managers Limited – 119298

Address: Perpetual Park
Perpetual Park Drive
Henley-on-Thames
Oxfordshire
RG9 1HH

Date: 24 April 2014

## 1. ACTION

1.1. For the reasons given in this notice, the Authority hereby imposes on Invesco Asset Management Limited ("IAML") and Invesco Fund Managers Limited ("IFML") (together, "Invesco Perpetual") a financial penalty of £18,643,000.

1.2. Invesco Perpetual agreed to settle at an early stage of the Authority's investigation. Invesco Perpetual therefore qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of 26,632,900 on Invesco Perpetual.

## 2. SUMMARY OF REASONS

2.1. Invesco Perpetual manages some of the largest retail funds in the UK and, as at December 2013, was responsible for managing funds totalling approximately £71 billion. Most of its investors are retail investors. These investors rely on Invesco

Perpetual to manage their money in line with their reasonable expectations. Business practices must reflect investors' interests at all times.

2.2. When investors place their funds with an asset management firm they are entitled to rely on the firm to act in accordance with regulatory requirements designed to ensure fairness and protection of investors' interests. Investors are not in a position to monitor how their investments are being managed and so it is vital that firms:

(1) invest their money in the way that investors reasonably expect and in accordance with the risk profile of the fund they invest in;

(2) disclose proper information to investors so that they can understand any risks involved; and

(3) put in place proper controls around their business practices.

2.3. For some or all of a four and a half year period from May 2008 to November 2012 (the "Relevant Period"), Invesco Perpetual failed to comply with its regulatory obligations towards its investors by:

(1) investing some of its funds in breach of investment limits;

(2) introducing leverage into certain funds without providing investors with proper disclosure about the risks involved; and

(3) failing to put adequate controls in place to ensure that all funds were valued accurately and that all trades were allocated fairly between funds.

2.4. As a result of these failings, Invesco Perpetual's investors were exposed to greater levels of risk than they had been led to expect. Funds suffered actual losses of nearly £5.3 million as a result of 11 of Invesco Perpetual's breaches of investment limits (Invesco Perpetual has already compensated the relevant funds), and there was a risk that they could have suffered more.

2.5. These failings amount to breaches of Principle 3 and Principle 7, together with certain of the Authority's Rules.

2.6. In particular:

(1) IFML failed to comply with investment restrictions set out in Rule 5.2 of the Authority's COLL Rules. These restrictions lay down standards that asset

management firms must comply with when investing investors' money in an authorised fund. They are an important control designed to protect investors by limiting the risk that investors' funds are exposed to (for example, by ensuring that there is an appropriate spread of risk within an authorised fund). Invesco Perpetual records show that 33 trades were made in breach of these restrictions during the Relevant Period, which affected over 70% of IFML's assets under management. This put investors at a greater level of risk than they had been led to expect when investing in the fund. During the Relevant Period Invesco Perpetual paid close to £5.3 million to its funds to compensate for losses suffered as a result of these breaches in compliance with the relevant COLL rules.

(2) Invesco Perpetual introduced leverage of up to £1 billion into certain of its funds through its use of derivatives (equivalent to 5% of the NAV of these funds), without disclosing this adequately to its investors. Introducing this level of leverage increased the risk that investors would suffer losses and could have amplified the magnitude of any losses. For most of the Relevant Period IFML failed to disclose adequately to its investors in the relevant Simplified Prospectus or KIID (the key documents available to investors when deciding to invest in a fund) that it was permitted to invest certain of its funds in derivatives (although an appendix of the relevant full prospectuses referred to the use of derivatives). This use of derivatives could, and did, introduce leverage into those funds.

(3) Invesco Perpetual failed to invest adequately in the systems and controls around its front office, in that it failed to put in place adequate systems and controls to ensure that it recorded trades in all fixed income funds on a timely basis. As a result, over a two-year period between 2010 and 2011, at least 9% of trades in fixed income funds were not recorded on the day of execution, creating a risk that the daily valuation of these funds would be inaccurate. This placed investors at a risk of loss, because:

(a) fund managers may have made inappropriate investment decisions because they were based on an inaccurate valuation of the portfolio;

(b) compliance checks would have been carried out on incomplete data; and

(c) units in the funds may not have been correctly priced (although a subsequent review by Invesco Perpetual's Internal Audit department did not identify any material compensatable errors).

(4) Invesco Perpetual similarly failed to put in place adequate controls around its front office to ensure that fund managers allocated partially executed aggregated trades fairly in respect of all fixed income funds. This gave rise to the risk that fund managers could have allocated stocks unfairly between funds, which in turn could have prejudiced investors.

2.7. The Authority's operational objectives include securing an appropriate degree of protection for consumers. Invesco Perpetual's failings threatened this objective. The Authority therefore imposes a financial penalty on Invesco Perpetual in the amount of £18,643,000 pursuant to section 206 of the Act for breaches of Principle 3, Principle 7 and COLL 6.6.14R. The level of the financial penalty reflects the significant revenue Invesco Perpetual derived from the very large sums of investors' money it managed.

2.8. Invesco Perpetual has co-operated fully with the Authority throughout the investigation.

2.9. Invesco Perpetual has compensated funds in full in respect of the £5.3 million losses caused by its breach of investment limits. In addition, in May 2012, Invesco Perpetual put in place new systems and controls in relation to the allocation of orders and timely recording of trades.

**3. DEFINITIONS**

3.1. The definitions below are used in this Final Notice.

"ACD" means Authorised Corporate Director.

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

"Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority.

"CRD" means the Charles River Development System.

"COBS" means the Conduct of Business Rules.

"COLL" means the Collective Investment Scheme Rules.

“DEPP” means the Decision Procedure and Penalties Manual.

“FTSE All-Share Index” means a market-capitalisation weighted index representing the performance of all eligible companies listed on the London Stock Exchange’s main market.

“IAML” means Invesco Asset Management Limited.

“ICVC” means Investment Company with Variable Capital.

“IFML” means Invesco Fund Managers Limited.

“IMA” means The Investment Management Association.

“IMA UK Equity Income sector” means the Investment Management Association UK Equity Income sector incorporating all funds that invest at least 80% in UK equities and which intend to achieve a historic yield on the distributable income in excess of 110% of the FTSE All Share yield at the fund’s year end.

“Invesco Perpetual” means Invesco Asset Management Limited and Invesco Fund Managers Limited.

“KII Regulation” means Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus.

“KIID” means Key Investor Information Document.

“NAV” means Net Asset Value.

“Relevant Equity Funds” means certain equity funds managed by Invesco Perpetual.

“Relevant Period” means 1 May 2008 to 16 November 2012.

“Simplified Prospectus” means a marketing document containing information about a simplified prospectus scheme which complies with COLL 4.6.2R and COLL 4.6.8R.

“Synthetic Risk Indicator” means the Synthetic Risk and Reward Indicator which is a rating prescribed by the KII Regulation, designed to provide investors with a standardised assessment of a fund’s risk profile.  It is based on the volatility of

the fund which is calculated using the annualised volatility of the total returns over the past five years.

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

"UCITS" means Undertakings for Collective Investments in Transferable Securities.

## 4. FACTS AND MATTERS

4.1. IAML and IFML operate under the trading name of Invesco Perpetual. Together, they manage the Invesco Perpetual branded range of funds. Invesco Perpetual represents one of the largest retail investment businesses in the United Kingdom, with assets under management totalling approximately £71 billion (as at December 2013) with around 75% being retail funds. The findings in this Warning Notice relate to Invesco Perpetual's management of its Invesco Perpetual branded range of funds, whose assets under management total approximately £47 billion (as at December 2013).

4.2. IFML was the ACD of these funds during the Relevant Period. As such, it was responsible for dealing with the day to day operation of the funds, managing the funds' portfolio of investments, buying and selling the funds' shares at the demand of investors, performing valuations of the funds' assets and calculating the price of shares.

4.3. Throughout the Relevant Period, IFML delegated its portfolio management responsibilities in respect of the funds in-house, to IAML. Although IFML delegated its management responsibilities, it retained its regulatory responsibilities in respect of the funds. Both IAML and IFML are authorised by the Authority and both are subject to its rules.

4.4. During the Relevant Period, IAML and IFML both failed to comply with their obligations when managing investors' funds. These failings (which are detailed below) resulted in investors taking on greater risk than they had been led to expect and resulted in losses of nearly £5.3 million (for which the affected funds have been compensated).

**Breaching the investment restrictions set out in COLL 5.2**

4.5. Invesco Perpetual made trades which breached investment restrictions set out in COLL 5.2. These breaches exposed investors to greater levels of risk than they had been led to expect and resulted in certain funds being compensated in respect of losses of nearly £5.3 million.

4.6. COLL 5.2 sets out a number of investment restrictions which must be followed when investing the scheme property of a UCITS scheme. These restrictions are an important control designed to protect investors by setting minimum standards for the investments which may be held by the fund, for example by ensuring that the fund's investments are sufficiently diversified to give a prudent spread of risk. These minimum standards limit the extent of risk that investors are exposed to when investing their money in the relevant fund. Where there are breaches of these rules, for example in relation to the spread of investments, investors may find themselves invested in a fund which has a more concentrated portfolio and hence a different level of risk than they had been led to expect.

4.7. The Authority views these investment restrictions as a very important safeguard for consumer protection. The restrictions set clear, defined limits, and other than in exceptional circumstances firms must not enter into trades which breach these restrictions.

4.8. During the Relevant Period, Invesco Perpetual's records show that trades were made on 33 separate occasions which resulted in avoidable breaches of the COLL 5.2 investment restrictions. While the Authority recognises that only a small minority of Invesco Perpetual's trades during the Relevant Period resulted in an avoidable breach of these restrictions, the Authority considers any such breach to be serious. Although each of these breaches (detailed below) was relatively self-contained, they occurred across 15 of the Invesco Perpetual branded range of funds which represented more than 70% (i.e. approximately £35 billion) of the assets under management of that range of funds:

(1) During the four and a half year Relevant Period, Invesco Perpetual recorded 22 trades made in breach of COLL 5.2.11R. Invesco Perpetual paid compensation totalling £1.74 million to its funds in respect of these breaches (as required by the rules in COLL). COLL 5.2.11R sets out the minimum level of safe diversification of investment risk in funds subject to the UCITS Directive. The majority of these breaches were of the specific restrictions in COLL 5.2.11R (4) and (5), which state that no more than

5% of a fund’s scheme property can consist of transferable securities issued by any single body, rising to 10% provided that the total value of transferable securities held in those bodies does not exceed 40% of the fund’s scheme property. For example, on 25 November 2010, one of Invesco Perpetual’s funds fell into an unavoidable breach of COLL 5.2.11(4)R when a price increase in the equities of a FTSE 100 company resulted in the fund’s holding in those equities rising to 5.01% of the fund’s NAV and the aggregate of the holdings in the fund above 5% rising to 44.46% of the NAV. The next day, rather than rectifying the position, the fund made further purchases of those equities which worsened the breach. Invesco Perpetual paid compensation of over £1.5 million to the fund to reflect the loss incurred by the fund.

(2) Invesco Perpetual recorded eight trades made in breach of COLL 5.2.27R over the Relevant Period, five of which resulted in compensation of £3.33 million being paid to the fund. COLL 5.2.27R states that a fund must not acquire transferable securities in an entity if it gives the fund power to influence significantly the conduct of that entity, and for this purpose sets a maximum limit of 20% of the transferable securities carrying voting rights.

(3) Invesco Perpetual recorded three trades made in breach of COLL 5.2.29R over the Relevant Period. One of these trades resulted in compensation of just over £200,000 being paid to the relevant fund. COLL 5.2.29R seeks to ensure that a fund does not exceed certain concentration limits, including that it must not acquire more than 10% of the non-voting transferable securities or debt securities issued by the same body.

**Failing to disclose adequately to investors the risks arising from the use of derivatives**

4.9. Invesco Perpetual’s investors were also exposed to increased levels of risk through the firms’ use of derivatives during the Relevant Period and consequent introduction of up to £1 billion of leverage (representing 5% of NAV) into the Relevant Equity Funds. Invesco Perpetual failed adequately to disclose the risks associated with its use of derivatives to its investors which meant that investors: (1) may not have been fully aware of the risks involved when investing their money; and (2) were exposed to a higher level of risk than they had been led to expect. There was a risk that investors may therefore have made investment

decisions which, with appropriate information, they might not otherwise have made.

Invesco Perpetual's use of derivatives in the Relevant Equity Funds

4.10. Invesco Perpetual first began investing the Relevant Equity Funds in derivatives in November 2008, and from mid-2010 the Relevant Equity Funds started using derivatives which resulted in leverage being introduced into the funds. These leveraged positions, and the resulting additional exposure, steadily increased up to 5% from mid-2010 to 2012.

4.11. Invesco Perpetual was permitted to use derivatives within the portfolios of the Relevant Equity Funds provided that no more than 20% of their net asset value would be exposed to derivatives. During the Relevant Period, the highest level of leverage was 5% which was within the limits set by Invesco Perpetual's own internal procedures. However given the size of the Relevant Equity Funds (which represented over 50% of the assets under management of the Invesco Perpetual branded range of funds) this in itself amounted to £1 billion of additional exposure. Introducing leverage into the Relevant Equity Funds exposed investors to additional risk because it meant that any losses suffered by the funds could have been greater than if the funds' positions were not leveraged.

Key sources of information available to investors

4.12. One of the main sources of information about a fund that is available to investors is the KIID. The KIID is a short document, designed to inform investors of the essential characteristics of the fund in question, including a fund's risk profile, so that an investor can understand the nature and risks of the investment and make an investment decision on an informed basis. As the ACD, IFML was responsible for producing these documents.

4.13. KIIDs were introduced in July 2011, with a one-year period for implementation. Prior to this, IFML was required to produce Simplified Prospectuses. Similar to the KIIDs, these documents were designed to include all information necessary to enable an investor to make an informed decision about whether to invest in an authorised fund, presented in a way that can be easily understood.

4.14. It is reasonable to expect that retail investors will rely on the product information in a KIID or Simplified Prospectus when deciding whether to invest in an authorised fund, without referring to the detailed prospectus. It is therefore vital that these documents contain the appropriate information to enable investors to

understand the key risks involved. Furthermore, it is essential that both KIIDs and Simplified Prospectuses are clear, fair and not misleading, and there are detailed rules governing the contents of these documents.

The Simplified Prospectus failings

4.15. IFML failed to disclose its use of derivatives in the Simplified Prospectuses it provided to investors in respect of the Relevant Equity Funds. IFML produced Simplified Prospectuses in early 2008, and produced revised versions in early February 2011. Although the full prospectuses provided for the use of derivatives, neither version of Invesco Perpetual's Simplified Prospectuses made any direct reference to the use of derivatives in the Relevant Equity Funds, nor to the specific risks associated with this.

4.16. As at the date of production of the initial Simplified Prospectuses (early 2008), Invesco Perpetual had not invested any of the Relevant Equity Funds in derivatives. Although the Relevant Equity Funds' full prospectuses and relevant internal risk management policies expressly permitted Invesco Perpetual to invest in derivatives, the Simplified Prospectus made no reference to this. The Simplified Prospectuses did state that: "*In pursuing* [its investment] *objective the fund managers may include investments that they consider appropriate which include transferable securities, money market instruments, warrants, collective investment schemes, deposits and other permitted investments and transactions as detailed in Appendix 2 of the most recent Full Prospectus.*" This list of permitted investments included every single investment listed in Appendix 2 of the relevant full prospectuses except for derivatives and government and public securities. By excluding any reference to derivatives from this list, investors may have had a misleading picture of Invesco Perpetual's investment strategy with regard to the Relevant Equity Funds, and the associated risks.

4.17. Further, when Invesco Perpetual first invested the Relevant Equity Funds in derivatives in November 2008, and also when the Relevant Equity Funds became leveraged as a result of Invesco Perpetual investing in derivatives again from mid-2010, IFML failed to update its Simplified Prospectus to disclose this change of strategy even though this was a factor which was likely to influence the average investor when deciding whether or not to invest, or realise their investment, in the Relevant Equity Funds.

4.18. In addition, the revised version of the Simplified Prospectus issued in early 2011 remained silent on the use of derivatives in the Relevant Equity Funds and the associated risks.

The KIID failings

4.19. As required by the Authority, IFML replaced the Simplified Prospectuses with KIIDs in February 2012. At the time this KIID became effective, Invesco Perpetual had invested the Relevant Equity Funds in derivatives, and the funds were leveraged as a result.

4.20. Unlike the Simplified Prospectuses, the KIIDs did refer to derivatives. The disclosure in the KIID was as follows: *"The Fund may use derivatives (complex instruments) in an attempt to reduce the overall risk of its investments or reduce the costs of investing, although this may not be achieved".* This statement appeared in each KIID in place between February 2012 and August 2012.

4.21. Whilst the KIIDs pre-August 2012 made reference to the use of derivatives, they only emphasised the potential benefits of the use of derivatives and not the downside risks. Specifically, the KIID suggested that investing in derivatives may reduce the overall risk of the fund. Despite the warning that the reduction may not be achieved, this description was misleading because it did not reflect the actual impact of the use of derivatives; that the Relevant Equity Funds' use of derivatives resulted in the funds becoming leveraged which could result in greater fluctuations in the value of the investment and would increase the magnitude of any losses. Introducing leverage into a fund does not reduce risk. This disclosure was unclear and gave investors a misleading impression of the specific risks involved in investing in the Relevant Equity Funds. The KIID did however include a Synthetic Risk Indicator which rated each of the Relevant Equity Funds at 6 out of 7, indicating a relatively high level of volatility as a measure of overall riskiness.

4.22. In August 2012, and at the Authority's request, Invesco Perpetual amended the KIIDs in place for the Relevant Equity Funds to include a clearer reference to the risks associated with Invesco Perpetual's use of derivatives. The revised KIIDs state: *"Investments in the Fund may include financial derivative instruments. Such instruments may be used to obtain, increase or reduce exposure to underlying assets and may create gearing: therefore their use may result in greater fluctuations of the Net Asset Value of the Fund. The Manager will ensure*

*that the use of derivatives does not materially alter the overall risk profile of the Fund."*

The performance of the Relevant Equity Funds

4.23. The Authority recognises that, during the Relevant Period, the Relevant Equity Funds achieved better returns for investors than the FTSE All-Share and the IMA UK Equity Income sector average. Nevertheless, the Authority considers Invesco Perpetual's disclosure failings to have been serious because the introduction of leverage through the use of derivatives into the portfolios of the Relevant Equity Funds from mid-2010 increased the risk that the funds would suffer losses and could have amplified the magnitude of any losses. Invesco Perpetual's disclosure failings may have also given it an unfair advantage over its competitors, as it may have benefited from the use of additional funds from investors who would not have invested had Invesco Perpetual made adequate disclosures.

**Deficiencies in the front office controls over fixed income securities**

4.24. Investors were also exposed to increased levels of risk as a result of Invesco Perpetual's failure to put adequate controls in place in its fixed income business and in particular its: (1) failure to record trades on a timely basis; and (2) failure to monitor the allocation of aggregated trades.

Failure to record trades on a timely basis

4.25. From the start of the Relevant Period to 8 May 2012, Invesco Perpetual failed to record trades in its fixed income business on a timely basis. This gave rise to the risk that the funds may not have been priced accurately and that investment decisions may have been made which were not appropriate for the fund.

4.26. Invesco Perpetual only recognised the seriousness of this issue in 2012 after it was flagged by its Internal Audit department. An Internal Audit report produced in May 2012 identified that over the two-year period from 2010 to 2011, Invesco Perpetual had failed to record 9% of trades in its Fixed Income business onto the CRD system on the day of execution. Approximately 17% of these late trades were booked two or more days after execution and in one instance, a late trade was not recorded onto CRD until 27 days after execution.

4.27. Trades not captured on CRD on the day of the trade would not be reflected in Invesco Perpetual's fund accounting system. This created a risk that the daily valuation of the funds would be inaccurate. Indeed, sample testing carried out by Invesco Perpetual's Internal Audit indicated that (on a sample basis) around 35%

of the trades not recorded on the day of execution between 2010 and 2011 had missed the relevant NAV valuation point.

4.28. Invesco Perpetual's persistent and repeated failure to ensure that it promptly recorded trades onto its accounting system placed its investors at an increased risk of loss. In particular:

(1) any decisions made by Invesco Perpetual's fund managers based on the portfolio at that valuation point may have been inappropriate;

(2) compliance checks would have been carried out on incomplete data; and

(3) units in the funds may not have been correctly priced (although a subsequent review by Invesco Perpetual's Internal Audit department did not identify any material compensatable errors in this respect).

4.29. Invesco Perpetual made the decision to pay compensation to the funds on two occasions for losses of nearly £1,500 recorded as arising from the late or incorrect input of trades.

4.30. The failure to record trades on a timely basis resulted from deficiencies within the front office control environment resulting from Invesco Perpetual's failure to invest adequately in the systems in place. Invesco Perpetual used a manual paper based system in its fixed income business which meant that it was more difficult to ensure that trades were captured in a timely fashion and Invesco Perpetual failed to put in place additional systems and controls to mitigate this risk. Furthermore, Invesco Perpetual failed to ensure that there was adequate oversight or challenge of the process surrounding late trades.

<u>Failure to monitor fund managers' allocation of trades in respect of aggregated trades</u>

4.31. Invesco Perpetual failed to put adequate controls in place (prior to May 2012) to monitor how partially executed aggregated trades within its fixed income business were allocated. This gave rise to the risk that some investors or funds could have been favoured over others, and as a result investors may have lost out.

4.32. Where a firm aggregates a client order with one or more other orders and the aggregated order is only partially executed, the Authority's rules require that firm to allocate the related trades in accordance with its order allocation policy. Each firm which carries out aggregated orders must establish and implement such an order allocation policy, and this policy must set out the fair value allocation of

aggregated orders and transactions including the treatment of partially executed orders. These rules are designed to ensure that trades are allocated fairly between funds, and that investors are not disadvantaged.

4.33. Invesco Perpetual relied on a manual, paper-based order entry process in relation to its Fixed Income funds rather than an automated order management system. The manual system in place did not provide a sufficient audit trail for Invesco Perpetual to monitor how its fund managers were reallocating trades where aggregated orders were partially executed. Specifically, whilst Invesco Perpetual retained records of how each aggregated trade was ultimately executed and therefore allocated, it failed to make or retain records of the initial decision to deal and the intended allocation. As a result, Invesco Perpetual was not able to monitor: (1) whether there were any reallocated trades; and (2) if so, whether fund managers were allocating such trades fairly and in accordance with Invesco Perpetual's order allocation policy.

4.34. Once it identified these issues in May 2012, Invesco Perpetual enhanced its processes so that investment decisions and intended allocations are now recorded on a pre-trade basis.

## 5. FAILINGS

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

### Breaching the investment restrictions set out in COLL 5.2

COLL 6.6.14R

5.2. COLL 6.6.14R requires authorised fund managers (including ACDs) to avoid scheme property being used or invested contrary to COLL 5.2 (except to the extent permitted by the rule). As set out in paragraphs 4.5 to 4.8 above, according to its records IFML (as ACD of the relevant Funds) failed to comply with this rule on 33 separate occasions during the Relevant Period, which resulted in compensation payments totalling close to £5.3 million being made to funds.

### Failing to disclose adequately to investors the risks arising from the use of derivatives

Principle 7

5.3. Principle 7 requires firms to pay due regard to the information needs of their clients, and communicate information to them in a way which is clear, fair and not misleading.

5.4. For the reasons set out in paragraphs 4.9 to 4.23, IFML failed to comply with Principle 7 when providing its investors with information about the Relevant Equity Funds in: (a) the Simplified Prospectuses in place between the start of the Relevant Period and February 2012; and (b) the KIIDs in place between February 2012 and August 2012. These documents failed adequately to inform investors about Invesco Perpetual's permitted and actual use of derivatives in respect of the Relevant Equity Funds and the associated risks.

COLL 4.6.2R (prior to February 2012)

5.5. COLL 4.6.2(3)R provides that IFML must be satisfied on reasonable grounds that its Simplified Prospectus contains all such information as is necessary to enable an investor to make an informed decision about whether to acquire units in the relevant fund. As set out in paragraphs 4.15 to 4.18 IFML failed to include any reference to its use of derivatives and associated risks in the Simplified Prospectuses in place for the Equity Funds. This information was necessary to enable an investor to make an informed decision as to whether to acquire units in the Relevant Equity Funds, and IFML's failure to include this information in the Simplified Prospectuses amounted to a breach of COLL 4.6.2(3)R.

COLL 4.6.3R (prior to February 2012)

5.6. COLL 4.6.3R required IFML to keep its Simplified Prospectuses up-to-date, and to revise them immediately upon the occurrence of any material change. COLL 4.6.4G indicates that any change that would be likely to influence the average investor in deciding whether to invest in the fund or realise his investment should be regarded as a material change. As set out in paragraphs 4.17 to 4.18 above, IFML failed to revise the Simplified Prospectuses in place in respect of the Relevant Equity Funds in late 2008 when Invesco Perpetual began to invest the funds in derivatives, or in mid-2010 when Invesco Perpetual used derivatives to introduce leverage into the Relevant Equity Funds. This amounts to a breach of COLL 4.6.3R.

COLL 4.6.8R (prior to February 2012)

5.7. The table at COLL 4.6.8R specifies the types of information that must be included in a Simplified Prospectus. In relation to a scheme's investment policy, COLL 4.6.8R (9)(e) states that "*if the scheme uses financial derivative instruments, an indication of whether this is done in pursuit of the scheme's objectives or for hedging only*".

5.8. As set out in paragraphs 4.15 to 4.18 above, IFML failed to include any reference to its use of derivatives in the Simplified Prospectuses in place in respect of the Relevant Equity Funds, and did not include any indication of whether its use of derivatives was made in pursuit of the scheme's objectives or for hedging only. This amounts to a breach of COLL 4.6.8R.

<u>COLL 4.7.2R (from February 2012 only)</u>

5.9. COLL 4.7.2(3)R provides that a KIID must include appropriate information about the essential characteristics of the fund in question so that investors are reasonably able to understand the nature and risks of the investment product that is being offered to them and, therefore, to take investment decisions on an informed basis. For the reasons set out in paragraphs 4.19 to 4.22 above, IFML failed to comply with this requirement from February 2012 until August 2012 because it failed to provide investors with clear information about the risks involved in its use of derivatives in the Relevant Equity Funds.

<u>COLL 4.7.5R (from February 2012 only)</u>

5.10. COLL 4.7.5(2)R states that a KIID must be clear, fair and not misleading. For the reasons set out in paragraphs 4.19 to 4.22 above, IFML failed to comply with this requirement between February 2012 and August 2012.

<u>KII Regulation (from February 2012)</u>

5.11. The KII Regulation is directly applicable in the United Kingdom and was binding on IFML (COLL 4.7.3G).

5.12. Article 8 of the KII Regulation provides that a KIID should include a narrative explanation of all risks which are materially relevant to the fund and which are not adequately captured by the synthetic indicator. Article 8(5)(e) further explains that this narrative explanation shall include the impact of financial techniques such as derivative contracts on the fund's risk profile where such techniques are used to obtain, increase or reduce exposure to underlying assets. As set out in paragraphs 4.10 to 4.11 above, from mid-2010, Invesco Perpetual was permitted to, and did, use derivatives to maintain or increase exposure in the Relevant Equity Funds. Up to 20% of the Relevant Equity Funds' NAVs could have been invested in derivatives therefore the exposure to investors could have been substantial. IFML's failure to refer to the risks associated with investing in derivatives in the KIIDs in place prior to August 2012 amounted to a breach of Article 8 of the KII Regulation between February 2012 and August 2012.

**Failure to record trades on a timely basis**

Principle 3

5.13. Principle 3 requires firms to take reasonable care to organise and control their affairs responsibly and effectively with adequate risk management systems. As set out in paragraphs 4.24 to 4.30 above, between May 2008 and May 2012 Invesco Perpetual failed to take reasonable care to ensure that the systems and controls that it put in place around the front office of its fixed income business were sufficient to record trades on a timely basis to enable it to value its funds accurately.

5.14. This created a risk that IFML would breach the Authority's rules in COLL 6.3, specifically:

(1) COLL 6.3.3R (applicable from the start of the Relevant Period) which required IFML to carry out a fair and accurate valuation of all the scheme property in accordance with the instrument constituting the scheme and the prospectus when determining the price of units;

(2) COLL 6.3.3AR (applicable from 1 July 2011) which required IFML to account for the relevant funds in such a way that all assets and liabilities could be directly identified at all times;

(3) COLL 6.3.3BR (applicable from 1 July 2011) which required IFML to establish, implement and maintain accounting policies to ensure that the calculation of the net asset value of each scheme it manages is accurately effected, on the basis of the accounting, and that subscription and redemption orders can be properly executed at that net asset value; and

(4) COLL 6.3.5R (applicable from the start of the Relevant Period) which required IFML to ensure that the price of a unit of any class was calculated by reference to the net value of the scheme property and in a firm that is accurate to at least four significant figures.

COLL 6.3.3DR (applicable from 1 July 2011)

5.15. The failings set out at paragraphs 4.24 to 4.30 above, also amounted to a breach of COLL 6.3.3DR between 1 July 2011 and May 2012 which required IFML to establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of each scheme it manages.

COBS 11.5.3EU

5.16. Under COBS 11.5.3EU, Invesco Perpetual was required, when transmitting an order to another person for execution, immediately to record certain details about that order after making the transmission (including the terms of the order transmitted and the date and exact time of transmission). As set out at paragraphs 4.24 to 4.30 above, Invesco Perpetual failed to record details of trades promptly, and therefore breached COBS 11.5.3EU between May 2008 and May 2012.

COLL 6.13.2R (applicable from 1 July 2011)

5.17. Under COLL 6.13.2R, IFML (as ACD of the funds) was required to produce without delay, for each portfolio transaction, a record of information which is sufficient to reconstruct the details of the order and executed transactions. This record had to include, for orders, the date and exact time of the transmission of the order and the name or other designation of the person to whom the order was transmitted, and for transactions, the date and exact time of the decision to deal and execution of the transaction. As set out in paragraphs 4.24 to 4.30 above, IFML failed to ensure that such records were made "without delay" on a consistent basis, and therefore breached COLL 6.13.2R between 1 July 2011 and May 2012.

COLL 6.13.5R (applicable from 1 July 2011)

5.18. Under COLL 6.13.5R, IFML was required to make appropriate arrangements for suitable electronic systems so as to permit a timely and proper recording of each portfolio transaction in order to be able to comply with COLL 6.13.2R (see above). As set out in paragraphs 4.24 to 4.30 above, IFML relied on a manual, paper based system in the front office of its Fixed Income business which proved insufficient to ensure that the firm complied with COLL 6.13.2R. This amounts to a breach of COLL 6.13.5R between 1 July 2011 and May 2012.

**Failure to monitor fund managers' allocation of trades in respect of aggregated trades**

Principle 3

5.19. As stated above, Principle 3 requires firms to take reasonable care to organise and control their affairs responsibly and effectively with adequate risk management systems. As set out in paragraphs 4.31 to 4.33 above, between May 2008 and May 2012 Invesco Perpetual failed to take reasonable care to ensure that the systems and controls that it put in place around the front office of its fixed income business were sufficient to ensure that partially executed

aggregated trades were fairly allocated between funds. This created a risk that Invesco Perpetual would breach COBS 11.3.8R, which states that if a firm aggregates a client order with one or more other orders and the aggregated order is partially executed, it must allocate the related trades in accordance with its order allocation policy.

COBS 11.5.1EU

5.20. Under COBS 11.5.1EU, Invesco Perpetual was required, in relation to: (a) every order received from a client; and (b) every decision to deal taken in providing the service of portfolio management, immediately to make a record of a number of specific details of the order or decision to deal. As set out in paragraphs 4.31 to 4.33 above, Invesco Perpetual failed to make or retain any records of orders received or decisions to deal in respect of its Fixed Income business between May 2008 and May 2012, and this amounted to a breach of COBS 11.5.1EU.

COLL 6.13.2R (applicable from 1 July 2011)

5.21. Under COLL 6.13.2R, IFML (as ACD of the Funds) was required to produce without delay for each portfolio transaction a record of information which is sufficient to reconstruct the details of the order and executed transaction. This record should include, for transactions, the date and exact time of the decision to deal. As set out in paragraphs 4.31 to 4.33 above, IFML failed to make and retain such records in its Fixed Income business, which amounted to a breach of COLL 6.13.2R between 1 July 2011 and May 2012.

## 6. SANCTION

6.1. The Authority's policy on the imposition of financial penalties is set out in Chapter 6 of DEPP. In determining the financial penalty, the Authority has had regard to this guidance.

6.2. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour. For the reasons set out above, the Authority considers that Invesco Perpetual breached Principle 3, Principle 7 and COLL 6.6.14R, as well as specific rules set out in section 5 above. In determining that a financial penalty is appropriate and proportionate in this case, the Authority has considered all the relevant circumstances.

6.3. Changes to the penalty policy set out in DEPP were introduced on 6 March 2010. As the conduct at issue occurred both before and after 6 March 2010 the Authority has had regard to the provisions of DEPP in force prior to 6 March 2010 (the "old penalty regime") in respect of the breaches that took place before March 2010 and the provisions of DEPP in force from 6 March 2010 (the "current penalty regime") for the later breaches.

6.4. The Authority has therefore:

(1) calculated the financial penalty for Invesco Perpetual's misconduct from 1 May 2008 to 5 March 2010 by applying the old penalty regime to that misconduct;

(2) calculated the financial penalty for Invesco Perpetual's misconduct from 6 March 2010 to 16 November 2012 by applying the current penalty regime to that misconduct; and

(3) added the penalties calculated under (1) and (2) together to produce the total penalty.

**Financial penalty under the old regime**

6.5. In determining the financial penalty to be attributed to Invesco Perpetual's misconduct prior to 6 March 2010, the Authority has had particular regard to the following:

(1) The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms from contravening regulatory requirements and demonstrating the benefits of compliant behaviour.

(2) The nature, seriousness and impact of the breach, in particular the extent to which investors could have suffered losses: (a) Invesco Perpetual's breaches of the COLL investment restrictions were each relatively self-contained and only affected a small minority of Invesco Perpetual's trades during the Relevant Period. Furthermore, compensation of just over £6,000 was paid to one fund in respect of a single breach which occurred prior to 6 March 2010; (b) Invesco Perpetual's breach of Principle 7 affected only certain of its equity funds; and (c) while Invesco Perpetual's Principle 3 breaches reveal systemic problems, these relate to specific weaknesses only within Invesco Perpetual's fixed income business.

(3) The size and resources of Invesco Perpetual: The assets under management of the Invesco Perpetual branded funds total approximately £47 billion (as at December 2013). During the Relevant Period Invesco Perpetual managed some of the largest retail funds in the UK, with 75% of its assets under management being retail funds. As a result, the impact of Invesco Perpetual's failings was potentially significant.

(4) The Authority does not consider that Invesco Perpetual's failings were deliberate or reckless.

(5) Other action taken by the Authority: The Authority has published a number of Final Notices relating to breaches of Principle 7 highlighting the importance of providing adequate disclosure to customers on the point of sale.

6.6. The Authority considers that Invesco Perpetual's breaches of Principle 3, Principle 7 and certain of the Authority's rules in the period prior to 6 March 2010 merit a financial penalty of £5,000,000.

6.7. Invesco Perpetual agreed to settle at an early stage of the Authority's investigation. Invesco Perpetual therefore qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. The financial penalty for the Firm's breach of Principle 3, Principle 7 and various Authority rules in the period prior to 6 March 2010 is therefore £3,500,000.

**Financial penalty under the current regime**

6.8. All references to DEPP in this section are references to the version of DEPP implemented as of 6 March 2010 and currently in force. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

6.9. The Authority has decided to impose a financial penalty in respect of Invesco Perpetual's breaches of Principle 3, Principle 7 and COLL 6.6.14R (and associated rules set out in section 5 above) from 6 March 2010 to the end of the Relevant Period.

Step 1: disgorgement

6.10. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.

6.11. The Authority has not identified any financial benefit that Invesco Perpetual derived directly from any of its breaches.

6.12. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.13. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.14. The Authority considers that the revenue generated by Invesco Perpetual is indicative of the harm or potential harm caused by its breach. The Authority has therefore determined a figure based on a percentage of Invesco Perpetual's relevant revenue as it relates to each of the breaches identified. This revenue comprises the relevant management fees in respect of the affected funds together with the portion of the initial charge not rebated to customers in respect of Relevant Equity Funds from the period when Invesco Perpetual was in breach.

6.15. The Authority considers Invesco Perpetual's relevant revenue for each of the breaches to be:

(1) Principle 3 - £136,958,154;

(2) COLL 6.6.14R - £516,261,380; and

(3) Principle 7 - £37,570,721.

6.16. The total relevant revenue is £690,790,255.

6.17. In determining the percentage of the relevant revenue that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%
Level 2 – 5%
Level 3 – 10%
Level 4 – 15%
Level 5 – 20%

6.18. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. These factors are set out in DEPP 6.5A.2G.

6.19. The Authority has assessed the seriousness level for Invesco Perpetual's breaches and considers that the following factors are relevant**:**

(1) actual loss was identified in relation to Invesco Perpetual's breach of the investment restrictions set out in COLL 5.2. Compensation payments to funds in respect of these losses totalled close to £5.3 million;

(2) in relation to its breach of Principle 3 (and associated COLL and COBS Rules) Invesco Perpetual has made two compensation payments to two funds of around £1,500 in total although the risk of loss was higher;

(3) for those investors who would not have invested but for Invesco Perpetual's breach of Principle 7, they were exposed to a greater level of risk than they had been led to expect and consequently may have individually suffered unexpected losses. However, the Relevant Equity Funds did not suffer losses over the Relevant Period as a whole;

(4) Invesco Perpetual was not aware of the extent of the Principle 3 failings in relation to the timely capture of trade and order aggregation and allocation until May 2012. Once they were made aware following an internal audit, they took steps to rectify the weaknesses;

(5) Invesco Perpetual's breaches of the COLL investment restrictions were each relatively self-contained in that they were not indicative of more widespread failings and only affected a small minority of Invesco Perpetual's trades during the Relevant Period;

(6) Invesco Perpetual's breach of Principle 7 affected only certain of its equity funds;

(7) Invesco Perpetual's Principle 3 breaches relate to specific weaknesses only within Invesco Perpetual's fixed income business; and

(8) none of the breaches were reckless or deliberate.

6.20. Taking the relevant factors for Invesco Perpetual's breaches into account, the Authority considers the seriousness of the breaches to be level 2 and so the Step 2 figure is 5% of £690,790,255.

6.21. Step 2 is therefore £34,539,512. Consistent with the revenue figures above, this breaks down as:

(1) Principle 3 - £6,847,907;

(2) COLL 6.6.14R - £25,813,069; and

(3) Principle 7 - £1,878,536.

6.22. DEPP 6.5.3(3)G provides that the Authority may decrease the level of penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breach concerned. The Authority considers that the level of penalty in respect of the COLL 6.6.14R breaches (£25,813,069) is disproportionate, in particular because:

(1) there were only 16 recorded breaches out of approximately 405,000 executed trades during the current penalty regime period (although the Authority notes that these affected over 70% of the assets under management of the Invesco Perpetual branded range of funds);

(2) each of these breaches was relatively self-contained and not indicative of any widespread failings at Invesco Perpetual; and

(3) this level of penalty is very high in comparison with the amount of loss caused by the breaches.

6.23. The Step 2 figure is therefore reduced from £34,539,512 to £21,632,978, a reduction of £12,906,534 which represents a 50% reduction in the penalty element in respect of the COLL 6.6.14R breaches. The Step 2 figure is therefore £21,632,978.

Step 3: mitigating and aggravating factors

6.24. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach. The Authority considers that there are no relevant aggravating or mitigating factors. Therefore there is no adjustment to the Step 2 figure.

6.25. The Step 3 figure is therefore £21,632,978.

Step 4: adjustment for deterrence

6.26. The Authority considers that the Step 3 figure of £21,632,978 represents a sufficient deterrent to Invesco Perpetual and others, and so has not increased the penalty at Step 4.

6.27. The figure at Step 4 remains £21,632,978.

Step 5: settlement discount

6.28. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.29. The Authority and Invesco Perpetual reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.30. The Step 5 figure for the penalty in respect of misconduct after 6 March 2010 is therefore £15,143,084.

Conclusion on financial penalty

6.31. The Authority therefore imposes a total financial penalty of £26,632,978 on Invesco Perpetual for breaching Principle 3, Principle 7, and various Authority rules (comprising a penalty of £5,000,000 in respect of misconduct prior to 6 March 2010 and a penalty of £21,632,978 in respect of misconduct after 6 March 2010). As the Authority and Invesco Perpetual reached agreement at Stage 1 a 30% discount applies, resulting in a total financial penalty of £18,643,084. It is

the Authority's policy to round down the final penalty figure to the nearest £100. The final penalty figure is therefore £18,643,000.

## 7. PROCEDURAL MATTERS

### Decision maker

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

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

### Manner of and time for Payment

7.3. The financial penalty must be paid in full by Invesco Perpetual to the Authority by no later than 8 May 2014, 14 days from the date of the Final Notice.

### If the financial penalty is not paid

7.4. If all or any of the financial penalty is outstanding on 9 May 2014 the Authority may recover the outstanding amount as a debt owed by Invesco Perpetual and due to the Authority.

### Publicity

7.5. 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.

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

### Authority contacts

7.7. For more information concerning this matter generally, contact Anna Couzens at the Authority (direct line: 020 7066 1452), Jennifer Hepworth (direct line: 020 7066 1908) or Anne Cosserat (direct line: 020 7066 8748).

Megan Forbes
Project Sponsor
Financial Conduct Authority, Enforcement and Financial Crime Division

**ANNEX A**

**RELEVANT STATUTORY PROVISIONS, REGULATORY PROVISIONS AND AUTHORITY GUIDANCE**

**1. STATUTORY PROVISIONS**

1.1. The Authority's operational objectives are set out in section 1B(3) of the Act and include the consumer protection objective.

1.2. Section 206(1) of the Act provides:

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

1.3. IFML and IAML are authorised persons for the purposes of section 206 of the Act.

1.4. The requirements imposed on an authorised person include those set out in the Authority's Principles and rules made under section 138 of the Act.

1.5. The Authority's rule making powers are set out in Chapter I of Part X of the Act (Rules and Guidance). The Authority has made rules, in particular those contained in COLL and COBS, in accordance with its powers and provisions under this part of the Act.

**2. REGULATORY PROVISIONS**

**Principles for Businesses**

2.1. The Principles are a general statement of the fundamental obligation 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 as set out in the Act and reflect the Authority's regulatory objectives. The relevant Principles are as follows.

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

2.3. Principle 7 provides: "*A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.*"

**Collective Investment Schemes (COLL)**

2.4. COLL 4.6.2(3)R (Production and publication of simplified prospectus) provides:

*"An operator of a simplified prospectus scheme must be satisfied on reasonable grounds that each simplified prospectus which it produces:*

*(a) includes all such information as is necessary to enable an investor to make an informed decision about whether to acquire units in the scheme;*

*(b) does not omit any key item of information;*

*(c) wherever possible is written in plain language which avoids technical language and jargon; and*

*(d) adopts a format and style of presentation which is clear and attractive to the average reader, so that it can be easily understood by him".*

2.5. COLL 4.6.3R (Revision of simplified prospectus) provides:

*"An operator of a simplified prospectus scheme must, for each simplified prospectus scheme of which it is the operator, keep its simplified prospectus up-to-date and must revise it immediately on the occurrence of any material change".*

2.6. COLL 4.6.4G (in force until 1 April 2013) provides:

*"It is the FSA's view that any change to a simplified prospectus scheme that would be likely to influence the average investor in deciding whether to invest in the scheme or realise his investment in it should be regarded as a material change for the purposes of revision of a simplified prospectus. Examples would be changes to the scheme's objectives or investment policy. The FSA would expect a simplified prospectus to be updated at least annually".*

2.7. COLL 4.6.8(9)(e)R provides that a simplified prospectus should include:

"*the scheme's investment policy, including … if the scheme uses financial derivatives, an indication of whether this is done in pursuit of the scheme's objectives or for hedging purposes only*".

2.8. COLL 4.7.2R (Key investor information) provides:

*"(1) An authorised fund manager must, for each UCITS scheme which it manages, draw up a short document in English containing key investor information (a "key investor information document") for investors.*

*…*

*(3) Key investor information must include appropriate information about the essential characteristics of the UCITS scheme which is to be provided to investors so that they are reasonably able to understand the nature and risks of the investment product that is being offered to them and, therefore, to take investment decisions on an informed basis …"*

2.9. COLL 4.7.3G (Form and content of a key investor information document) provides:

*"The KII Regulation sets out the form and content of a key investor information document. This Regulation is directly applicable in the United Kingdom and accordingly its articles (but not the preceding recitals) are binding on all firms to which it applies. Under the Regulation an authorised fund manager must ensure that each key investor information document it produces for a UCITS scheme complies with the requirements of the Regulation. For ease of reference the Regulation is reproduced in COLL Appendix 1EU (The KII Regulation)".*

2.10. Article 8 of the KII Regulation provides:

*"(1) The 'Risk and reward profile' section of the key investor information document shall contain a synthetic indicator, supplemented by:*

*(a) A narrative explanation of the indicator and its main limitations;*

*(b) A narrative explanation of risks which are materially relevant to the UCITS and which are not adequately captured by the synthetic indicator.*

*...*

*(5) The narrative explanation referred to in paragraph 1(b) shall include the following categories of risks, where these are material:*

*…*

*(e) impact of financial techniques as referred to in Article 50(1)(g) of Directive 2009/65/EC such as derivative contracts on the UCITS' risk provides*

*where such techniques are used to obtain, increase or reduce exposure to underlying assets".*

2.11. COLL 4.7.5(2)R (Pre-contractual information) provides:

"*The key investor information document must … be fair, clear and not misleading ...*"

2.12. COLL 5.2.11R (Spread: general) provides:

"*(1) This rule does not apply to government and public securities.*

*(2) For the purposes of this rule companies included in the same group for the purposes of consolidated accounts as defined in accordance with the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts or, in the same group in accordance with international accounting standards, are regarded as a single body.*

*(3) Not more than 20% in value of the scheme property is to consist of deposits with a single body.*

*(4) Not more than 5% in value of the scheme property is to consist of transferable securities or approved money-market instruments issued by any single body.*

*(5) The limit of 5% in (4) is raised to 10% in respect of up to 40% in value of the scheme property. Covered bonds need not be taken into account for the purpose of applying the limit of 40%.*

*(5A) The limit of 5% in (4) is raised to 25% in value of the scheme property in respect of covered bonds, provided that when a UCITS scheme invests more than 5% in covered bonds issued by a single body, the total value of covered bonds held must not exceed 80% in value of the scheme property.*

*(6) In applying (4) and (5), certificates representing certain securities are to be treated as equivalent to the underlying security.*

*(7) The exposure to any one counterparty in an OTC derivative transaction must not exceed 5% in value of the scheme property; this limit being raised to 10% where the counterparty is an approved bank.*

*(8) Not more than 20% in value of the scheme property is to consist of transferable securities and approved money-market instruments issued by the same group (as referred to in (2)).*

*(9) Not more than 20% in value of the scheme is to consist of the units of any one collective investment scheme.*

*(10) In applying the limits in (3),(4),(5),(6) and (7), and subject to (5A),[4] not more than 20% in value of the scheme property is to consist of any combination of two or more of the following:*

> *(a) transferable securities (including covered bonds) or approved money-market instruments issued by: or*
>
> *(b) deposits made with; or*
>
> *(c) exposures from OTC derivatives transactions made with a single body".*

2.13. COLL 5.2.27R (Significant influence for ICVCs) provides:

*"(1) An ICVC must not acquire transferable securities issued by a body corporate and carrying rights to vote (whether or not on substantially all matters) at a general meeting of that body corporate if:*

> *(a) immediately before the acquisition, the aggregate of any such securities held by the ICVC gives the ICVC power to influence significantly the conduct of business of that body corporate; or*
>
> *(b) the acquisition gives the ICVC that power.*

*(2) For the purpose of (1), an ICVC is to be taken to have power significantly to influence the conduct of business of a body corporate if it can, because of the transferable securities held by it, exercise or control the exercise of 20% or more of the voting rights in that body corporate (disregarding for this purpose any temporary suspension of voting rights in respect of the transferable securities of that body corporate)".*

2.14. COLL 5.2.29R (Concentration) provides:

*"A UCITS scheme:*

*(1) must not acquire transferable securities (other than debt securities) which:*

*(a) do not carry a right to vote on any matter at a general meeting of the body corporate that issued them; and*

*(b) represent more than 10% of those securities issued by that body corporate;*

*(2) must not acquire more than 10% of the debt securities issued by any single body;*

*(3) must not acquire more than 25% of the units in a collective investment scheme;*

*(4) must not acquire more than 10% of the approved money-market instruments issued by any single body; and*

*(5) need not comply with the limits in (2), (3) and (4) if, at the time of acquisition, the net amount in issue of the relevant investment cannot be calculated".*

2.15. COLL 6.3.3(1)R (Valuation) provides:

*"To determine the price of units the authorised fund manager must carry out a fair and accurate valuation of all the scheme property in accordance with the instrument constituting the scheme and the prospectus".*

2.16. COLL 6.3.3AR (Accounting procedures) provides:

*"(1) An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must ensure the employment of the accounting policies and procedures referred to in SYSC 4.1.9 R (Accounting policies), so as to ensure the protection of unitholders.*

*(2) Accounting for the scheme shall be carried out in such a way that all assets and liabilities of the scheme can be directly identified at all times.*

*(3) If the scheme is an umbrella, separate accounts must be maintained for each sub-fund".*

2.17. COLL 6.3.3BR provides:

*"An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must have accounting policies and procedures established, implemented and maintained, in accordance with the accounting*

*rules of the UCITS Home State, so as to ensure that the calculation of the net asset value of each scheme it manages is accurately effected, on the basis of the accounting, and that subscription and redemption orders can be properly executed at that net asset value".*

2.18. COLL 6.3.3DR provides:

*"An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of each scheme it manages".*

2.19. COLL 6.3.5R (Price of a unit) provides:

*"(1) An authorised fund manager must ensure that the price of a unit of any class is calculated:*

*(a) by reference to the net value of the scheme property; and*

*(b) in accordance with the provisions of both the instrument constituting the scheme and the prospectus.*

*(2) Any unit price calculated in accordance with (1) must be expressed in a form that is accurate to at least four significant figures.*

*(3) For each class of units in a single-priced authorised fund, a single price must be calculated at which units are to be issued and cancelled".*

2.20. COLL 6.6.14R (Duties of the depositary and the authorised fund manager: investment and borrowing powers) provide:

*"(1) The authorised fund manager must avoid the scheme property being used or invested contrary to COLL 5, or any provision in the instrument constituting the scheme or the prospectus as referred to in COLL 5.2.4 R (Investment powers: general) and COLL 5.6.4 R (Investment powers: general), except to the extent permitted by (3)(b).*

*(2) The authorised fund manager must, immediately upon becoming aware of any breach of a provision listed in (1), take action, at its own expense, to rectify that breach, unless the breach occurred as the result of any of the circumstances within (3).*

*(3) The authorised fund manager must restore compliance with COLL 5 as soon as reasonably practicable having regard to the interests of the unitholders and, in any event, within the period specified in (5) or, when applicable, (6) where:*

*(a) the scheme property is:*

*(i) used or invested contrary to COLL 5 (other than a provision excusing a failure to comply on a temporary basis); and*

*(ii) the contravention is beyond the control of both the authorised fund manager and the depositary; or*

*(b) there is a transaction ("subsequent transaction") deriving from a right (such as the right to convert stock or subscribe to a rights issue) attributable to an investment ('original investment') of the scheme if:*

*(i) the subsequent transaction, but for this rule would constitute a breach of COLL 5; and*

*(ii) at the time of the acquisition of the original investment, it was reasonable for the authorised fund manager, to expect that a breach would not be caused by the subsequent transaction; and*

*in this rule the reference to the exercise of a right includes the taking effect of a right without any action by or on behalf of the depositary or the authorised fund manager.*

*(4) Immediately upon the depositary becoming aware of any breach of any provision listed in (1), it must ensure that the authorised fund manager complies with (2).*

*(5) The maximum period for restoration of compliance under (3) starts at the date of discovery of the relevant circumstance and lasts, subject to any extension under (6):*

*(a) for six months; or*

*(b) where the transaction in question was a transaction in derivatives or a forward transaction under COLL 5.2.20 R (Permitted transactions (derivatives and forwards)) or COLL 5.6.13R (Permitted transactions (derivatives and forwards)), until the close of business five business days later; or*

*(c) where the transaction relates to an immovable, for two years.*

*(6) The period specified at (5)(b) is extended where:*

*(a) the transaction involved a delivery of a commodity, from five to twenty business days;*

*(b) the reason for the contravention in (3)(a) is the inability of the authorised fund manager to close out a transaction because of a limit in the number or value of transactions imposed by an eligible derivatives market, until five business days after:*

*(i) the inability resulting from any such limit is removed; or*

*(ii) it becomes, to the knowledge of the authorised fund manager, reasonably practicable and reasonably prudent for the transaction to be closed out in some other way".*

2.21. COLL 6.13.2R (Recording of portfolio transactions) provides:

*"(1) An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must ensure, for each portfolio transaction relating to a scheme it manages, that a record of information which is sufficient to reconstruct the details of the order and the executed transaction is produced without delay.*

*(2) The record referred to in (1) must include:*

*(a) the name or other designation of the scheme and of the person acting on behalf of the scheme;*

*(b) the details necessary to identify the instrument in question;*

*(c) the quantity;*

*(d) the type of the order or transaction;*

*(e) the price;*

*(f) for orders, the date and exact time of the transmission of the order and the name or other designation of the person to whom the order was transmitted, or for transactions, the date and exact time of the decision to deal and execution of the transaction;*

*(g) the name of the person transmitting the order or executing the transaction;*

*(h) where applicable, the reasons for the revocation of an order; and*

*(i) for executed transactions, the counterparty and execution venue identification".*

2.22. COLL 6.13.5R (Electronic data processing) provides:

*"An authorised fund manager of a UCITS scheme or a UK UCITS management company of an EEA UCITS scheme must make appropriate arrangements for suitable electronic systems so as to permit a timely and proper recording of each portfolio transaction or subscription or redemption order, in order to be able to comply with COLL 6.13.2 R (Recording of portfolio transactions) and COLL 6.13.3 R (Recording of subscription and redemption orders)".*

**Conduct of Business Rules (COBS)**

2.23. COBS 11.3.7R (Aggregation and allocation of orders) provides:

*"A firm is not permitted to carry out a client order or a transaction for own account in aggregation with another client order unless the following conditions are met:*

*(1) it must be unlikely that the aggregation of orders and transactions will work overall to the disadvantage of any client whose order is to be aggregated;*

*(2) it must be disclosed to each client whose order is to be aggregated that the effect of aggregation may work to its disadvantage in relation to a particular order;*

*(3) an order allocation policy must be established and effectively implemented, providing in sufficiently precise terms for the fair allocation of aggregated orders and transactions, including how the volume and price of orders determines allocations and the treatment of partial executions".*

2.24. COBS 11.3.8R provides:

*"If a firm aggregates a client order with one or more other orders and the aggregated order is partially executed, it must allocate the related trades in accordance with its order allocation policy".*

2.25. COBS 11.5.1EU (Record keeping of client orders and decisions to deal) provides:

*"An investment firm shall, in relation to every order received from a client, and in relation to every decision to deal taken in providing the service of portfolio management, immediately make a record of the following details, to the extent they are applicable to the order or decision to deal in question:*

*(1) the name or other designation of the client;*

*(2) the name or other designation of any relevant person acting on behalf of the client;*

*(3) the details specified in point 4, 6, and in points 16 to 19, of Table 1 of Annex I;*

*(4) the nature of the order if other than buy or sell;*

*(5) the type of the order;*

*(6) any other details, conditions and particular instructions from the client that specify how the order must be carried out;*

*(7) the date and exact time of the receipt of the order, or of the decision to deal, by the investment firm".*

2.26. COBS 11.5.3EU(Record-keeping of transactions) provides:

*"If an investment firm transmits an order to another person for execution, the investment firm shall immediately record the following details after making the transmission:*

*(1) the name or other designation of the client whose order has been transmitted;*

*(2) the name or other designation of the person to whom the order was transmitted;*

*(3) the terms of the order transmitted;*

*(4) the date and exact time of transmission".*

## 3. AUTHORITY GUIDANCE

### Decision, procedure and penalties manual (DEPP)

3.1. 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. Changes to DEPP were introduced on 6 March 2010. Given that the misconduct occurred both before and after that date, the Authority has had regard to the provisions of DEPP in force before and after that date.

### The Enforcement Guide

3.2. The Enforcement Guide, which forms part of the Authority’s Handbook, sets out the Authority’s approach to exercising its main enforcement powers under the Act.

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