Financial Conduct Authority

FINAL NOTICE

To: **Xcap Securities PLC**

FRN: **504211**

Address: **24 Cornhill**
London
EC3V 3ND
United Kingdom

Date: **31 May 2013**

ACTION

1. For the reasons given in this notice, the Financial Conduct Authority ("the Authority") hereby imposes on Xcap Securities PLC ("Xcap") a financial penalty of £120,900.

2. Xcap agreed to settle at an early stage of the Authority's investigation and therefore qualified for a 20% (stage 2) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £151,136 on Xcap.

SUMMARY OF REASONS

3. On the basis of the facts and matters described below, the Authority considers that Xcap breached Principle 3 (Management and Control) and Principle 10 (Clients' Assets) of the Authority's Principles for Business ("the Principles") and associated rules in the Client Asset Sourcebook ("the CASS Rules") between 29 June 2010 and 31 August 2011 ("the Relevant Period") by failing to ensure adequate protection of client money and (to a lesser extent) safe custody assets.

4. Specifically, Xcap failed during the Relevant Period to comply with requirements to:

   a) ensure that client money was properly segregated from Xcap's money;

   b) ensure that ***all*** safe custody assets were clearly identified as belonging to the client (although the vast majority of safe custody assets were correctly registered in CREST);

   c) maintain accurate records and accounts in respect of client money and safe custody assets held by Xcap;

   d) have in place adequate organisational arrangements, policies and procedures to detect and manage its client money and safe custody assets risks;

   e) put in place adequate trust documentation in relation to certain of its client money bank accounts;

   f) carry out timely and accurate client money reconciliations;

   g) pay interest received on client money to clients (the total amount of interest involved was £1,620); and

   h) report without delay failures to comply with CASS requirements.

5. These breaches had the consequence that client money and safe custody assets were not adequately protected in accordance with the CASS Rules. However, it is accepted that the vast majority of safe custody assets were correctly registered in CREST.

6. As a result, had Xcap become insolvent at any point during the Relevant Period, some of Xcap's clients could have faced difficulties and/or delay in recovering client money and/or safe custody assets and client money and safe custody assets would have been exposed to the risk of diminution in the event of Xcap's insolvency.

7. Details of the relevant CASS Rules breached by Xcap (and other relevant regulatory provisions) are set out in the Annex A to this Final Notice.

8. The Authority considers Xcap's failings to be serious because:

   a) the failings took place from the outset of Xcap starting its business and at a time when there was a high level of awareness in the financial services industry of the importance of adequately protecting client money and assets. The failings continued through a period of expansion of the Firm's business, meaning that it was exposing additional clients to risk of loss whilst its arrangements were inadequate;

   b) failings were found throughout Xcap's client money and safe custody assets processes, indicating that the Firm's client money and safe custody assets arrangements were seriously flawed;

   c) Xcap had a responsibility to manage and protect client money and safe custody assets, but its failings exposed individual clients to a significant risk of loss in the event of Xcap's insolvency (although, save for the failure to pay client interest, which was

ultimately remedied, none of Xcap's clients suffered any loss as a result of the failures); and

d) some of the failings were not identified by Xcap through its own compliance monitoring, but rather were drawn to Xcap's attention by its auditors or by a skilled person. Further, in relation to those failings that it did identify, Xcap failed to bring the breaches to the attention of the Authority without delay, as required by the CASS Rules.

9. The Authority has taken into account that whilst client money and assets were at risk there was no actual ongoing loss of client money or assets. The Authority has also taken into account the following factors, which have served to mitigate the seriousness of Xcap's failings, namely:

a) Xcap fully cooperated with the Authority's investigation from the outset;

b) Xcap identified that breaches had occurred and notified the Authority of some of the issues regarding CASS compliance;

c) Xcap took remedial action, including the appointment of a compliance consultancy to provide compliance support on, inter alia, CASS issues and raising matters with its CASS auditor;

d) Xcap had relied in good faith on third party advice as to the need for trust letters and as to the reconciliation processes required to be adopted;

e) the Skilled Person's report acknowledged that the majority of CASS issues had been resolved prior to the Skilled Person's engagement; and

f) Xcap has implemented a wide range of additional remedial steps and improvements to its governance and compliance arrangements, the key aspects of which are detailed at paragraph 29 below.

10. This action supports the Authority's operational objectives of securing an appropriate degree of protecting protection for consumers and maintaining confidence in protecting and enhancing the integrity of the UK financial system.

11. In calculating the penalty imposed on Xcap, the Authority has adopted a methodology using a percentage of average client balances (as set out at paragraph 41 below) as part of the five step framework in the current Authority penalty regime. This methodology sets a precedent going forward for breaches of the CASS Rules and is expected to increase the level of financial penalty for such breaches, compared to the penalty levels under the previous penalty regime for similar breaches.

DEFINITIONS

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

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

"CASS" means client money and safe custody assets

"CASS Rules" means the Authority's Client Assets Sourcebook

"DEPP" means the the Authority's Decision Procedures and Penalties Manual

"the Firm" and "Xcap" means Xcap Securities PLC

"the Authority" means the Financial Services Authority until 31 March 2013 and the Financial Conduct Authority from 1 April 2013

"the Principles" means the Authority's Principles for Business

"the Relevant Period" means 29 June 2010 to 31 August 2011

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

FACTS AND MATTERS

Background

13. Xcap is a retail investment and capital markets business, offering retail stock broking, asset management, market making, corporate broking and institutional sales. The Firm has been authorised and regulated by the Authority since 17 May 2010 and is permitted to hold client money and safeguard and administer safe custody assets. Xcap began trading on 29 June 2010 and was admitted to trading on the AIM market on 17 September 2010.

14. In the course of its business, Xcap receives and administers money and assets on behalf of its clients for the provision of its retail stock broking and asset management services. The money Xcap receives on behalf of its clients is "client money" and the assets it receives on behalf of its clients are "safe custody assets" and both are therefore subject to the relevant requirements and standards set out in CASS. During the Relevant Period, the amount of client money held by Xcap on any given day ranged between £5,000 and £5,425,000 and averaged £3, 451,101, and the amount of safe custody assets held ranged from £7.7 million to £48.3 million and averaged £34,187,298.

Initial Notification of Breaches to the Authority

15. On 11 October 2010, the Authority received an email from Xcap informing the Authority that *"a limited number of client balances* [had been] *misstated for a limited period of time"* and that there may have been some shortfalls or excesses in client accounts that had not been corrected. Accordingly, the Firm stated that it was reporting breaches of CASS 7.6.1R[1], 7.6.2R[2] and 7.6.13R[3] as required under CASS 7.6.16R[4].

16. The email explained that the Firm had "*encountered a small number of system issues since its commencement of trading for retail clients*", which were immediately identified by management, and that action to rectify the root causes had already been undertaken. The email stated that the issues had centred on the timing of trades being processed within the

[1] A firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money.
[2] A firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients.
[3] When any discrepancy arises as a result of a firm's internal reconciliations, the firm must identify the reason for the discrepancy and ensure that: (1) any shortfall is paid into a client bank account by the close of business on the day that the reconciliation is performed; or (2) any excess is withdrawn within the same time period (but see CASS 7.4.20 G and CASS 7.4.21 R).
[4] A firm must inform the Authority in writing without delay if it has not complied with, or is unable, in any material respect, to comply with the requirements in CASS 7.6.1 R, CASS 7.6.2 R or CASS 7.6.9 R

Firm's settlements system, particularly in relation to placings undertaken on behalf of the Firm's retail clients. It went on to say that the issues meant that the client money balances used in the Firm's daily client money calculation were prepared manually, leading the Firm to suspect that there may have been client money shortfalls or excesses, the extent and correction of which the Firm had been unable to determine and carry out.

17. The email went on to claim that the Firm's systems were now producing an accurate list of client money balances and that accurate client money calculations were being performed, along with investigation of any movements/discrepancies on those balances and the making good of any shortfalls or excesses on the day the calculations were performed. On the basis of matters established following this email (as set out below) it is apparent that these statements did not in fact reflect the correct position at the Firm, although it is not suggested that there was any attempt to withhold information from the Authority. In addition, the Firm had been aware of certain breaches since mid-July 2010.

18. Following the notification to the Authority, Xcap retained a compliance consultancy to review its governance and compliance arrangements, including the secondment of a CASS specialist to the firm.

19. Between December 2010 and March 2011 Xcap's CASS auditor conducted a review of the arrangements for the management and protection of client money and safe custody assets at the Firm for the purposes of producing its first annual client asset report to the Authority. On 7 February 2011, following a dialogue between Xcap and its CASS auditor to identify any issues and the steps taken to resolve them, an initial review was produced, and then Xcap again wrote to the Authority. This second email provided more information as to the breaches notified four months earlier (referred to above) and informed the Authority of further issues which constituted breaches of CASS Rules. The issues notified extended to money transfers, trust letters, segregation, procedures and client agreements and it was apparent that they had largely existed since the Firm had commenced its operations.

20. On 23 March 2011, Xcap met with the Authority to present an update on the Firm's ongoing CASS compliance and to discuss the further issues raised in the 7 February 2011 email. As a result of comments made by the Firm in the meeting, the Authority identified additional serious deficiencies in Xcap's CASS compliance arrangements. In particular, it was noted that:

    a) there were numerous instances of client money being co-mingled with Xcap's own money;

    b) Xcap's internal records were inadequate to comply with the requirements that:

        i) they be sufficient to enable the Firm, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money; and

        ii) their accuracy is ensured, in particular their correspondence to the client money held for clients;

    and that, due to the prolonged and widespread nature of the issues, breaches had occurred on numerous occasions and yet the Firm had only notified the Authority on two occasions contrary to the requirement to inform the Authority of such non-compliance without delay;

c) Xcap's overall organisational arrangements meant that the Firm was not able to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence;

d) Xcap had not (since authorisation) performed an acceptable internal reconciliation – either via the "standard method of internal client money reconciliation" outlined in CASS, or a comparable method;

e) Xcap did not have written acknowledgement of trust status from a third party bank in respect of two currency accounts at that bank (one USD and one EUR); and

f) safe custody assets were held in accounts that did not comply with requirements that they be identifiable separately from the applicable assets belonging to the Firm and from the applicable assets belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

21. At the meeting the Firm accepted that it had not fulfilled its obligations under CASS and provided details of the improvements it had subsequently made to its systems and procedures to remedy the situation. The details provided made it clear however that a number of the breaches identified during the course of the meeting were ongoing.

Auditor's Client Asset Report to the Authority

22. In April 2011 the Authority was provided with the external auditor's client asset report in respect of the Firm. This was submitted in accordance with the requirement on firms under SUP 3.1.1R and 3.1.2R and auditors under SUP 3.10.

23. The report covered the period 17 May 2010 to 28 February 2011, and provided information as to Xcap's failure to comply with various CASS Rules concerning risk assessment, segregation, client money reconciliations and client agreements. The breaches identified in this report that posed a significant risk of loss to individual clients during the period were:

a) Xcap's failure (which continued throughout the Relevant Period) to ensure that certain safe custody assets were clearly identified as belonging to the client;

b) Xcap's failure (which continued throughout the Relevant Period) to carry out accurate client money calculations and, consequently, accurate reconciliations meaning that it was unable to identify discrepancies and therefore know whether it was necessary to pay any shortfall into or withdraw any excess from its client bank accounts; and

c) Xcap's failure (which continued up to 31 March 2011) to ensure that client money (in the form of mixed remittances and foreign currency) was paid into a segregated client bank account.

24. The auditors concluded that during the period covered by the report Xcap did not maintain systems adequate to enable it to comply with the rules in CASS 6 and CASS 7, and that the Firm was still not in compliance as at 28 February 2011. This meant that Xcap had not been compliant with CASS Rules 6 and 7 during the eight month period since starting to trade.

Skilled Person's Report

25. Due to its ongoing concerns, the Authority required Xcap to provide a Skilled Person's report, under the provisions of section 166 of the Act, to determine whether urgent regulatory action was necessary to secure the protection of client money and safe custody assets. The Skilled Person was appointed in September 2011 and issued its report on 27 October 2011.

26. The Skilled Person's findings were that:

a) the earliest date on which Xcap's internal and external reconciliation processes complied with the essential requirements of the CASS Rules was 2 June 2011 in relation to its principal client bank accounts (Client Free Money Account and Client Settlement Account) and 11 August 2011 in respect of its other, less active, client accounts (ISA, ISA Dividend and Nominee Dividend client accounts) although it was accepted that in certain instances Xcap had acted in accordance with advice received from a third party CASS adviser which the Skilled Person considered to be incorrect;

b) Xcap did not have letters of acknowledgement of trust in place in relation to 18 client money accounts held with a third party bank, in breach of CASS 7.8.1R. The situation was rectified for all the accounts by a letter of acknowledgement of trust issued by the bank to Xcap;

c) Xcap had not complied with the terms and conditions agreed between it and its retail clients relating to the calculation and distribution of interest to clients on client money balances. This was caused in part by difficulties Xcap had with calculating interest using its (then) current operating systems;

d) Xcap's custody procedures had certain weaknesses, such as failure to ensure all safe custody assets were correctly registered in the name of Xcap Nominees Limited, rather than in the Firm's name;

e) Xcap's compliance function had been under resourced throughout the Relevant Period and had not adequately monitored the adequacy or effectiveness of the Firm's CASS procedures;

f) the vast majority of safe custody assets were correctly registered within CREST; and

g) that Xcap was now in a position to comply with the essential requirements of the CASS regime.

Further Reports from the Auditors

27. A second auditor's report was received by the Authority on 20 December 2011 regarding the status of Xcap's compliance with CASS in the period from 1 March 2011 to 31 August 2011. The report repeated various findings of the Skilled Person and concluded that the

Firm had failed during the period to comply with a number of the specific CASS Rules concerning:

a) the registering of title to, and the clear identification of, safe custody assets;

b) the use of safe custody assets to settle Firm's trades;

c) the requirement for trust status letters in respect of client money accounts;

d) carrying out a regular internal reconciliation of safe custody assets, preventing the firm from ensuring that the correct stock is held for each client and

e) the payment of interest to clients in accordance with Xcap's client agreements.

28. The second auditors' report identified that over the period it covered, Xcap had not taken sufficient action to remedy the failings identified in their first report and concluded, pursuant to SUP 3.10.5R, that Xcap therefore did not maintain systems adequate to enable it to comply with the rules in CASS 6 and CASS 7 from 1 March 2011 to 31 August 2011. However, as at 31 August 2011, the auditors considered that Xcap had remedied the failings identified in their first report and that Xcap, save in respect of certain limited matters, was in compliance with the requirements of CASS 6 and 7.

Remedial Steps

29. The Firm has undertaken the following remedial steps:

a) increased its compliance resources, including the appointment of a new non-executive chairman, a dedicated compliance monitoring employee and an external compliance consultant to provide challenge and improvements with regard to the Firm's compliance and regulatory functions;

b) appointed a new compliance manager in July 2011;

c) opened separate CREST accounts for client and Firm monies in order to improve its management and segregation of client money and reconciliation process;

d) introduced a new computer operating system to address some of the CASS issues that had arisen partly as a result of the inadequacies of Xcap's existing accounting system, particularly with regard to posting cash and provision of a cash book for the purposes of internal and external reconciliations;

e) improved its client money processes and procedures so that it is now in a position to comply with CASS rules;

f) paid the sum of £1,620 to certain of its clients in respect of interest that had been received on client money balances which had not been paid;

g) introduced bespoke CASS training for back office staff to further emphasise the importance of CASS compliance; and

h) there have in addition been recent and significant managerial and board changes within Xcap as a result of the recent merger with Hume Capital. A new Chief Executive and non-executive Chairman are now in place.

FAILINGS

30. Based on the facts and the matters described above, the Authority concludes that Xcap has failed to satisfy Principles 3 and 10, and associated CASS Rules (see Annex A).

31. Specifically, throughout the Relevant Period, in its client money and safe custody assets arrangements the Firm breached:

a) Principle 3: by failing to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems to ensure:

i) that it had in place adequate organisational arrangements in respect of client money and safe custody assets; and

ii) that it implemented and maintained adequate policies and procedures to detect and manage its client money and safe custody assets risks.

b) Principle 10: by failing to arrange adequate protection for all clients' assets when it was responsible for them.

c) In particular, Xcap:

i) failed to carry out adequate internal and external reconciliation and calculations of client money. This means that it was unable to identify discrepancies and therefore know whether it was necessary to pay any shortfall into or withdraw any excess from its client money accounts. This created a risk to clients' money in the event of insolvency;

ii) failed to ensure appropriate segregation of client money. In the event of Xcap's insolvency, failure to segregate client money (mixed remittance, foreign currency etc.) promptly puts all clients at risk of potential loss and in any event such client money would have been difficult to identify, leading to potential delay and diminution;

iii) failed to carry out adequate reconciliation of all safe custody assets and to ensure that all such assets were clearly identified as belonging to the client. In the event of Xcap's insolvency, these assets may have been at risk of the administrator claiming that they belonged to the Firm. Failure to identify the assets in accordance with CASS 6 could have also led to the risk of set-off, delays in return and potentially expensive litigation where the assets are held by third parties;

iv) failed to have in place adequate trust status letters. Without these letters, client money was at risk of set-off by the bank and/or being claimed by the Firm's administrator in the event of the Firm's insolvency.

32. The weaknesses in Xcap's approach to the accounting and treatment of client money meant that the same was not adequately segregated from its own funds and clients were consequently exposed to risk of loss in the event the Firm became insolvent.

33. It is recognised that the Firm self-reported its initial client money failings in October 2010 following consultation with its auditors. However, this report was insufficient in its detail and not followed up with a more comprehensive report until four months later. Xcap did not therefore bring the breaches to the attention of the Authority without delay as required by CASS 7.6.16R.

34. Having regard to the issues above, the Authority considers it appropriate and proportionate in all the circumstances to take disciplinary action against Xcap for its breaches of the Principles and associated CASS Rules over the Relevant Period.

SANCTION

Financial penalty

35. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. 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.

Step 1: disgorgement

36. 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.

37. The Authority has not identified any direct financial benefit that Xcap derived directly from its breaches.

38. Step 1 is therefore £0.

Step 2: the seriousness of the breach

39. 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.

40. The Authority considers that the revenue generated by Xcap is not an appropriate indicator of the harm or potential harm caused by its breaches in this case. This is because a firm's revenue could increase or decrease without the amount of client money and/or safe custody assets it is holding (and therefore the associated risks) being directly affected. The Authority has determined therefore that the appropriate indicator in this case is the daily averages of each of the safe custody assets balance and the client money balance over which Xcap had a responsibility to ensure were adequately protected from risk of loss, diminution or delay of return to clients during the Relevant Period ("Average Client Balances").

41. In determining the percentage of Average Client Balances that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage that is appropriate to the relevant fixed level which represents, on a sliding scale of 1 to 5, the seriousness of the breach; the more serious the breach, the higher the level.

42. Pursuant to DEPP 6.5A.2G(13) where the Authority determines that revenue is not an appropriate indicator of harm or potential harm that a firm's breach may cause, it will nonetheless adopt a similar approach to that described in DEPP 6.5A.2G. However, where relevant revenue is not appropriate to use, the Authority may not use the percentage levels applied in cases using revenue. The corresponding percentage levels that the Authority intends to apply to CASS cases are therefore as follows.

Level of Seriousness	Percentage – Client Money	Percentage – Safe custody assets
Level 1	0	0
Level 2	1	0.2
Level 3	2	0.4
Level 4	3	0.6
Level 5	4	0.8

43. As the table above outlines, two different percentage scales apply, one in respect of client money and one in respect of safe custody assets. This is necessary as the Authority considers that the risk profile and CASS Rules applicable to safe custody assets are different to those relating to client money. In general, safe custody assets tend to be much higher quantitatively, however, the risk of loss tends to be smaller.

44. 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. DEPP 6.5A.2G(11) lists factors likely to be considered "level 4 or 5 factors". Of these, the Authority considers the following factors to be relevant in this case.

    a) Significant risk of loss to individual clients: Xcap's breaches meant that the client money of individual clients was at risk of not being properly segregated into a client trust account and the safe custody assets at risk of not being correctly recognised as such and thereby being subject to loss, diminution or delayed return in the event of the Firm's insolvency.

    b) Serious/systemic weaknesses in the Firm's internal controls: Xcap's CASS failures were widespread and its non-compliance continued for several months, even after weaknesses and breaches had become apparent.

45. DEPP 6.5A.2(12) lists factors likely to be considered "level 1, 2 or 3 factors". Of these, the Authority considers the following factors to be relevant in this case.

    a) Little/no profits made or losses avoided: the Firm did not profit from its failure to comply with the various CASS Rules (although it may have saved money by not implementing adequate systems and retaining adequate resources from the outset).

    b) There was no effect on the orderliness of/confidence in the markets.

    c) The breaches were committed negligently: there is no evidence to suggest that Xcap deliberately failed to comply with CASS.

46. The Authority also considers that the following factors are relevant.

    a) The Firm was non-compliant with the CASS Rules for a period of 15 months.

    b) The quantum of assets that were placed at risk of direct loss due to the failures of the Firm in registering of title to, and the clear identification of, some safe custody assets was a small minority of the average client asset balance held during the Relevant Period.

47. Taking all of these factors into account, the Authority considers the seriousness of the breach in respect of client money to be level 3 and so for this element of the penalty the Step 2 figure is 2% of £3,451,101 (the average client money balance).

48. The Authority considers that the nature of the breaches in respect of safe custody assets at the Firm would, in general, also constitute level 3 seriousness. However, specifically in view of the low level of safe custody assets placed at risk of direct loss (see 46.b) above) a seriousness level of 2 is applied in this case, which results in a Step 2 figure for this element of the penalty of 0.2% of £34,187,298 (the average client asset balance). The Step 2 figure is the sum of both these calculations.

49. Step 2 is therefore £137,397.

Step 3: mitigating and aggravating factors

50. 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.

51. The Authority considers that the following factors aggravate the breach.

    a) The extended period for which a number of the breaches were not fully remedied (i.e. up to September 2011 in respect of the letters of acknowledgement of trust, up to December 2011 for the correct registration of safe custody assets and up to April 2012 for settling client interest).

    b) The Firm was not in a position to comply with CASS from the outset of its operations and yet it continued to expand its business at a time when it was aware of at least some of its failures, increasing the amount of client money and safe custody assets it held, thereby putting more clients at risk of loss. Firms are reminded that they must ensure that they are in a position to comply with regulatory requirements from the commencement of business as an authorised person.

    c) The importance of compliance with CASS has been well publicised by the Authority both prior to and during the Relevant Period, including numerous enforcement actions which have drawn firms' attention to the need for improved focus on this area and the importance of protecting client money and safe custody assets.

52. The Authority considers that the factors set out at paragraph 9 above mitigate the breach.

53. Having taken into account these aggravating and mitigating factors, the Authority considers that the Step 2 figure should be increased by 10%.

54. Step 3 is therefore £151,136.

Step 4: adjustment for deterrence

55. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.

56. The Authority considers that the Step 3 figure of £151,136 represents a sufficient deterrent to Xcap and others, and so has not increased the penalty at Step 4.

57. Step 4 is therefore £151,136.

Step 5: settlement discount

58. 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.

59. The Authority and Xcap reached agreement at Stage 2 and so a 20% discount applies to the Step 4 figure.

60. Step 5 is therefore £120,909.

Penalty

61. The Authority hereby imposes a total financial penalty of £120,900 on Xcap for breaching Principle 3 and Principle 10.

PROCEDURAL MATTERS

Decision maker

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

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

Manner of and time for Payment

64. The financial penalty is to be paid in 6 monthly instalments. The first instalment of £20,150 must be paid by Xcap to the Authority within 14 days of the date of the Final Notice. The following 5 equal instalments of £20,150 each must be paid on the first day of the month following the previous instalment (the "Due Date"). If the Due Date for any given payment falls on a public holiday (including Saturdays or Sundays) in any given month then the Due Date is deemed to be the first business day immediately following the public holiday concerned.

If the financial penalty is not paid

65. If any instalment is not paid by the Due Date for that instalment then the remainder of the financial penalty becomes payable immediately and in full. The Authority may recover the outstanding amount as a debt owed by Xcap and due to the Authority.

Publicity

66. 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 Xcap or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

Authority contacts

68. For more information concerning this matter generally, contact Naomi Thomas at the Authority (direct line: 020 7066 7382 /fax: 020 7066 7383).

Jamie Symington

Head of Department

Enforcement and Financial Crime Division

ANNEX A

STATUTORY PROVISIONS, REGULATORY GUIDANCE AND POLICY

STAUTORY PROVISIONS

1. The Authority's operational objectives are set out in section 1B(3) of the Financial Services Act 2012 and include the consumer protection objective, i.e. securing an appropriate degree of protection for consumers.

2. The Authority has the power, pursuant to section 206 of the Act, to impose a financial penalty of such amount as it considers appropriate where the Authority considers an authorised person has contravened a requirement imposed on him by or under the Act.

3. The Authority has the power, pursuant to section 166 of the Act, to require an authorised person to provide the Authority with a report, made by a person nominated or approved by the Authority and appearing to have the skills necessary to make such report (referred to as a skilled person) on any matter about which the Authority has required or could require the provision of documents or information under section 165 of the Act.

REGULATORY PROVISIONS

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

Principles for Businesses ("Principles")

5. Under the Authority's rule-making powers, the Authority has published in the Authority Handbook the Principles which apply either in whole, or in part, to all authorised persons.

6. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the Authority's objectives. A firm may be liable to disciplinary sanction where it is in breach of the Principles.

7. The Principles relevant to this case are:

   7.1. Principle 10 (Clients' Assets) which states that:

   "A firm must arrange adequate protection for clients' assets when it is responsible for them"

   7.2. Principle 3 (Management and Control) which states that:

   "*A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems*"

Client Assets sourcebook ("CASS")

8. CASS 6.1.22G states that Principle 10 (Clients' assets) requires a firm to arrange adequate protection for clients' assets when it is responsible for them. As part of these protections, the custody rules require a firm to take appropriate steps to protect safe custody assets for which it is responsible.

9. CASS 6.2.1R states that a firm must, when holding safe custody assets belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the firm's insolvency, and to prevent the use of safe custody assets belonging to a client on the firm's own account except with the client's express consent.

10. CASS 6.2.2R states that a firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of clients' safe custody assets, or the rights in connection with those safe custody assets, as a result of the misuse of the safe custody assets, fraud, poor administration, inadequate record-keeping or negligence.

11. CASS 6.2.3R states that to the extent practicable, a firm must effect appropriate registration or recording of legal title to a safe custody asset in the name of:

    (1) the client (or, where appropriate, the trustee firm), unless the client is an authorised person acting on behalf of its client, in which case it may be registered in the name of the client of that authorised person;

    (2) a nominee company which is controlled by:

        (a) the firm;

        (b) an affiliated company;

        (c) a recognised investment exchange or a designated investment exchange; or

        (d) a third party with whom financial instruments are deposited under CASS 6.3

12. CASS 6.3.1R(1) states that a firm may deposit safe custody assets held by it on behalf of its clients into an account or accounts opened with a third party, but only if it exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those 1safe custody assets.

13. CASS 6.3.1R(2) states that a firm must take the necessary steps to ensure that any client's safe custody assets deposited with a third party, in accordance with this rule are identifiable separately from the applicable assets belonging to the firm and from the applicable assets belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

14. CASS 6.5.1R states that a firm must keep such records and accounts as necessary to enable it at any time and without delay to distinguish safe custody assets held for one client from safe custody assets held for any other client, and from the firm's own applicable assets.

15. CASS 6.5.2R states that a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the safe custody assets held for clients.

16. CASS 6.5.4G(1) states that carrying out internal reconciliations of the safe custody assets held for each client with the safe custody assets held by the firm and third parties is an important step in the discharge of the firm's obligations under CASS 6.5.2 R (Records and accounts) and, where relevant,1 SYSC 4.1.1 R (General requirements) and SYSC 6.1.1 R (Compliance).

17. CASS 6.5.4G(2) states that a firm should perform such internal reconciliations:

    (a) as often as is necessary; and

    (b) as soon as reasonably practicable after the date to which the reconciliation relates;

    to ensure the accuracy of the firm's records and accounts.

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

19. CASS 7.3.1R states that a firm must, when holding client money, make adequate arrangements to safeguard the client's rights and prevent the use of client money for its own account.

20. CASS 7.3.2R states that a firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence.

21. CASS 7.4.1R states that a firm, on receiving any client money, must promptly place this money into one or more accounts opened with any of the following:

    (1) a central bank;

    (2) a BCD credit institution;

    (3) a bank authorised in a third country;

    (4) a qualifying money market fund.

22. CASS 7.4.11R states that a firm must take the necessary steps to ensure that client money deposited, in accordance with CASS 7.4.1 R, in a central bank, a credit institution, a bank authorised in a third country or a qualifying money market fund is held in an account or accounts identified separately from any accounts used to hold money belonging to the firm.

23. CASS 7.4.17G states that under the normal approach, a firm that receives client money should either:

    (1) pay it promptly, and in any event no later than the next business day after receipt, into a client bank account; or

    (2) pay it out in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (see CASS 7.2.15 R).

24. CASS 7.4.23G states that pursuant to the client money segregation requirements, a firm operating the normal approach that receives a mixed remittance (that is part client money and part other money) should:

    (1) pay the full sum into a client bank account promptly, and in any event, no later than the next business day after receipt; and

    (2) pay the money that is not client money out of the client bank account promptly, and in any event, no later than one business day of the day on which the firm would normally expect the remittance to be cleared.

25. CASS 7.6.1R states that a firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money.

26. CASS 7.6.2R states that a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients.

27. CASS 7.6.5G states that a firm should ensure that it makes proper records, sufficient to show and explain the firm's transactions and commitments in respect of its client money.

28. CASS 7.6.6G(1) states that carrying out internal reconciliations of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds in client bank accounts and client transaction accounts should be one of the steps a firm takes to satisfy its obligations under CASS 7.6.2 R, and where relevant SYSC 4.1.1 R and SYSC 6.1.1 R.

29. CASS 7.6.6G(2) states that a firm should perform such internal reconciliations:

    (a) as often as is necessary; and

    (b) as soon as reasonably practicable after the date to which the reconciliation relates;

    to ensure the accuracy of the firm's records and accounts.

30. CASS 7.6.6G(3) states that the standard method of internal client money reconciliation sets out a method of reconciliation of client money balances that the Authority believes should be one of the steps that a firm takes when carrying out internal reconciliations of client money

31. CASS 7 Annex 1 G states that, as explained in CASS 7.6.6 G, in complying with its obligations under CASS 7.6.2 R (Records and accounts), and where relevant SYSC 4.1.1 R (General organisational requirements) and SYSC 6.1.1 R (Compliance), a firm should carry out internal reconciliations of records and accounts of client money the firm holds in client bank accounts and client transaction accounts. This Annex sets out a method of reconciliation that the Authority believes is appropriate for these purposes (the "standard method" of internal client money reconciliation).

32. CASS 7.6.9R states that a firm must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom client money is held.

33. CASS 7.6.10G(1) states that a firm should perform the required reconciliation of client money balances with external records:

    (a) as regularly as is necessary; and

    (b) as soon as reasonably practicable after the date to which the reconciliation relates;

    to ensure the accuracy of its internal accounts and records against those of third parties by whom client money is held.

34. CASS 7.6.10G(2) states that in determining whether the frequency is adequate, the firm should consider the risks which the business is exposed, such as the nature, volume and complexity of the business, and where and with whom the client money is held.

35. CASS 7.6.11G states that a method of reconciliation of client money balances with external records that the Authority believes is adequate is when a firm compares:

    (1) the balance on each client bank account as recorded by the firm with the balance on that account as set out on the statement or other form of confirmation issued by the bank with which those accounts are held; and

    (2) the balance, currency by currency, on each client transaction account as recorded by the firm, with the balance on that account as set out in the statement or other form of confirmation issued by the person with whom the account is held;

    and identifies any discrepancies between them.

36. CASS 7.6.12R states that any approved collateral held in accordance with the client money rules must be included within this reconciliation.

37. CASS 7.6.13R – When any discrepancy arises as a result of a firm's internal reconciliations, the firm must identify the reason for the discrepancy and ensure that:

    (1) any shortfall is paid into a client bank account by the close of business on the day that the reconciliation is performed; or

    (2) any excess is withdrawn within the same time period (but see CASS 7.4.20 G and CASS 7.4.21 R).

38. CASS 7.6.14R states that when any discrepancy arises as a result of the reconciliation between a firm's internal records and those of third parties that hold client money, the firm must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the firm.

39. CASS 7.6.15R states that while a firm is unable to resolve a difference arising from a reconciliation between a firm's internal records and those of third parties that hold client money, and one record or a set of records examined by the firm during its reconciliation indicates that there is a need to have a greater amount of client money or approved collateral than is in fact the case, the firm must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own money into a relevant account.

40. CASS 7.6.16R states that a firm must inform the Authority in writing without delay:

(1) if it has not complied with, or is unable, in any material respect, to comply with the requirements in CASS 7.6.1 R, CASS 7.6.2 R or CASS 7.6.9 R;

(2) if having carried out a reconciliation it has not complied with, or is unable, in any material respect, to comply with CASS 7.6.13 R to CASS 7.6.15 R.

41. CASS 7.8.1R(1) states that when a firm opens a client bank account, the firm must give or have given written notice to the bank requesting the bank to acknowledge to it in writing that:

(a) all money standing to the credit of the account is held by the firm as trustee (or if relevant, as agent) and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm; and

(b) the title of the account sufficiently distinguishes that account from any account containing money that belongs to the firm, and is in the form requested by the firm.

42. CASS 7.8.1R(2) states that in the case of a client bank account in the United Kingdom, if the bank does not provide the required acknowledgement within 20 business days after the firm dispatched the notice, the firm must withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible.

Decision Procedure and Penalties Manual ("DEPP")

43. The Authority's policy in relation the imposition and amount of penalties that applied during the Relevant Period is set out in Chapter 6 of DEPP.

44. DEPP 6.1.2G provides that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour. Financial penalties are therefore tools that the Authority may employ to help it to achieve its regulatory objectives.

45. DEPP 6.5.1G states that for the purpose of DEPP 6.5 to DEPP 6.5D and DEPP 6.6.2 G, the term "firm" means firms and those unauthorised persons who are not individuals.

46. DEPP 6.5.2(G) states that the Authority's penalty-setting regime is based on the following principles:

(1) Disgorgement - a firm or individual should not benefit from any breach;

(2) Discipline - a firm or individual should be penalised for wrongdoing; and

(3) Deterrence - any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.

47. DEPP 6.5.3(1) states that the total amount payable by a person subject to enforcement action may be made up of two elements: (i) disgorgement of the benefit received as a

result of the breach; and (ii) a financial penalty reflecting the seriousness of the breach. These elements are incorporated in a five-step framework, which can be summarised as follows:

(a) Step 1: the removal of any financial benefit derived directly from the breach;

(b) Step 2: the determination of a figure which reflects the seriousness of the breach;

(c) Step 3: an adjustment made to the Step 2 figure to take account of any aggravating and mitigating circumstances;

(d) Step 4: an upwards adjustment made to the amount arrived at after Steps 2 and 3, where appropriate, to ensure that the penalty has an appropriate deterrent effect; and

(e) Step 5: if applicable, a settlement discount will be applied. This discount does not apply to disgorgement of any financial benefit derived directly from the breach.

48. DEPP 6.5.3(2) states that these steps will apply in all cases, although the details of Steps 1 to 4 will differ for cases against firms (DEPP 6.5A), cases against individuals (DEPP 6.5B) and market abuse cases against individuals (DEPP 6.5C).

49. DEPP 6.5.3(3) states that the Authority recognises that a penalty must be proportionate to the breach. The Authority may decrease the level of the penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breach concerned. For cases against firms, the Authority will have regard to whether the firm is also an individual (for example, a sole trader) in determining whether the figure arrived at after applying Step 2 is disproportionate.

50. DEPP 6.5.3(4) states that the lists of factors and circumstances in DEPP 6.5A to DEPP 6.5D are not exhaustive. Not all of the factors or circumstances listed will necessarily be relevant in a particular case and there may be other factors or circumstances not listed which are relevant.

51. DEPP 6.5.3(6) states that Part III (Penalties and Fees) of Schedule 1 to the Act specifically provides that the Authority may not, in determining its policy with respect to the amount of penalties, take account of expenses which it incurs, or expects to incur, in discharging its functions.

52. DEPP 6.5A sets out the five steps, as described in DEPP 6.5.3(1), for penalties imposed on firms.

53. DEPP 6.5A.2G(1) states that the Authority will determine a figure that reflects the seriousness of the breach. In many cases, 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, and in such cases the Authority will determine a figure which will be based on a percentage of the firm's revenue from the relevant products or business areas. The Authority also believes that the amount of revenue generated by a firm from a particular product or business area is relevant in terms of the size of the financial penalty necessary to act as a credible deterrent. However, the Authority recognises that there may be cases where revenue is not an appropriate indicator of the harm or potential harm that

a firm's breach may cause, and in those cases the Authority will use an appropriate alternative.

54. DEPP 6.5A.2G(4) states that the Authority will assess the seriousness of the breach to determine which level (out of the five levels available, 1 being the least serious and 5 being the most) is most appropriate to the case.

55. DEPP 6.5A.2(G) (5) to (12) set out various factors which are likely to be relevant to and how these will be applied in determining the level of seriousness for the breach.

56. DEPP 6.5A.2(13) states that in those cases where revenue is not an appropriate indicator of the harm or potential harm that a firm's breach may cause, the Authority will adopt a similar approach, and so will determine the appropriate Step 2 amount for a particular breach by taking into account relevant factors, including those referred to above. In these cases the Authority may not use the percentage levels that are applied in those cases in which revenue is an appropriate indicator of the harm or potential harm that a firm's breach may cause.

57. DEPP 6.5A.3G(1) states that 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. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

58. DEPP 6.5A.3G(2) sets out a list of factors which may have the effect of mitigating or aggravating the breach.

59. DEPP 6.5A.4(G) sets out circumstances in which the Authority may consider the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach or others from committing further or similar breaches and will therefore increase the penalty.

60. DEPP 6.5A.5(G) states that the Authority and the firm on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, 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 concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.