Policy Statement

10/4

Financial Services Authority

Enforcement financial penalties

Feedback on CP09/19

March 2010

Financial Services Authority

Contents

This Policy Statement reports on the issues arising from Consultation Paper 09/19 relating to Enforcement financial penalties. It publishes final amendments to the Decision Procedure and Penalties, the Enforcement Guide and the Regulated Covered Bonds sourcebook.

Please address any comments or enquiries to:

Clive Gordon
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 1412
E-mail: cp09_019@fsa.gov.uk

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1 Overview

Introduction

1.1 In this Policy Statement (PS) we respond to comments received concerning *Consultation Paper 09/19 (CP 09/19): Enforcement financial penalties* and amendments to the text of the Decision Procedure and Penalties manual (DEPP), the Regulated Covered Bonds sourcebook (RCB) and the Enforcement Guide (EG).

1.2 We received 20 responses to CP09/19. A non-confidential list of the people from whom we received responses is set out in Annex 1. We are grateful to all respondents for taking the time to share their views with us. We have carefully considered the comments made and have amended our proposals where appropriate. We have also made some changes on our own initiative.

Main feedback

1.3 CP09/19 contained three main proposals:

- To change our current policy, set out in DEPP, on the determination of the level of penalties in enforcement cases. We proposed a structured five-step penalty framework to improve the transparency and consistency of our penalty-setting process, and increase penalties in line with our credible deterrence strategy.
- To explain in DEPP our approach in cases where a person claims a financial penalty will cause them serious financial hardship (we consulted on two options).
- To make a minor change to EG in order to clarify the situations where we may publicise our actions in criminal investigations.

1.4 Respondents agreed that introducing more transparency and consistency to our penalty-setting process is desirable. However, they generally thought our proposals would not achieve these objectives, mainly because they give us too much discretion, at too many different stages. Many respondents also disputed the need to increase the level of financial penalties, although some welcomed a tougher approach. Respondents queried if higher penalties would increase deterrence, and thought they may have negative consequences, including damaging firms' open and cooperative

relationship with us, deterring individuals from becoming Approved Persons (APs), and increased challenge to our decisions, putting more pressure on our resources.

1.5 There was also opposition to specific parts of the proposed framework. In particular:

- our use of 'relevant income' as the basis for setting penalties for firms was queried;
- the proposed maximum 40% of gross income at Step 2 for penalties against individuals was considered unreasonably high;
- the minimum £100,000 penalty for all market abuse cases against individuals was considered disproportionate; and
- concern was raised with the amount of discretion we would have at Steps 3 and 4.

1.6 We recognise that the proposed framework gives us a significant amount of discretion. However, we consider this discretion to be appropriate and the new framework to be an improvement on our current approach. We believe the new framework will make our penalty setting more transparent, and, consequently, will make it easier to predict the expected level of a penalty. We also consider that the new framework seeks to ensure that the penalties imposed are fair, proportionate and appropriate.

1.7 While we recognise that more of our decisions may be challenged, we believe that any effects this may have on our resources will be outweighed by ongoing cost savings as a result of increased compliance. We consider that firms should now be used to our more intrusive supervisory approach; consequently we do not expect the new framework to damage our relationship with those we regulate. We do not believe that the new regime will discourage appropriate people from becoming APs.

1.8 Therefore, we are proceeding with the five step framework and our proposed Step 2 levels in cases against firms and individuals, although we have revised certain technical aspects. We have made a more significant change concerning our policy for determining penalties in market abuse cases against individuals. We have aligned this more closely to the framework for imposing penalties on individuals in non-market abuse cases.

1.9 We made the following proposals concerning serious financial hardship:

- For individuals:
  - Option 1 was that we would never reduce a penalty on the grounds of serious financial hardship; and
  - Option 2 was that we would consider reducing a penalty on the grounds of serious financial hardship if its payment would result in the person's net annual income falling below £14,000 and capital falling below £16,000.
- For firms, in both options we would consider our regulatory objectives when deciding whether it would be appropriate to reduce the penalty.

1.10 Respondents showed considerable preference for option 2. Option 1 was considered disproportionately harsh, although several respondents considered the threshold levels in option 2 too low. After considering the responses, we have decided to adopt

a revised version of option 2. We have also amended our proposals concerning firms to make it clear that we will consider the impact of the penalty on the firm.

1.11 Most respondents agreed with our proposal that we should clarify when we will normally publicise enforcement action in criminal cases. We have therefore decided to proceed with this proposal.

Who should read this?

1.12 This PS will be of general interest, as it gives guidance on aspects of our use of enforcement action as a regulatory tool. It will be particularly relevant to both the regulated community and to those unregulated persons against whom we may use our enforcement powers, for example, in relation to market abuse. It will also be of interest to those firms and individuals we regulate under the Money Laundering Regulations 2007, the Transfer of Funds (Information on the Payer) Regulations 2007, the Regulated Covered Bond Regulations 2008, the Payment Services Regulations 2009 and the Cross-Border Payments in Euro Regulations 2010.

1.13 This PS will also be of interest to consumers and consumer groups, to the extent that they benefit from or are affected by our approach to enforcement.

Structure of this PS

1.14 In the CP we asked the following six questions:

- Do you have any comments about our proposals in relation to the determination of penalty levels in cases against firms?
- Do you have any comments about our proposals in relation to the determination of penalty levels in disciplinary cases against individuals?
- Do you have any comments about our proposals in relation to the determination of penalty levels in cases against individuals for market abuse?
- Do you agree that we should have the same penalty framework for FSMA and non-FSMA cases?
- Do you have any comments on our proposals for deciding whether and, if so, when we should reduce a penalty on the grounds of serious financial hardship?
- Do you agree that we should clarify when we will normally publicise enforcement action in criminal cases?

1.15 The structure of this PS does not follow the structure of the questions we asked in the CP. This is because we believe it would be clearer to group similar issues together under the same topic headings. Consequently, this PS is structured as follows:

- Chapter 2 summarises the general comments we have received on our proposals to adopt a new penalties framework concerning cases brought under our Financial Services and Markets Act 2000 (FSMA) powers, and sets out our response.

- Chapter 3 summarises the comments we have received on specific aspects of our proposals for a new penalties framework and sets out our response.
- Chapter 4 summarises the comments we have received on our proposal to apply the new penalties framework to non-FSMA cases and sets out our response.
- Chapter 5 summarises the comments we have received on our proposals in relation to the issue of serious financial hardship and sets out our response.
- Chapter 6 summarises the comments we have received on our proposed policy in relation to publicising our action in criminal cases and sets out our response.
- Chapter 7 summarises the comments we have received on our cost benefit analysis and sets out our response.
- Annex 1 sets out a list of the respondents to CP09/19.
- Appendix 1 contains the final text of amendments made to DEPP, RCB and EG, including consequential amendments required to RCB and EG as a result of the changes described in this PS.

Next steps

1.16 The amendments contained in Appendix 1 to this PS will come into effect on 6 March 2010. Sections 69(8), 93(5), 124(6) and 210(7) of FSMA require us to have regard to the policy on imposing penalties which was in force at the time the firm or the individual committed the breach. Consequently, the changes to how we impose penalties as set out Appendix 1 will only apply to conduct which takes place on or after 6 March 2010. When a breach occurs before 6 March and continues after that date, the new penalty framework will apply to the part of the breach which occurred on or after 6 March 2010.

2 General comments

Introduction

2.1 This chapter summarises the general comments we have received on our proposal to adopt a new penalty framework and sets out our response.

2.2 In CP09/19 we set out proposals for a new five-step penalty framework. The five steps were set out as follows:

Step 1 (disgorgement): In all cases where we are able to identify a benefit directly derived from the breach, whether in the form of a profit made or a loss avoided, and such benefit is quantifiable, we will seek to deprive the person of that benefit.

Step 2 (discipline): This examines the seriousness, nature and impact of the breach. For regulatory cases against all firms we proposed that the starting point for assessing the punitive element of a penalty would, in many of our cases, be a percentage of the firm's 'relevant income'. Relevant income is the income derived by the firm during the period of the breach from the business area or product sales to which the breach relates.

We proposed that the percentage of income used as the starting point for a penalty would depend on the seriousness, nature and impact of the misconduct. The more serious the case, the higher the percentage of relevant income would be. For penalties imposed on firms, we proposed it should be 0-20% of the firm's relevant income. We proposed that fixed levels within this range would make the system easier to use. For penalties imposed against firms the fixed levels would be 0%, 5%, 10% 15% and 20%.

For regulatory penalties against individuals, we proposed that the starting point would be a percentage of the individual's income, which would be their gross remuneration and benefits (including salary, bonus, share options and share schemes), for the period of the breach, from their job at the authorised firm where the breach was committed. Our assessment of the seriousness of the breach would determine the relevant percentage of income used. We proposed that the range for penalties imposed on individuals (excluding market abuse cases) should be 0-40%, with fixed levels of 0%, 10%, 20%, 30% and 40%. For market abuse cases against individuals, we proposed that the starting point would be the greater of 40% of

income (if the breach is referable to the individual's employment), two times any benefit received, and £100,000.

Step 3 (mitigating or aggravating circumstances): We proposed that the figure arrived at in Step 2 could be increased or decreased if there are any mitigating or aggravating factors present.

Step 4 (deterrence): We proposed that the figure arrived at after Step 3 could be increased if we considered it insufficient to deter both the person who committed the breach, and others, from committing further breaches.

Step 5 (settlement discount): We did not propose any changes to the settlement scheme.

Comments on the effectiveness of the proposed framework

2.3 Respondents agreed that more transparency and consistency in how we determine the appropriate level of a penalty is desirable, and welcomed a more structured approach. However, many respondents were unconvinced that our proposals would improve predictability, transparency and consistency. The main criticism was that the framework is too flexible, giving us too much discretion at too many different stages. No respondents proposed we should continue using our current approach without any changes; however few alternatives were proposed. Suggestions included that instead of using a formulaic approach, the five steps should be seen as guidance, and we should use final notices to explain how we decide upon the penalty level.

2.4 One respondent commented that we should not underestimate the deterrent effect, as well as the potential commercial harm of naming and shaming an individual or a firm in addition to any financial penalty. Another respondent argued that high penalties on their own will not deter and will not be seen as credible. Reinforcing penalties needs to be accompanied by focusing equally on effective policing.

Our response: We recognise that the proposed framework allows us a significant degree of discretion, but we consider such discretion to be appropriate. The scope of cases we deal with, and differing facts in each case, necessarily preclude an overly prescriptive formula. We believe the new framework to be the most effective way of improving the transparency and consistency of setting penalties, and consequently, the predictability in terms of what penalties should be expected. Although we recognise that factors other than a penalty may deter firms and individuals from misconduct, we still believe it is appropriate that the penalty itself should act as a credible deterrent. We agree that a reinforcement of penalties needs to be accompanied by focusing equally on effective policing. This approach forms part of our credible deterrence strategy.

Comments on the level of detail to be disclosed

2.5 Respondents asked what level of detail we intended to disclose about how we determined the penalty level in each case. Respondents believed that if the process was to be transparent, we should provide details of how the relevant penalty level was decided at each step of the framework, including the factual basis upon which

the assessment was carried out. There was also concern that we could disclose commercially sensitive income information.

Our response: Section 391 of the FSMA requires us to publish such information about a final notice as we consider appropriate. In order to ensure that the new framework is transparent, we would have to set out in a final notice how we determined the penalty. This may result in us disclosing commercially sensitive information, but we will consider how such disclosure may impact on a firm when making our decision.

Comments on how we will review the new framework

2.6 Several respondents questioned how we would measure the success of the new approach and what we would do if it was not successful. They questioned if we would conduct a review of the new policy and when we would do so.

Our response: Increased penalties should lead to individuals and firms taking more account of the prospect of enforcement action. Consequently, we would expect to see fewer examples of repeated behaviour in particular areas.

We have no current plans to conduct a specific review of our new penalties policy. However, we would welcome comments from stakeholders as we start to implement it.

Comments on the transitional application of the new framework

2.7 Respondents asked how we would act in cases where misconduct occurred during both the current and new regimes. They asked which regime would apply if an incorrect decision that led to the rule breach preceded the new penalty regime. Another respondent thought our proposals should apply to all current cases.

Our response: Sections 69(8), 93(5), 124(6) and 210(7) of the FSMA require us to have regard to the policy on imposing penalties which was in force at the time the firm or the individual committed the breach. Consequently, when a breach begins before 6 March 2010 (when the new penalties regime takes effect) and continues after that date, two different penalty regimes will apply. The penalty regime in place before 6 March 2010 will apply to conduct before that date, and the new penalties regime will apply to conduct from that date onwards. Therefore, the new regime will apply where a rule breach occurred in the new regime as a result of an incorrect decision that was taken in the previous regime.

Comments on our proposal to increase penalties

2.8 Many respondents challenged our decision to increase the level of penalties. It was thought that higher penalties could have negative consequences, including:

- damage to firms' open and cooperative relationship with us;
- reducing the level of cooperation given by persons investigated;

- deterring firms from disclosing their breaches to the FSA;
- reducing innovation;
- the possibility that firms may change their company structure to limit the impact of regulatory sanction, with the cost ultimately passed on to the consumer; and
- the possibility that individuals and firms will take evasive measures to limit financial liability in the event of enforcement action.

Our response: We believe firms should now be used to our more intrusive supervisory approach, and consequently we do not expect the new framework to damage our relationship with the firms and individuals we regulate. We do not believe the new regime will reduce innovation. In order to address the concern that people may take evasive measures to limit financial liability, such action is included as an aggravating factor in the DEPP text (DEPP 6.5A.3 G(2)(e) for firms, DEPP 6.5B.3 G(2)(e) for individuals in non-market abuse cases and DEPP 6.5C.3 G(2)(d) for individuals in market abuse cases). Also, we would take into account any such actions when considering representations of serious financial hardship (DEPP 6.5D.5 G).

2.9 Respondents were concerned that combining higher penalties with the introduction of a five-step framework could increase the extent to which penalties are challenged. Individuals or firms could challenge each step of the framework, and they may also be more likely to dispute the penalty level if it is higher. This would result in longer cases, less settlement, more cases referred to the Regulatory Decisions Committee (RDC) and the Financial Services and Markets Tribunal, increased costs and increased pressure on our resources. One respondent commented that more contested cases would create a delay between the breach and final notice publication, and argued that this would undermine our credible deterrence agenda.

Our response: In our Cost Benefit Analysis in CP09/19 we made allowances for the possibility of increased challenges to our decisions and more referrals to the Financial Services and Markets Tribunal. Despite the challenges of increased litigation we still believe it is appropriate to increase the level of penalties. We consider any effects on our resources owing to increased challenge will be outweighed by the ongoing cost savings and wider benefits of increased compliance. We note that there may be increased delays between the breach and the publication of a final notice; however, we have other powers if we need to address on-going concerns about conduct in the industry. We do not believe that any additional delay between the breach and final notice publication will materially decrease deterrence.

2.10 Another concern was that increasing penalties on individuals could deter people from becoming APs, and could result in individuals in the financial services receiving harsher penalties than those received by individuals in other industries for professional misconduct or criminal activities. Respondents questioned the appropriateness of raising penalties on individuals now, before it has been possible to assess the success of recent measures to extend the AP regime and to take action against those individuals exercising significant influence functions. Respondents also highlighted how simply imposing higher penalties on individuals ignores the implications for individuals beyond the penalty.

Our response: We do not believe that fit and proper people will be deterred from becoming APs by the possibility of a higher penalty. We consider it is important to increase the deterrent effect of our penalties now, instead of waiting for the effectiveness of other policy initiatives to be measured. We acknowledge that penalties on individuals may have implications for individuals beyond the financial penalty. However, we aim to have a penalties regime which, by itself, acts as a credible deterrent.

2.11 Some respondents questioned our belief that higher penalties would increase compliance, and asked what research we had undertaken to support this. They asked if regulators in other countries had increased compliance through higher penalties, and what evidence we have that existing penalties are not a sufficient deterrent. It was suggested that reputational damage may be a greater deterrent than a higher penalty, and that our real reason for proposing to increase penalties was to become more of an enforcement-led regulator.

Our response: Our experience as a regulator, and constant interaction with stakeholders, has led us to believe that increasing penalties should increase compliance with our rules. In principle, the degree of deterrence increases with the severity of the penalty, given a specific probability of detection. We note recent research which supports this link between higher penalties and greater deterrence.[1] We also note that several respondents did favour a tougher approach, arguing that much higher penalties are needed so these are not seen only as a regulatory cost of doing business. These respondents also wanted us to take more action against senior management. We agree that reputational damage, in some cases, may act as a deterrent, however, experience suggests it is not enough, by itself, to deter breaches. We have decided to implement the new framework to support our strategy of having an enforcement regime which is seen as a credible deterrent.

1 See the Office of Fair Trading's October 2009 paper *An Assessment of Discretionary Penalties Regimes* available at: http://www.oft.gov.uk/shared_oft/economic_research/oft1132.pdf.

3 Responses on specific aspects of the proposed framework

Introduction

3.1 This chapter summarises the responses we have received on specific aspects of the proposed five-step framework, and explains how we have addressed respondents' comments.

Step 1 (disgorgement) concerning all categories of penalties

3.2 In CP09/19 Step 1 provided that, as a minimum, the financial penalty imposed should deprive a person of the benefit derived directly from the breach, and that, in those cases where we agree a redress programme with a firm, there may be no need for disgorgement, or the disgorgement element might be reduced.

3.3 Respondents thought it was appropriate for disgorgement to be the first step of the proposed framework, but questioned how it would work in practice. Some respondents thought it could be difficult to identify the financial benefit, and felt it was unclear how the financial benefit would be calculated. We were asked what costs and expenses would be taken into account; how we would determine whether it was practicable to disgorge; how disgorgement would apply to different categories of cases, and what happens when the benefit is subject to a third party claim.

3.4 Some respondents asked how we would take into account redress, and especially whether internal administrative costs would be a factor when deciding if any benefit from the breach had been eliminated. A couple of respondents wanted it to be clear that there will be no disgorgement for firms which have initiated a customer redress programme. In contrast, another respondent thought there should be no further disgorgement only if redress was proactive and complete, and suggested further penalties for inadequate redress programmes.

Our response: In light of the variety of cases we handle, our approach to determining the amount to be disgorged must remain flexible and will depend on the facts of each case. We do not believe that it is possible for any guidance to cover all eventualities. Redress will be taken into account when quantifying disgorgement, however, the extent to which we consider redress will depend on the facts of the case and the details of the redress programme. For these reasons we have not added any more detail on this issue in DEPP.

3.5 We were also questioned how we would determine the rate of interest to be applied, and the period the applicable interest rate would cover.

Our response: We will determine the relevant interest rate, and the date from which it will apply, on a case by case basis. In deciding what interest rate to use, we may have regard to the interest rates applied by the Financial Ombudsman Service and the civil courts.

Other changes:

3.6 We have made the following change to Step 1 concerning penalties imposed on individuals in non-market abuse cases:

- In the CP, the draft DEPP text stated that, where the success of a firm's entire business model is dependent on breaching our rules and the breach is at the core of the firm's regulated activities, we will seek to deprive the firm of all the financial benefit it has derived from such activities. We now consider that this should also apply to individuals (DEPP 6.5B.1 G). We have added this to ensure that in such cases an individual does not benefit from their misconduct.

Step 2 (the seriousness of the breach): general comments

3.7 In CP09/19 we proposed that at Step 2 of the framework we would determine a figure that reflected the nature, impact and seriousness of the breach. The way we would do this would differ between cases against firms, non-market abuse cases against individuals, and market abuse cases against individuals.

3.8 For cases against firms, we proposed that the Step 2 figure would be 0%, 5%, 10%, 15% or 20% of the firm's relevant income over the period of the breach from the product or business area to which the breach relates. For non-market abuse cases against individuals, we proposed that the Step 2 figure would be 0%, 10%, 20%, 30% or 40% of the individual's relevant income. We proposed that 'relevant income' would consist of their gross benefits from their relevant employment in connection with which the breach occurred, for the period of the breach.

3.9 For market abuse cases against individuals, we proposed that the Step 2 figure would be the greater of:

- twice the profit made or loss avoided by the individual as a direct result of the market abuse;
- £100,000; and
- where the individual commits market abuse referable to their employment, 40% of the gross amount of all benefits received from their employment in the 12 months preceding the market abuse.

3.10 One respondent commented we had not given adequate justification for the levels or for why these are different between firms and individuals. They were concerned our

proposals would mean that a director of a single member company would be treated differently to a sole trader for the same misconduct.

Our response: We have chosen levels we believe will achieve our aim of penalties that will be a credible deterrent. In CP09/19 we outlined why we had chosen different levels for individuals and firms. We said we considered this approach is justified because action against individuals has a significantly greater impact in terms of deterrence than action against firms, and that focus on individuals is a key component of our credible deterrence strategy.

We recognise that one consequence of the new penalty regime is that a director of a single member company will be treated differently to a sole trader. We have now added text to DEPP (DEPP 6.5.3 G(3)) that states that in considering whether a Step 2 figure for a firm is disproportionate, we will also have regard to whether the person is an individual (e.g. a sole trader).

3.11 Respondents were concerned that the lack of guidance on how the relevant level would be determined would undermine our objectives of consistency and transparency. The examples in CP09/19 were considered unhelpful in this respect. One respondent wanted the relevant factors for all five levels to be identified. There was also concern that little emphasis and space was given to factors that tended to indicate levels 1-3 breaches, and that the majority of cases could be levels 4 or 5. It was thought there would be little incentive to settle level 5 cases. One respondent also asked us to elaborate on the kind of cases where public censure is appropriate.

Our response: We consider that the new DEPP text strikes the right balance between offering sufficient guidance to assist transparency and consistency and being flexible enough to apply to our cases. We anticipate that as we start implementing the new framework, its application will make it easier for our stakeholders to see how it applies in practice. DEPP 6.4 continues to set out our policy on public censure.

3.12 Some respondents wanted a clearer distinction between the different levels, and between deliberate, reckless, negligent and inadvertent breaches. It was argued that it was inappropriate for level 5 to apply to non-deliberate behaviour, and that negligent or inadvertent behaviour should be included as factors tending to indicate levels 1-3 breaches. One respondent thought we should be required to have evidence that the behaviour in question was deliberate or reckless.

Our response: We consider that whether a breach is deliberate, reckless, negligent or inadvertent is only one factor to be taken into consideration in determining a penalty. A non-deliberate breach could cause more consumer harm, or potential harm, than a deliberate breach, and, therefore, may deserve a higher penalty. However, committing a breach deliberately or recklessly is included in the list of factors which are likely to be considered 'level 4 factors' or 'level 5 factors' for the purposes of Step 2 (DEPP 6.5A.2 G(11)(f), 6.5B.2 G(12)(g) and 6.5C.2 G(15)(f)). Also, whether a breach was committed negligently or inadvertently is now included among the list of factors likely to be considered level 1, 2 or 3 factors (DEPP 6.5A.2 G(12)(e), 6.5B.2 G(13)(d) and 6.5C.2 G(16)(c)).

3.13 One respondent thought the factors should distinguish between clear breaches of rules from cases where a judgement about what a rule entails is required. They also believed we should recognise steps taken to comply with the FSA's rules, even if inadequate, and requested guidance on different standards of proof that may apply.

Our response: DEPP recognises that a person's intention is relevant to the seriousness of the conduct. It is also relevant to our assessment of whether enforcement action is appropriate at all. It is not, however, helpful to suggest that there are different standards of proof which apply to the breach of different rules. In order for us to take disciplinary action, we must be satisfied that there has been a breach, having looked at all relevant facts and circumstances.

3.14 There was disagreement with our proposal to multiply the relevant income by the period of the breach, as it was considered undesirable that we could impose larger penalties for minor breaches of our systems and controls requirements which went undetected for several years than for short-term deliberate misconduct. It was suggested, as an alternative, that the percentage of a single year's income should be taken. The fairness of basing the penalty on a minimum of one year's income for minor short-term breaches was also questioned.

Our response: We still believe that a penalty should be based on the period of the breach as this reflects the harm or potential harm that can flow from the breach. It also encourages firms to put an end to any ongoing breaches they uncover. We also now clarify in DEPP that we will look at relevant income over the whole period in respect of action we take for market abuse, which was referable to an individual's employment, which took place on multiple occasions over a period of more than a year (DEPP 6.5C.2 G(4)).

We still believe it is appropriate to base a penalty on a minimum of a year's income. This ensures the penalty acts as a credible deterrent. However, we stated in the proposed DEPP text that in cases where an individual commits a breach which lasts less than a year, or which is a one-off event, the relevant period will be the income earned in the year preceding the breach. We now think it is more appropriate to use the relevant income in the 12 months up to the end of the breach (DEPP 6.5B.2 G(2)). We are also using this approach in relation to penalties imposed on firms (DEPP 6.5A.2 G(2)). We believe this is more appropriate because it better reflects the income earned by the individual or firm while the breach took place. For market abuse cases referable to an individual's employment, the relevant period will be the 12 months preceding the market abuse or, where there are multiple instances of market abuse over a period of less than a year, the 12 months preceding the last instance of market abuse (DEPP 6.5C.2 G(5)).

Where the individual was in the relevant employment for less than a year, the relevant income will be calculated on a pro rata basis to the equivalent of 12 months' relevant income. This applies to individuals in both non-market and market abuse cases (DEPP 6.5B.2 G(2) and DEPP 6.5C.2 G(5)). If the firm was in existence for less than 12 months, its relevant revenue will be extrapolated from the period during which the firm was in existence to create a figure which represents the equivalent of 12 months' relevant income (DEPP 6.5A.2 G(2)).

Other changes:

3.15 In line with our aim for a clear framework, we also made the following main changes in relation to Step 2:

- We recognise that the final amount of the penalty we impose must be proportionate to the breach. We now state in DEPP that we may decrease the level of the penalty arrived at after applying Step 2 of the framework if we consider the penalty is disproportionately high for the breach concerned (DEPP 6.5.3 G(3)). We have made this addition because we believe the issue of proportionality is most likely to arise at Step 2. For example, a firm's relevant revenue may be the correct metric for measuring the likely impact and harm caused by a breach but could produce a disproportionate figure. In considering whether a Step 2 figure for a firm is disproportionate, we will also have regard to whether the person is an individual, e.g. a sole trader (DEPP 6.5.3 G(3)).
- We have deleted the comment included in the proposed DEPP text that level 1 cases will generally result in a public censure with no financial penalty, because we think it is more appropriate that our policy in respect of public censure is set out completely in DEPP 6.4.
- We have deleted the fact that a person knew of the possible consequences of their behaviour but ignored them from the proposed DEPP text's list of factors likely to show that the breach was deliberate. This applies to all types of cases.
- For all types of cases, we have added the following factors which are likely to show that the breach was deliberate:
  - the person sought to conceal their misconduct (DEPP 6.5A.2 G(8)(c), 6.5B.2 G(10)(d) and 6.5C.2 G(13)(d));
  - the person was influenced to commit the breach by the belief that it would be difficult to detect (DEPP 6.5A.2 G(8)(e), 6.5B.2 G(10)(f) and 6.5C.2 G(13)(f)); and
  - the breach was repeated (DEPP 6.5A.2 G(8)(f), 6.5B.2 G(10)(h) and 6.5C.2 G(13)(g)).

Step 2 (the seriousness of the breach) for firms

3.16 Several respondents objected to our proposal to use 'relevant income' as the basis for setting a penalty. Some thought its exact meaning was unclear and it was suggested that 'relevant revenue' would be a more appropriate term. Many respondents expected that the interpretation of relevant income would be keenly debated, as it could differ according to the circumstances of each case. There was concern that there may be inconsistency in how relevant income is calculated. Some respondents therefore wanted 'relevant income' to be defined for different kinds of regulated activity.

Our response: In light of the responses, we have decided that the term 'relevant revenue' is more apt than 'relevant income'. However, we do not intend this term to be a 'term of art'

or to reflect a precise accounting definition. Also, we do not think it is practical to have different definitions for different categories of cases. The diversity of the cases we take would make that inappropriate. The meaning and quantification of 'relevant revenue' will depend on the facts of each case.

3.17 Many respondents suggested that 'relevant income' may not be a suitable indicator of harm, or potential harm, for example, because it does not take into account the relative profitability of different types of business and because firms assess income for specific parts of their business in different ways. However, other than one call for profit, no alternative measures were put forward. Even where income was a suitable indicator of harm, or potential harm, it was feared it could result in very large or disproportionate penalties, especially for large firms. One respondent thought this would mean that firms would be penalised for the size of their business rather than the seriousness of the breach.

Our response: We continue to believe that revenue will, in many of our cases, be a good indicator of harm or potential harm. We do not agree that profit is the most appropriate measure of harm, or potential harm, and it is difficult to attribute profit for a particular breach. We believe revenue is a more objective metric than profit as it does not require any calculation or attribution of costs to activities.

As the proportion of relevant revenue would be dependent on the seriousness of the breach, and the revenue of a particular product or business area, we do not think that we would be penalising a firm for its size.

3.18 Many respondents thought our proposals were unclear on when income would be appropriate, and whether there was a procedure for deciding the appropriateness or inappropriateness of using income. Further, when income is inappropriate, respondents wanted to know the alternative measure that we would use and how we would use it.

Our response: We will use revenue where the extent of a firm's involvement in a particular product line or business area is indicative of the harm, or potential harm, that its breach may cause. Where revenue is not indicative of the harm, or potential harm, that a firm's breach could cause, we will still apply the five steps of the framework, but we will use an appropriate alternative means of arriving at a figure in Step 2. It is difficult to predict in advance what the relevant alternative measure may be in a particular case and therefore we do not think it would be helpful to set out prospectively the alternative measures we would use. However, we give two examples that may be applicable in particular cases: (i) in a case concerning a breach of the listing rules, we may consider the firm's market capitalisation as an alternative; (ii) in cases concerning systems and controls in relation to the holding of client money, the relevant measure could be a percentage of the client money held by the firm during the breach. Both these alternatives may be indicative of the harm, or potential harm, caused by the breach.

3.19 One respondent questioned how we would decide whether to look at the firm's product or at its business area, and thought that 'business area' should be defined more clearly. A small number of respondents asked if redress would be taken into account to reduce income, and one respondent queried if we would take into account third party claims.

Our response: Where the breach relates to a specific product or products, we will look at the revenue generated by those products. Where there are a series, or categories of products, all of which fall within in a particular business area, then we are more likely to take the revenue of that business area.

We do not consider it appropriate to take into consideration redress or third party claims at Step 2, as the figure we are seeking to determine is one which acts as a proxy for the general harm or potential harm that has been caused.

3.20 The levels proposed at Step 2 for firms were thought to be reasonable, although one respondent suggested they should be increased to a range of 10-50%. Some respondents suggested other factors that could be taken into account at Step 2, including the extent to which the firm failed to adequately and fairly deal with complaints relating to the breach; the inconvenience or distress caused to consumers; whether the firm should reasonably have identified the risk to consumers; and whether the firm, in committing the breach, took any steps to comply with FSA rules, and the adequacy of those steps. One respondent also thought that if internal procedures are not followed, this should only indicate deliberate behaviour if they were knowingly not followed.

Our response: We still believe the 0-20% range in Step 2 for firms is appropriate because it will produce an appropriate figure that will reflect the seriousness of the breach, and will act as a credible deterrent. After considering factors suggested to us, we have amended DEPP so that:

- the inconvenience or distress caused to consumers is now included as a factor relating to the impact of the breach (DEPP 6.5A.2 G(6)(e));
- whether the firm, in committing the breach, took any steps to comply with our rules, and the adequacy of those steps is now included as a factor relating to the nature of the breach (DEPP 6.5A.2 G(7(h)); and
- the fact that a person knew their actions were not in accordance with the firm's internal procedures is now a factor tending to show a breach was deliberate (DEPP 6.5A.2 G(8)(b)).

Other changes:

3.21 We have also made the following main changes in relation to Step 2 for penalties imposed on firms:

- we have moved the factor 'whether the firm's senior management were aware of the breach' from Step 3 to Step 2 (nature of the breach) (DEPP 6.5A.2 G(7)(d)) as we felt that it was more relevant to the seriousness of the breach;
- whether the firm failed to conduct its business with integrity has been added as a factor relating to the nature of the breach (DEPP 6.5A.2 G(7(g));
- whether the breach created a significant risk that financial crime would be facilitated, occasioned or otherwise occur has been included as a factor which is likely to be considered a level 4 or 5 factor (DEPP 6.5A.2 G(11)(d)); and

- the fact that the firm's senior management, or a responsible individual, sought to conceal their misconduct has been deleted from the factors likely to be considered a level 4 or 5 factor. This is because it is already listed as a factor which tends to show a breach was committed deliberately.

Step 2 (the seriousness of the breach) for individuals

3.22 One respondent asked whether it is appropriate to use an individual's income as the basis for the penalty given that it is not indicative of the harm caused by a breach. No other respondents questioned the appropriateness of using income, although one respondent thought that, as relevant income includes benefits such as bonuses and share options, it could be difficult to calculate. One respondent asked how we would obtain details of an individual's income, and what firms were required to disclose in respect of their employees' benefits.

Our response: We consider that income is the most appropriate basis for setting a penalty. Individuals are remunerated according to their responsibilities. It is therefore reasonable to base the penalty for an individual's failure to discharge their duties properly on the level of remuneration. The percentage of an individual's income used will reflect our assessment of the seriousness of the conduct, including the impact of the breach.

We acknowledge there may be cases where calculating an individual's income may not be straightforward. It is likely we will require individuals (and, where necessary, firms) to disclose relevant information.

3.23 Many respondents believed that taking a maximum 40% of income was disproportionately high and suggested that the percentage levels should be equivalent to those proposed for firms, although one respondent thought the levels should range from 10-50%. There was also objection to our proposal to take a percentage of gross income, with respondents arguing that it contrasts with the approach used in criminal sentencing, that gross income includes deferred benefits which may create a higher immediate impact on the individual, and that it could unfairly benefit overseas residents who are non-tax payers. Therefore, there was a preference for net income to be used instead, although one respondent thought we should use gross income. Several respondents also thought it unfair for relevant income to cover all benefits received from an individual's employment, as opposed to only the benefits from the controlled functions related to the breach.

Our response: In CP09/19 we acknowledged that our proposals concerning individuals were more stringent than those proposed for firms in two key respects:

- First, when considering the most serious cases against firms, the Step 2 figure is a maximum of 20% of the firm's income, whereas the maximum for individuals is 40%.
- Secondly, the starting point for the penalty imposed on an individual is based on all the benefits obtained from their employment, regardless of whether part of their role may relate to non-regulated activities or activities otherwise unrelated to the breach.

We continue to consider this approach is justified because action against individuals has a significantly greater impact in terms of deterrence than action against firms, and this focus on individuals is a key part of our credible deterrence strategy. We continue to consider it is appropriate to use 0-40% of gross income as using net income is administratively more difficult, and also because we believe the likely penalties from the 0-40% range will result in penalties that are proportionate and act as a credible deterrent.

Other changes:

3.24 We have made the following main changes to Step 2 in relation to penalties imposed on individuals in non-market abuse cases:

- Following respondents' calls for a clearer distinction between Steps 2 and 3, we have moved the following factors from Step 3 to Step 2 (nature of the breach):
  - whether the individual abused a position of trust (DEPP 6.5B.2 G(9)(f));
  - whether the individual committed a breach of any professional code of conduct (DEPP 6.5B.2 G(9)(g));
  - whether the individual held a prominent position within the industry (DEPP 6.5B.2 G(9)(i));
  - whether the individual is an experienced industry professional (DEPP 6.5B.2 G(9)(j));
  - whether the individual held a senior position with the firm (DEPP 6.5B.2 G(9)(k)); and
  - whether the individual acted under duress (DEPP 6.5B.2 G(9)(m)).
- We have added the following factor, relating to the nature of the breach: whether the individual caused or encouraged other individuals to commit breaches (DEPP 6.5B.2 G(9)(h)).
- We have added the following factor which tends to show the breach was deliberate: the individual intended to financially benefit from the breach, either directly or indirectly (DEPP 6.5B.2(10)(b)).
- We have removed this factor from the list of factors tending to show the breach was reckless: the individual gave no apparent consideration to the consequences of their actions or inaction.
- We have added the following factors to the list of those likely to be considered level 4 or 5 factors:
  - the individual failed to act with integrity (DEPP 6.5B.2 G(12)(d));
  - the individual abused a position of trust (DEPP 6.5B.2 G(12)(e)); and
  - the individual held a prominent position within the industry (DEPP 6.5B.2 G(12)(f)).

- We have removed the following factors from the list of those likely to be considered level 4 or 5 factors. This is because they are covered by the factor: the breach was committed deliberately or recklessly:
  - the individual sought to conceal their misconduct;
  - the individual intended or foresaw the potential or actual consequences of their actions; and
  - the individual was motivated by personal gain.
- In line with similar suggestions to those made for firms and set out in the section above, we have also added the following factors:
  - The inconvenience or distress caused to consumers as a factor relating to the impact of the breach (DEPP 6.5B.2 G(8)(e));
  - Whether the individual failed to act with integrity (DEPP 6.5B.2 G(9)(e)), and whether the individual took any steps to comply with FSA rules and the adequacy of those steps (DEPP 6.5B.2 G(9)(n)), as factors relating to the nature of the breach;
  - The fact the individual knew that his actions were not in accordance with internal procedures as a factor tending to show the breach was deliberate (DEPP 6.5B.2 G(10)(c)); and
  - The fact the breach created a significant risk that financial crime would be facilitated, occasioned or otherwise occur as a factor likely to be considered a level 4 or 5 factor (DEPP 6.5B.2 G(12(c)).

Step 2 (the seriousness of the breach) for market abuse cases against individuals

3.25 Respondents had mixed views on whether we should have a separate regime for market abuse. Some respondents agreed that it is such a serious issue that a distinct approach is appropriate, but others thought the general approach for individuals should also apply, as other types of breaches are also premeditated.

3.26 Most respondents appreciated the seriousness of market abuse and the need for it to be deterred. However, many felt that a minimum penalty of £100,000, regardless of whether the market abuse was committed intentionally, was too harsh and could be disproportionate. One respondent thought that taking 40% of an individual's income, regardless of the seriousness of the market abuse, could be too severe. Another queried whether the RDC would be likely to issue public censures where they thought a £100,000 penalty would be too harsh.

3.27 Two respondents argued that we would be fettering our discretion by imposing a minimum £100,000 penalty, and any action we take should depend on all the circumstances of the case. Respondents questioned if we would be complying with our obligations under section 124 FSMA if we imposed a minimum £100,000 penalty at

Step 2. Section 124 FSMA provides that our policy for setting a market abuse penalty must have regard to (a) whether the behaviour had an adverse effect on the market in question and, if so, the seriousness of that effect; (b) the extent to which the behaviour was deliberate or reckless; and (c) whether the person on whom the penalty is to be imposed is an individual. Concern was raised that our proposed policy would result in a more penal outcome than would be imposed as a consequence of any criminal action.

3.28 Several alternatives to our proposals were offered, including: not having a minimum penalty; linking the penalty to the benefit gained; and including a statement that we will normally impose a penalty of at least £100,000 in serious cases.

Our response: In light of the responses received we have reviewed our proposals. Within Step 2, we will now determine a figure based on whether the market abuse was referable to the individual's employment and the seriousness of the market abuse.

Where the market abuse is referable to the individual's employment, we will use the greater of:

- a percentage of his relevant income (0%, 10%, 20%, 30%, or 40%);
- a multiple of the profit made or loss avoided by the individual for his benefit or the benefit of others (zero, one, two, three, or four times); and
- £100,000 for the most serious cases of market abuse.

Where the market abuse is not referable to the individual's employment, we will use the greater of:

- a multiple of the profit made or loss avoided by the individual for his benefit or the benefit of others (zero, one, two, three, or four times); and
- £100,000 for the most serious cases of market abuse.

In both instances the £100,000 minimum penalty will only apply in cases which we assess to fall within Step 2 seriousness levels of 4 or 5. We usually expect to assess market abuse committed deliberately as seriousness level 4 or 5.

Our new approach is now more closely aligned to the framework for imposing penalties on individuals in non-market abuse cases. We will now focus on the seriousness of the breach at Step 2 and will determine the relevant percentage of income, or the relevant profit multiple, by using the relevant indicators of seriousness set out in DEPP. These seriousness indicators include many factors which previously were included at Step 3 in the proposed DEPP text, including whether the market abuse was committed deliberately or recklessly.

Other changes:

3.29 We have also made the following additional main changes to Step 2 in relation to penalties imposed on individuals in market abuse cases:

- The profit multiple will be the profit made or loss avoided by the individual for his own benefit, or for the benefit of other individuals where the individual has been instrumental in achieving that benefit, as a direct result of the market abuse (DEPP 6.5C.2 G(2)(b) and 6.5C.2 G(3)(a)).

- The Step 2 factors included in respect of market abuse cases against individuals replicate, where relevant, those included in respect of non-market abuse cases against individuals. However, the following factors only apply in respect of market abuse cases against individuals:
  - Whether the market abuse had a significant impact on the price of shares or other investments – this additional factor relates to the impact of the market abuse (DEPP 6.5C.2 G(11)(c)).
  - The fact the individual knew his actions were not in accordance with exchange rules, share dealing rules and/or the firm's internal procedures – this factor tends to show the market abuse was deliberate (DEPP 6.5C.2 G(13)(c)).
  - For market abuse falling within section 118(2) FSMA, the fact that the individual knew or recognised that the information on which the dealing was based was inside information – this factor tends to show the market abuse was deliberate (DEPP 6.5C.2 G(13)(h)).
  - For market abuse falling within section 118(4) FSMA, the fact that the individual's behaviour was based on information which he knew or recognised was not generally available to those using the market, and the individual regarded the information as relevant when deciding the terms on which transactions in qualifying investments should be effected – this factor tends to show the market abuse was deliberate (DEPP 6.5C.2 G(13)(i)).
- Consistent with the Step 2 approach for firms and individuals, Step 2 of the market abuse section also now includes factors likely to be considered level 4 or 5, and factors likely to be considered level 1, 2 or 3. These, where relevant, replicate those in Step 2 in respect of non-market abuse cases against individuals. However, factors likely to be considered level 4 or 5 factors also include:
  - the level of benefit gained or loss avoided, or intended to be gained or avoided, directly by the individual from the market abuse was significant (DEPP 6.5C.2 G(15)(a));
  - the market abuse had a serious adverse effect on the orderliness of, or confidence in, markets (DEPP 6.5C.2 G(15)(b)); and
  - the market abuse was committed on multiple occasions (DEPP 6.5C.2 G(15)(c)).

Step 3 (mitigating or aggravating circumstances) concerning all categories of penalties

3.30 In CP09/19 we proposed that the figure arrived at in Step 2 could be increased or decreased at Step 3 if there are any aggravating or mitigating factors present.

3.31 Respondents did not dispute the need for this step, but questioned how we would determine the size of any adjustment made. There were several suggestions for appropriate Step 3 factors. In particular, it was thought that there should be a

significant discount for self-reporting and for effective cooperation. However, concerns were raised that defending an enforcement action would be seen as non-cooperation, thereby resulting in an increased penalty.

Our response: We have made a change to the way we make adjustments at Step 3 concerning the penalties imposed on firms and on individuals in non-market abuse cases. Instead of adjusting the percentage of relevant revenue determined in Step 2, any adjustments at Step 3 will now be made by reducing, or increasing, the Step 2 figure by an appropriate percentage figure (DEPP 6.5A.3 G(1) and 6.5B.3 G(1)). This also applies to penalties imposed on individuals in market abuse cases (DEPP 6.5C.3 G(1)). We are likely to determine the size of the adjustment by deciding upon the relevant Step 3 factors and calculating the overall percentage change needed. This will be done on a case by case basis and we think it would be unhelpful to adopt an overly rigid approach.

We do not consider defending FSA action to be non-cooperation.

3.32 Other Step 3 factors suggested by respondents were:

- whether there was significant uncertainty as to the applicable law;
- whether supervisors had previously known about the conduct but not taken any action;
- whether consumer groups, trade associations or other regulators had identified and publicly called for improvements in standards in relation to the breach; and
- the level of complaints about the breach, which were upheld in favour of the consumer by the Financial Ombudsman Service.

Our response: We do not consider these generally to be mitigating or aggravating factors so have not included them in the final DEPP text.

Other changes:

3.33 In addition to moving several factors to Step 2, we have also made the following main changes to Step 3:

- We have removed the factor included in the proposed DEPP text concerning cases against firms and non-market abuse cases against individuals: other action that we (or a previous regulator) have taken in relation to similar breaches. This is because we can take this into account at Step 4.
- We have moved the statement that we may make a prohibition order or withdraw an individual's approval as well as impose a financial penalty to the serious financial hardship section (DEPP 6.5D.3 G). We have also amended the statement so that it is clear that prohibition or withdrawal of approval relates to an individual's fitness or suitability for a particular role, and does not affect our assessment of the appropriate financial penalty in relation to a breach. However, we add that any such action may be relevant in assessing whether a penalty will cause an individual serious financial hardship.

- Other Step 3 factors for cases against individuals for market abuse include those, where relevant, which also apply to non-market abuse cases against individuals.
- We have introduced these new Step 3 factors:
  - For all categories of cases, whether the person had previously been told of the FSA's concerns in relation to the issue, either by means of a private warning or in supervisory correspondence (DEPP 6.5A.3 G(2)(f), 6.5B.3 G(2)(f), and 6.5C.3 G(2)(e)).
  - For cases against firms and non-market abuse cases against individuals, whether the person had previously undertaken not to perform a particular act or engage in particular behaviour.
  - For penalties imposed in market abuse cases against individuals only, we will now take into account whether the individual assisted the FSA in action taken against other individuals for market abuse and/or in criminal proceedings (DEPP 6.5C.3 G(2)(c)). This will allow us to decrease a penalty where a witness who has committed market abuse cooperates with us.

Step 4 (deterrence) in relation to all categories of penalties

3.34 In CP09/19 Step 4 of the proposed framework allowed us to increase the figure arrived at after Step 3 if we thought that figure was insufficient to deter the firm that committed the breach, and others, from committing further breaches.

3.35 Many respondents were concerned about the lack of guidance on when or how the discretion to uplift penalties would be exercised, arguing that this reduced transparency and could result in inconsistent outcomes. Respondents wanted to know how, when and how often we would use this power; how we would decide a penalty is too small to achieve credible deterrence, and how we would determine that a particular level of penalty is a suitable deterrent. One respondent thought Step 4 should only apply in exceptional circumstances. A couple of respondents commented that any increase at Step 4 should be proportionate to the nature of the breach and the size of income.

Our response: We are confident that Steps 1-3 of the framework are sufficiently robust to arrive at the appropriate figure in most cases. However, we recognise that in certain circumstances we will need to increase the penalty at Step 4, to ensure it acts as a deterrent. We are aware of stakeholders' concerns about the use of this step but will ensure we use it only where we consider it justified.

3.36 Several respondents held views about proportionality. The power to reduce a disproportionate penalty was welcomed, although one respondent thought it would be unsatisfactory if we did this often. We were also asked how we will decide that a penalty is disproportionately high.

Our response: We recognise that a penalty must be proportionate to the misconduct, assessed against our goal of securing changes in behaviour using enforcement action. We believe that the judgement about the proportionality of our action can only be made on a case-by-case basis and that it will often be clear when a proposed penalty is disproportionate.

3.37 Several respondents believed we should not be reliant on enforcement action to drive industry behaviour. However, one respondent thought we should be able to increase penalties to deter others from committing similar breaches. Another respondent asked how we would determine that similar breaches will happen in the future.

Our response: As the regulator of the financial services industry we seek to establish the standards of conduct we expect from the firms and individuals we regulate. Enforcement is only one of the ways we achieve this. Our enforcement strategy is to achieve credible deterrence. Therefore, when we take action against a person for breaching our rules it is appropriate for us to use that case as an opportunity to try and deter others from similar misconduct. It is likely that our supervisory experience will help in deciding whether it is likely that similar breaches will be committed in the future.

3.38 Objections were made to our proposal to use Step 4 where there have been similar breaches relating to different products. Respondents commented that the standards required of firms were unlikely to apply across different products or sectors, and that we should communicate directly with firms where a trend for unacceptable behaviour transcends products, rather than expect firms to analyse every FSA publication. Some respondents were concerned that smaller firms would be disproportionately punished because they are deemed more difficult to regulate.

Our response: A crucial element of our deterrence function is our ability to increase a penalty where we have previously taken action for similar misconduct. Our decision to apply this uplift will naturally depend on the facts of the case. We do not agree that this will prejudice smaller firms. A final notice is not a notification of new standards of conduct. It is a notice that in a certain situation a firm or individual fell below our existing standards and an explanation of how we came to that conclusion. It reasserts the type of behaviour we expect.

In CP09/19 we noted that deterrence is a function of both the size of penalty a firm or individual could expect and the likelihood of detection of misconduct. Where the likelihood of detection is relatively low, the penalty should therefore be relatively high in order to achieve credible deterrence. Detection may be low due to the nature of the breach or the nature of the product. For example, a breach may not come to light until a product matures, which may be ten or twenty years after it was purchased. Furthermore, detection may be low due to our risk-based supervisory approach. For instance, a thematic review may visit all relationship-managed firms but only a sample of small firms. In such circumstances the likelihood of detecting a breach by a small firm is consequently low compared to relationship-managed firms.

Other changes:

3.39 We have also made the following additional main changes to Step 4 in relation to penalties imposed in all categories of cases (unless otherwise stated):

- We have amended DEPP to clarify that we may increase the penalty in situations where the penalty appears to be too small in relation to the breach (DEPP 6.5A.4 G(1)(a), 6.5B.4 G(1)(a) and 6.5C.4 G(1)(a)).

- We are now able to increase a penalty at Step 4 in market abuse cases if the Step 3 penalty is too small and therefore lacks sufficient deterrent effect (DEPP 6.5C.4 G(1)(a)). As we are no longer imposing a £100,000 minimum penalty at Step 2 in all cases, we believe it is appropriate to be able to increase the market abuse penalty at Step 4 where we consider the penalty is too small in relation to the breach.

Other changes not already covered:

3.40 We have decided to amend DEPP 6.4, which sets out the criteria for determining whether it is appropriate to issue a public censure rather than impose a financial penalty. This is to clarify the link between public censure and serious financial hardship (DEPP 6.4.2 G(8)).

4 Penalty policy for non-FSMA cases

Introduction

4.1 This chapter summarises the responses we have received on our proposals in respect of determining the appropriate level of financial penalty in non-FSMA cases.

4.2 In CP09/19 we explained that, in addition to FSMA powers, we have powers to impose financial penalties under the Money Laundering Regulations 2007, the Transfer of Funds (Information on the Payer) Regulations 2007, the Regulated Covered Bonds Regulations 2008, and the Payment Services Regulations 2009. We proposed that the same penalties framework for firms and individuals, and the same serious financial hardship proposals, should also apply to penalties imposed in non-FSMA cases. The same penalties regime will also apply to breaches of the Cross-Border Payments in Euro Regulations 2010. This is because as we do not have a separate penalty policy for breaches of these Regulations, so our policy for imposing penalties under the Payment Services Regulations 2009 automatically applies.

Comments received

4.3 The overwhelming majority of respondents agreed that the same penalty regime should apply for non-FSMA cases.

Our response: We have adopted the same penalty-setting approach for FSMA and non-FSMA cases.

5 Serious financial hardship

Introduction

5.1 This chapter summarises the responses we have received on our alternative serious financial hardship proposals and explains how we have addressed respondents' comments.

5.2 We proposed two alternative approaches in the CP. For individuals, option 1 was that we would never reduce a penalty on the grounds of serious financial hardship, and option 2 was that we would consider reducing a penalty on the grounds of serious financial hardship if its payment would result in the person's net annual income falling below £14,000 and capital falling below £16,000. For firms, our proposal in both cases was that we would take into consideration our regulatory objectives in deciding whether it is appropriate to reduce the penalty.

Comments Received

5.3 Most responses concentrated on our proposals regarding individuals and the majority of respondents preferred option 2. Option 1 was considered disproportionate and unnecessary to achieve credible deterrence. One respondent accepted that there was no explicit legal obligation on the FSA to consider financial circumstances. Others thought that, under the Human Rights Act 1998, we are required to take into account an individual's financial situation, and that option 1 could be unlawful. We also received comments that it would be contrary to the provisions of the Criminal Justice Act 1993 and the European Commission guidelines on competition penalties.

Our response: In light of the responses received, we have implemented a revised version of option 2, as set out below.

5.4 Although respondents preferred option 2, some considered its threshold levels too low and thought the effect of the penalty on innocent parties had not been adequately considered. It was suggested that we should take the effect on future earning capacity into account where there is a prohibition order or withdrawal of approval. Other respondents thought our proposals favoured home owners by

excluding the value of owner-occupied housing from the capital threshold, while another thought that it would only be justifiable for a person to lose their home if there was gross lack of integrity. One respondent wanted us to make clear the circumstances in which home and personal possessions will count as capital. Another respondent wanted the instalment arrangement for penalties to be made clearer.

Our response: We have maintained our minimum thresholds of £14,000 for income and £16,000 for capital for individuals (DEPP 6.5D.2 G(1)). Our starting point will be that an individual will suffer serious financial hardship only if his net annual income will fall below £14,000 and his capital will fall below £16,000 as a result of paying the penalty. We continue to believe that these figures represent an objective assessment of the thresholds below which serious financial hardship is experienced. We have decided to move to these thresholds to aid consistency in how we assess whether someone will suffer serious financial hardship because of the imposition of a penalty.

We now state that we will normally consider as capital the equity that an individual has in the home in which he lives. We will consider any representations by the individual about this, for example, as to the exceptionally severe impact a sale of the property might have upon other occupants of the property or the impracticability of re-mortgaging or selling the property within a reasonable period (DEPP 6.5D.2 G(4)).

With regard to the effect of prohibition in assessing an individual's ability to pay a penalty, DEPP 6.5D.3 G states: "In cases against individuals, including market abuse cases, the FSA may make a prohibition order under section 56 of the Act or withdraw an individual's approval under section 63 of the Act, as well as impose a financial penalty. Such action by the FSA reflects the FSA's assessment of the individual's fitness to perform regulated activity or suitability for a particular role, and does not affect the FSA's assessment of the appropriate financial penalty in relation to a breach. However, the fact that the FSA has made a prohibition order against an individual or withdrawn his approval, as a result of which the individual may have less earning potential, may be relevant in assessing whether the penalty will cause the individual serious financial hardship."

Instalment arrangements will depend on the facts of each case and it is, therefore, difficult to set out general guidance in this area.

5.5 The use of thresholds was criticised by several respondents on the grounds that an individual would not have all of their salary available at any point of the year and their capital reserves would not be immediately realisable. There was also a general belief that our approach could lead to longer cases and more referrals to the Financial Services and Markets Tribunal. Some respondents therefore suggested that we continue with the current financial hardship approach.

Our response: In terms of income, we will calculate an individual's ability to pay based on the income they are due to receive on a forward looking basis. For example, if an individual has an annual net income of £50,000 we would consider he would be able to pay £36,000 from his income in each of the following three years. Similarly, in terms of capital, we will look at what the individual can pay straight away, and what he would be able to pay after a reasonable time has passed for him to realise his assets. As previously stated, we recognise that more of our decisions may be challenged, but consider that any effect that this may

have on our resources will be outweighed by ongoing cost savings to the FSA in general as a result of increased compliance.

5.6 We received fewer comments on our serious financial hardship proposal for firms. Some respondents agreed with our proposal, but others thought we should avoid making a firm insolvent, as this is unnecessary to achieve deterrence and could have negative consequences on third parties. One respondent questioned whether our proposal would be contrary to the Human Rights Act 1998 because our proposal allows us to disregard the effect of the penalty on the subject's financial position.

Our response: In light of these responses, we have amended our approach towards firms to make it clear we will consider reducing the amount of a penalty if a firm will suffer serious financial hardship as a result of having to pay the entire amount. When deciding if it is appropriate to reduce the penalty, we will consider the firm's financial circumstances, including whether the penalty would threaten the firm's solvency or render it insolvent. We will also take into account the impact of a firm paying a penalty on our regulatory objectives. For example, in situations where consumers would be harmed or market confidence would suffer, we may consider it appropriate to reduce the penalty so the firm can continue in business and/or pay redress (DEPP 6.5D.4 G(1)).

Other changes:

5.7 We have made the following additional main changes to the DEPP text relating to serious financial hardship:

- We clarify that it is the individual's or firm's responsibility to satisfy us that paying the penalty will result in serious financial hardship. The onus is on the individual or firm to provide full, frank and timely disclosure of evidence and co-operate with our investigation (DEPP 6.5D.1 G(2) and (3)).
- We have added a statement that we may consider the extent to which an individual has access to other means of financial support in deciding if they can pay the penalty without being caused serious financial hardship (DEPP 6.5D.2 G(5)).
- We state that in certain circumstances, after considering an individual's or firm's claim that they will suffer serious financial hardship, we may not reduce the level of the penalty. These circumstances are set out in DEPP 6.5D.2 G(7) regarding individuals, and DEPP 6.5D.4 G(2) regarding firms. They include, for example, where the firm or individual directly derived a financial benefit from the breach and, if so, the extent of that financial benefit.

The FSA's current policy concerning serious financial hardship

5.8 Chapter 5 of this PS sets out the policy concerning serious financial hardship which will apply to misconduct occurring on or after 6 March 2010. Our current approach to serious financial hardship is set out in DEPP 6.4, DEPP 6.5.2(5) and EG 7.7. The substantive part of this policy states that, in setting the level of a penalty, we will

take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the person were to pay the level of the penalty appropriate for the particular breach. The policy is drafted in broad terms and allows us to consider all the relevant circumstances. We believe that the use of indicative thresholds of capital and income is consistent with the existing statements of policy in DEPP and EG, and will assist to promote a coherent approach to assessments of hardship in cases of misconduct which pre-date the introduction of the new penalty framework.

6 Publicising criminal investigations

Introduction

6.1 This chapter summarises the responses we have received to our proposal to clarify when we will normally publicise enforcement action in criminal cases and explains the approach we will take.

Comments received

6.2 Most respondents agreed with our proposal. However, one respondent worried that disclosure could damage a firm's share price and financial stability. They suggested the firm in question should send us submissions about its intended course of action before we publicise the action. Another respondent thought we should only publicise enforcement action in exceptional cases.

Our response: We see no reason to consult with the relevant firm, nor do we believe it necessary to restrict our change in policy only to exceptional cases. We have decided to adopt the proposals unchanged.

7 Cost benefit analysis

Introduction

7.1 This chapter summarises the comments we have received on the cost benefit analysis included in CP09/19 and sets out our views. It also considers the main changes we have made to the proposals set out in the CP.

Comments received

7.2 Some respondents commented that the accounting and consultant figures used in the CBA are unrealistic.

Our response: No alternative figures were presented, nor reasons given as to why our figures were considered unrealistic. We continue to believe that our figures are realistic. It is standard practice for us and other public bodies to use official statistics. While there might be geographic or industry differences between average rates charged, taking this into account in the CBA would not make a material difference to its outcome.

Changes made since the consultation

7.3 The main changes to DEPP and EG since the consultation have been made in order to enhance the effectiveness of the framework, to increase clarity and practicability and to add safeguards regarding the proportionality of a penalty.

7.4 We have analysed the changes but do not consider that they materially impact on the CBA we carried out for the CP. This is because the costs we considered in the CP related to training and the provision of data to the FSA and the FSA's analysis of that data. These costs will not be materially affected by the changes made to the policy set out in the CP. We also think that the changes are more likely to enhance the benefits flowing from the new framework than reducing them.

7.5 We therefore do not believe that any of these changes materially impact the outcome of the CBA.

Annex 1

List of respondents to Consultation Paper (CP09/19)

The Consulting Consortium

Prudential Plc

International Underwriting Association (IUA)

HSBC

AXA UK

ABI

AIFA

Nationwide

RSA Insurance Group Plc

BBA

Barclays

Eversheds

Clifford Chance

APCIMS

Berwin Leighton Paisner

Aviva

The City Liaison Group

Which?

City of London Law Society

One respondent asked for their response to remain confidential.

Appendix 1

Decision procedure and penalties manual (financial penalties) instrument 2010

DECISION PROCEDURE AND PENALTIES MANUAL (FINANCIAL PENALTIES) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 69(1) (Statement of policy);
(b) section 93(1) (Statement of policy);
(c) section 124(1) (Statement of policy);
(d) section 157(1) (Guidance); and
(e) section 210(1) (Statements of policy);

(2) regulations 36 (Financial penalties) and 42 (Guidance) of the Regulated Covered Bonds Regulations 2008; and

(3) regulations 86 (Proposal to take disciplinary measures) and 93 (Guidance) of and paragraph 1 of Schedule 5 (Disciplinary powers) to the Payment Services Regulations 2009.

Commencement

B. This instrument comes into force on 6 March 2010.

Amendments to the Handbook

C. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with Annex A to this instrument.

D. The Regulated Covered Bonds sourcebook (RCB) is amended in accordance with Annex B to this instrument.

Amendments to the Enforcement Guide

E. The Enforcement Guide (EG) is amended in accordance with Annex C to this instrument.

Notes

E. In Annex A to this instrument, the "notes" (indicated by "**Note:**") are included for the convenience of readers but do not form part of the legislative text.

Citation

F. This instrument may be cited as the Decision Procedure and Penalties Manual (Financial Penalties) Instrument 2010.

By order of the Board
25 February 2010

Annex A

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

6.4 Financial penalty or public censure

6.4.1 G The *FSA* will consider all the relevant circumstances of the case when deciding whether to impose a penalty or issue a *public censure*. As such, the factors set out in *DEPP* 6.4.2G are not exhaustive. Not all of the factors may be relevant in a particular case and there may be other factors, not listed, that are relevant.

6.4.2 G The criteria for determining whether it is appropriate to issue a *public censure* rather than impose a financial penalty ~~are similar to those for~~ include those factors that the *FSA* will consider in determining the amount of penalty set out in *DEPP* ~~6.5~~ 6.5A to *DEPP* 6.5D. Some particular considerations that may be relevant when the *FSA* determines whether to issue a *public censure* rather than impose a financial penalty are:

…

(8) the impact on the *person* concerned. ~~In exceptional circumstances, if the *person* has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their *breach* would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it~~ It would only be in an exceptional case that the *FSA* would be prepared to agree to issue a *public censure* rather than impose a financial penalty if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include ~~where there is~~:

(a) ~~verifiable evidence that a *person* would suffer serious financial hardship if the *FSA* imposed a financial penalty~~ where the application of the *FSA's* policy on serious financial hardship (set out in *DEPP* 6.5D) results in a financial penalty being reduced to zero;

(b) where there is verifiable evidence that the *person* would be unable to meet other regulatory requirements, particularly financial resource requirements, if the *FSA* imposed a financial penalty at an appropriate level; or

(c) in Part VI cases in which the *FSA* may impose a financial penalty, where there is the likelihood of a severe adverse impact on a *person's* shareholders or a consequential impact on market confidence or market stability if a financial penalty was imposed. However, this does not exclude the imposition

of a financial penalty even though this may have an impact on a *person's* shareholders.

DEPP 6.5 is deleted in its entirety. The deleted text is not shown.

DEPP 6.5 is replaced by DEPP 6.5, DEPP 6.5A, DEPP 6.5B, DEPP 6.5C and DEPP 6.5D. The new text is not underlined.

6.5 Determining the appropriate level of financial penalty

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

6.5.2 G The *FSA'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*.

6.5.3 G (1) 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*.

(2) 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).

(3) The *FSA* recognises that a penalty must be proportionate to the *breach*. The *FSA* 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 *FSA* 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.

(4) 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.

(5) The *FSA* may decide to impose a financial penalty on a mutual (such as a *building society*), even though this may have a direct impact on that mutual's *customers*. This reflects the fact that a significant proportion of a mutual's *customers* are shareholder-members; to that extent, their position involves an assumption of risk that is not assumed by *customers* of a firm that is not a mutual. Whether a firm is a mutual will not, by itself, increase or decrease the level of a financial penalty.

(6) Part III (Penalties and Fees) of Schedule 1 to the *Act* specifically provides that the *FSA* 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.

6.5A The five steps for penalties imposed on firms

Step 1 – disgorgement

6.5A.1 G (1) The *FSA* will seek to deprive a firm of the financial benefit derived directly from the *breach* (which may include the profit made or loss avoided) where it is practicable to quantify this. The *FSA* will ordinarily also charge interest on the benefit.

(2) Where the success of a firm's entire business model is dependent on breaching *FSA rules* or other requirements of the *regulatory system* and the *breach* is at the core of the firm's *regulated activities*, the *FSA* will seek to deprive the firm of all the financial benefit derived from such activities. Where a firm agrees to carry out a redress programme to compensate those who have suffered loss as a result of the *breach*, or where the *FSA* decides to impose a redress programme, the *FSA* will take this into consideration. In such cases

the final penalty might not include a disgorgement element, or the disgorgement element might be reduced.

[**Note:** For the purposes of *DEPP* 6.5A, "firm" has the special meaning given to it in *DEPP* 6.5.1G.]

Step 2 – the seriousness of the *breach*

6.5A.2 G (1) The *FSA* 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 *FSA* will determine a figure which will be based on a percentage of the firm's revenue from the relevant products or business areas. The *FSA* 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 *FSA* 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 *FSA* will use an appropriate alternative.

(2) In those cases where the *FSA* considers that revenue is an appropriate indicator of the harm or potential harm that a firm's *breach* may cause, the *FSA* will determine a figure which will be based on a percentage of the firm's "relevant revenue". "Relevant revenue" will be the revenue derived by the firm during the period of the *breach* from the products or business areas to which the *breach* relates. Where the *breach* lasted less than 12 *months*, or was a one-off event, the relevant revenue will be that derived by the firm in the 12 months preceding the end of the *breach*. Where the firm was in existence for less than 12 *months*, its relevant revenue will be calculated on a pro rata basis to the equivalent of 12 *months*' relevant revenue.

(3) Having determined the relevant revenue, the *FSA* will then decide on the percentage of that revenue which will form the basis of the penalty. In making this determination the *FSA* will consider the seriousness of the *breach* and choose 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:

(a) level 1 - 0%;

(b) level 2 - 5%;

(c) level 3 - 10%;

(d) level 4 - 15%; and

(e) level 5 - 20%.

(4) The *FSA* will assess the seriousness of a *breach* to determine which level is most appropriate to the case.

(5) In deciding which level is most appropriate to a case involving a firm, the *FSA* will take into account various factors, which will usually fall into the following four categories:

(a) factors relating to the impact of the *breach*;

(b) factors relating to the nature of the *breach*;

(c) factors tending to show whether the *breach* was deliberate; and

(d) factors tending to show whether the *breach* was reckless.

(6) Factors relating to the impact of a *breach* committed by a firm include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the firm from the *breach*, either directly or indirectly;

(b) the loss or risk of loss, as a whole, caused to *consumers*, investors or other market users in general;

(c) the loss or risk of loss caused to individual *consumers*, investors or other market users;

(d) whether the *breach* had an effect on particularly vulnerable people, whether intentionally or otherwise;

(e) the inconvenience or distress caused to *consumers*; and

(f) whether the *breach* had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

(7) Factors relating to the nature of a *breach* by a firm include:

(a) the nature of the *rules*, requirements or provisions breached;

(b) the frequency of the *breach*;

(c) whether the *breach* revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business;

(d) whether the firm's senior management were aware of the

breach;

(e) the nature and extent of any *financial crime* facilitated, occasioned or otherwise attributable to the *breach*;

(f) the scope for any potential *financial crime* to be facilitated, occasioned or otherwise occur as a result of the *breach*;

(g) whether the firm failed to conduct its business with integrity;

(h) whether the firm, in committing the *breach*, took any steps to comply with *FSA rules*, and the adequacy of those steps; and

(i) in the context of contraventions of Part VI of the *Act*, the extent to which the *behaviour* which constitutes the contravention departs from current market practice.

(8) Factors tending to show the *breach* was deliberate include:

(a) the *breach* was intentional, in that the firm's senior management, or a responsible individual, intended or foresaw that the likely or actual consequences of their actions or inaction would result in a *breach*;

(b) the firm's senior management, or a responsible individual, knew that their actions were not in accordance with the firm's internal procedures;

(c) the firm's senior management, or a responsible individual, sought to conceal their misconduct;

(d) the firm's senior management, or a responsible individual, committed the *breach* in such a way as to avoid or reduce the risk that the *breach* would be discovered;

(e) the firm's senior management, or a responsible individual, were influenced to commit the *breach* by the belief that it would be difficult to detect;

(f) the *breach* was repeated; and

(g) in the context of a contravention of any *rule* or requirement imposed by or under Part VI of the *Act*, the firm obtained reasonable professional advice before the contravention occurred and failed to follow that advice. Obtaining professional advice does not remove a *person's* responsibility for compliance with applicable *rules* and requirements.

(9) Factors tending to show the *breach* was reckless include:

(a) the firm's senior management, or a responsible individual, appreciated there was a risk that their actions or inaction

could result in a *breach* and failed adequately to mitigate that risk; and

(b) the firm's senior management, or a responsible individual, were aware there was a risk that their actions or inaction could result in a *breach* but failed to check if they were acting in accordance with the firm's internal procedures.

(10) Additional factors to which the *FSA* will have regard when determining the appropriate level of financial penalty to be imposed under regulation 34 of the *RCB Regulations* are set out in *RCB* 4.2.5G.

(11) In following this approach factors which are likely to be considered 'level 4 factors' or 'level 5 factors' include:

(a) the *breach* caused a significant loss or risk of loss to individual *consumers*, investors or other market users;

(b) the *breach* revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business;

(c) *financial crime* was facilitated, occasioned or otherwise attributable to the *breach*;

(d) the *breach* created a significant risk that *financial crime* would be facilitated, occasioned or otherwise occur;

(e) the firm failed to conduct its business with integrity; and

(f) the *breach* was committed deliberately or recklessly.

(12) Factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

(a) little, or no, profits were made or losses avoided as a result of the *breach*, either directly or indirectly;

(b) there was no or little loss or risk of loss to *consumers*, investors or other market users individually and in general;

(c) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the *breach*;

(d) there is no evidence that the *breach* indicates a widespread problem or weakness at the firm; and

(e) the *breach* was committed negligently or inadvertently.

(13) In those cases where revenue is not an appropriate indicator of the

harm or potential harm that a firm's *breach* may cause, the *FSA* 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 listed above. In these cases the *FSA* 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.

Step 3 – mitigating and aggravating factors

6.5A.3 G (1) The *FSA* 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.

(2) The following list of factors may have the effect of aggravating or mitigating the *breach*:

(a) the conduct of the firm in bringing (or failing to bring) quickly, effectively and completely the *breach* to the *FSA's* attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the firm showed during the investigation of the *breach* by the *FSA*, or any other regulatory authority allowed to share information with the *FSA*;

(c) where the firm's senior management were aware of the *breach* or of the potential for a *breach*, whether they took any steps to stop the *breach*, and when these steps were taken;

(d) any remedial steps taken since the *breach* was identified, including whether these were taken on the firm's own initiative or that of the *FSA* or another regulatory authority; for example, identifying whether *consumers* or investors or other market users suffered loss and compensating them where they have; correcting any misleading statement or impression; taking disciplinary action against staff involved (if appropriate); and taking steps to ensure that similar problems cannot arise in the future. The size and resources of the firm may be relevant to assessing the reasonableness of the steps taken;

(e) whether the firm has arranged its resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;

(f) whether the firm had previously been told about the *FSA's*

concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;

(g) whether the firm had previously undertaken not to perform a particular act or engage in particular behaviour;

(h) whether the firm concerned has complied with any requirements or rulings of another regulatory authority relating to the *breach*;

(i) the previous disciplinary record and general compliance history of the firm;

(j) action taken against the firm by other domestic or international regulatory authorities that is relevant to the *breach* in question;

(k) whether *FSA guidance* or other published materials had already raised relevant concerns, and the nature and accessibility of such materials; and

(l) whether the *FSA* publicly called for an improvement in standards in relation to the behaviour constituting the *breach* or similar behaviour before or during the occurrence of the *breach*.

Step 4 – adjustment for deterrence

6.5A.4 G (1) If the *FSA* 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 *FSA* may increase the penalty. Circumstances where the *FSA* may do this include:

(a) where the *FSA* considers the absolute value of the penalty too small in relation to the *breach* to meet its objective of credible deterrence;

(b) where previous *FSA* action in respect of similar *breaches* has failed to improve industry standards. This may include similar *breaches* relating to different products (for example, action for mis-selling or claims handling failures in respect of 'x' product may be relevant to a case for mis-selling or claims handling failures in respect of 'y' product);

(c) where the *FSA* considers it is likely that similar *breaches* will be committed by the firm or by other firms in the future in the absence of such an increase to the penalty; and

(d) where the *FSA* considers that the likelihood of the detection of such a *breach* is low.

Step 5 – settlement discount

6.5A.5 G The *FSA* 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 *FSA* and the firm concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.5B The five steps for penalties imposed on individuals in non-market abuse cases

Step 1 – disgorgement

6.5B.1 G The *FSA* will seek to deprive an individual of the financial benefit derived directly from the *breach* (which may include the profit made or loss avoided) where it is practicable to quantify this. The *FSA* will ordinarily also charge interest on the benefit. Where the success of a firm's entire business model is dependent on breaching *FSA rules* or other requirements of the *regulatory system* and the individual's *breach* is at the core of the firm's *regulated activities*, the *FSA* will seek to deprive the individual of all the financial benefit he has derived from such activities.

[**Note:** For the purposes of *DEPP* 6.5B, "firm" has the special meaning given to it in *DEPP* 6.5.1G.]

Step 2 – the seriousness of the *breach*

6.5B.2 G (1) The *FSA* will determine a figure which will be based on a percentage of an individual's "relevant income". "Relevant income" will be the gross amount of all benefits received by the individual from the employment in connection with which the *breach* occurred (the "relevant employment"), and for the period of the *breach*. In determining an individual's relevant income, "benefits" includes, but is not limited to, salary, bonus, pension contributions, *share* options and *share* schemes; and "employment" includes, but is not limited to, employment as an adviser, *director*, partner or contractor.

(2) Where the *breach* lasted less than 12 *months*, or was a one-off event, the relevant income will be that earned by the individual in the 12 *months* preceding the end of the *breach*. Where the individual was in the relevant employment for less than 12 months, his relevant income will be calculated on a pro rata basis to the equivalent of 12 *months*' relevant income.

(3) This approach reflects the *FSA's* view that an individual receives remuneration commensurate with his responsibilities, and so it is reasonable to base the amount of penalty for failure to discharge his duties properly on his remuneration. The *FSA* also believes that the

extent of the financial benefit earned by an individual is relevant in terms of the size of the financial penalty necessary to act as a credible deterrent. The *FSA* recognises that in some cases an individual may be approved for only a small part of the work he carries out on a day-to-day basis. However, in these circumstances the *FSA* still considers it appropriate to base the relevant income figure on all of the benefit that an individual gains from the relevant employment, even if his employment is not totally related to a controlled function.

(4) Having determined the relevant income the *FSA* will then decide on the percentage of that income which will form the basis of the penalty. In making this determination the *FSA* will consider the seriousness of the *breach* and choose a percentage between 0% and 40%.

(5) This range is divided into five fixed levels which reflect, on a sliding scale, the seriousness of the *breach*. The more serious the *breach*, the higher the level. For penalties imposed on individuals there are the following five levels:

(a) level 1 – 0%;

(b) level 2 - 10%;

(c) level 3 - 20%;

(d) level 4 - 30%; and

(e) level 5 - 40%.

(6) The *FSA* will assess the seriousness of a *breach* to determine which level is most appropriate to the case.

(7) In deciding which level is most appropriate to a case against an individual, the *FSA* will take into account various factors which will usually fall into the following four categories:

(a) factors relating to the impact of the *breach*;

(b) factors relating to the nature of the *breach*;

(c) factors tending to show whether the *breach* was deliberate; and

(d) factors tending to show whether the *breach* was reckless.

(8) Factors relating to the impact of a *breach* committed by an individual include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the *breach*, either

directly or indirectly;

(b) the loss or risk of loss, as a whole, caused to *consumers*, investors or other market users in general;

(c) the loss or risk of loss caused to individual *consumers*, investors or other market users;

(d) whether the *breach* had an effect on particularly vulnerable people, whether intentionally or otherwise;

(e) the inconvenience or distress caused to *consumers*; and

(f) whether the *breach* had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

(9) Factors relating to the nature of a *breach* by an individual include:

(a) the nature of the *rules*, requirements or provisions breached;

(b) the frequency of the *breach*;

(c) the nature and extent of any *financial crime* facilitated, occasioned or otherwise attributable to the *breach*;

(d) the scope for any potential *financial crime* to be facilitated, occasioned or otherwise occur as a result of the *breach*;

(e) whether the individual failed to act with integrity;

(f) whether the individual abused a position of trust;

(g) whether the individual committed a breach of any professional code of conduct;

(h) whether the individual caused or encouraged other individuals to commit *breaches*;

(i) whether the individual held a prominent position within the industry;

(j) whether the individual is an experienced industry professional;

(k) whether the individual held a senior position with the firm;

(l) the extent of the responsibility of the individual for the product or business areas affected by the *breach*, and for the particular matter that was the subject of the *breach*;

(m) whether the individual acted under duress;

(n) whether the individual took any steps to comply with *FSA rules*, and the adequacy of those steps; and

(o) in the context of contraventions of Part VI of the *Act*, the extent to which the *behaviour* which constitutes the contravention departs from current market practice.

(10) Factors tending to show the *breach* was deliberate include:

(a) the *breach* was intentional, in that the individual intended or foresaw that the likely or actual consequences of his actions or inaction would result in a *breach*;

(b) the individual intended to benefit financially from the *breach*, either directly or indirectly;

(c) the individual knew that his actions were not in accordance with his firm's internal procedures;

(d) the individual sought to conceal his misconduct;

(e) the individual committed the *breach* in such a way as to avoid or reduce the risk that the *breach* would be discovered;

(f) the individual was influenced to commit the *breach* by the belief that it would be difficult to detect;

(g) the individual knowingly took decisions relating to the *breach* beyond his field of competence; and

(h) the individual's actions were repeated.

(11) Factors tending to show the *breach* was reckless include:

(a) the individual appreciated there was a risk that his actions or inaction could result in a *breach* and failed adequately to mitigate that risk; and

(b) the individual was aware there was a risk that his actions or inaction could result in a *breach* but failed to check if he was acting in accordance with internal procedures.

(12) In following this approach factors which are likely to be considered 'level 4 factors' or 'level 5 factors' include:

(a) the *breach* caused a significant loss or risk of loss to individual *consumers*, investors or other market users;

(b) *financial crime* was facilitated, occasioned or otherwise

attributable to the *breach*;

(c) the *breach* created a significant risk that *financial crime* would be facilitated, occasioned or otherwise occur;

(d) the individual failed to act with integrity;

(e) the individual abused a position of trust;

(f) the individual held a prominent position within the industry; and

(g) the *breach* was committed deliberately or recklessly.

(13) Factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

(a) little, or no, profits were made or losses avoided as a result of the *breach*, either directly or indirectly;

(b) there was no or little loss or risk of loss to *consumers*, investors or other market users individually and in general;

(c) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the *breach*; and

(d) the *breach* was committed negligently or inadvertently.

Step 3 – mitigating and aggravating factors

6.5B.3 G (1) The *FSA* 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.

(2) The following list of factors may have the effect of aggravating or mitigating the *breach*:

(a) the conduct of the individual in bringing (or failing to bring) quickly, effectively and completely the *breach* to the *FSA's* attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the individual showed during the investigation of the *breach* by the *FSA*, or any other regulatory authority allowed to share information with the *FSA*;

(c) whether the individual took any steps to stop the *breach*, and

when these steps were taken;

(d) any remedial steps taken since the *breach* was identified, including whether these were taken on the individual's own initiative or that of the *FSA* or another regulatory authority;

(e) whether the individual has arranged his resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;

(f) whether the individual had previously been told about the *FSA's* concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;

(g) whether the individual had previously undertaken not to perform a particular act or engage in particular behaviour;

(h) whether the individual has complied with any requirements or rulings of another regulatory authority relating to the *breach*;

(i) the previous disciplinary record and general compliance history of the individual;

(j) action taken against the individual by other domestic or international regulatory authorities that is relevant to the *breach* in question;

(k) whether *FSA guidance* or other published materials had already raised relevant concerns, and the nature and accessibility of such materials;

(l) whether the *FSA* publicly called for an improvement in standards in relation to the behaviour constituting the *breach* or similar behaviour before or during the occurrence of the *breach*; and

(m) whether the individual agreed to undertake training subsequent to the *breach*.

Step 4 – adjustment for deterrence

6.5B.4 G (1) If the *FSA* considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the *breach*, or others, from committing further or similar *breaches* then the *FSA* may increase the penalty. Circumstances where the *FSA* may do this include:

(a) where the *FSA* considers the absolute value of the penalty too small in relation to the *breach* to meet its objective of credible deterrence;

(b) where previous *FSA* action in respect of similar *breaches* has failed to improve industry standards. This may include similar *breaches* relating to different products (for example, action for mis-selling or claims handling failures in respect of 'x' product may be relevant to a case for mis-selling or claims handling failures in respect of 'y' product);

(c) where the *FSA* considers it is likely that similar *breaches* will be committed by the individual or by other individuals in the future;

(d) where the *FSA* considers that the likelihood of the detection of such a *breach* is low; and

(e) where a penalty based on an individual's income may not act as a deterrent, for example, if an individual has a small or zero income but owns assets of high value.

Step 5 – settlement discount

6.5B.5 G The *FSA* and the individual 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 *FSA* and the individual concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.5C The five steps for penalties imposed on individuals in market abuse cases

Step 1 – disgorgement

6.5C.1 G The *FSA* will seek to deprive an individual of the financial benefit derived as a direct result of the *market abuse* (which may include the profit made or loss avoided) where it is practicable to quantify this. The *FSA* will ordinarily also charge interest on the benefit.

Step 2 – the seriousness of the *market abuse*

6.5C.2 G (1) The *FSA* will determine a figure dependent on the seriousness of the *market abuse* and whether or not it was referable to the individual's employment. This reflects the *FSA's* view that where an individual has been put into a position where he can commit *market abuse* because of his employment the fine imposed should reflect this by reference to the gross amount of all benefits derived from that employment.

(2) In cases where the *market abuse* was referable to the individual's employment, the figure for the purpose of Step 2 will be the greater

of:

(a) a figure based on a percentage of the individual's "relevant income". The percentage of relevant income which will apply is explained in paragraphs (6) and (8) to (16) below;

(b) a multiple of the profit made or loss avoided by the individual for his own benefit, or for the benefit of other individuals where the individual has been instrumental in achieving that benefit, as a direct result of the *market abuse* (the "profit multiple"). The profit multiple which will apply is explained in paragraphs (6) and (8) to (16) below; and

(c) for *market abuse* cases which the *FSA* assesses to be seriousness level 4 or 5, £100,000. How the *FSA* will assess the seriousness level of the *market abuse* is explained in paragraphs (9) to (16) below. The *FSA* usually expects to assess *market abuse* committed deliberately as seriousness level 4 or 5.

(3) In cases where the *market abuse* was not referable to the individual's employment, the figure for the purpose of Step 2 will be the greater of:

(a) a multiple of the profit made or loss avoided by the individual for his own benefit, or for the benefit of other individuals where the individual has been instrumental in achieving that benefit, as a direct result of the *market abuse* (the "profit multiple"). The profit multiple which will apply is explained in paragraphs (7) to (16) below; and

(b) for *market abuse* cases which the *FSA* assesses to be seriousness level 4 or 5, £100,000. How the *FSA* will assess the seriousness level of the *market abuse* is explained in paragraphs (9) to (16) below. The *FSA* usually expects to assess *market abuse* committed deliberately as seriousness level 4 or 5.

(4) An individual's "relevant income" will be the gross amount of all benefits received by the individual from the employment in connection with which the *market abuse* occurred (the "relevant employment") for the period of the *market abuse.* In determining an individual's relevant income, "benefits" includes, but is not limited to, salary, bonus, pension contributions, *share* options and *share* schemes; and "employment" includes, but is not limited to, employment as an adviser, *director*, partner or contractor.

(5) Where the *market abuse* lasted less than 12 *months*, or was a one-off event, the relevant income will be that earned by the individual in the 12 *months* preceding the final *market abuse*. Where the individual was in the relevant employment for less than 12 *months*, his relevant

income will be calculated on a pro rata basis to the equivalent of 12 *months*' relevant income.

(6) In cases where the *market abuse* was referable to the individual's employment:

(a) the *FSA* will determine the percentage of relevant income which will apply by considering the seriousness of the *market abuse* and choosing a percentage between 0% and 40%; and

(b) the *FSA* will determine the profit multiple which will apply by considering the seriousness of the *market abuse* and choosing a multiple between 0 and 4.

(7) In cases where the *market abuse* was not referable to the individual's employment the *FSA* will determine the profit multiple which will apply by considering the seriousness of the *market abuse* and choosing a multiple between 0 and 4.

(8) The percentage range (where the *market abuse* was referable to the individual's employment) and profit multiple range (in all cases) are divided into five fixed levels which reflect, on a sliding scale, the seriousness of the *market abuse*. The more serious the *market abuse*, the higher the level. For penalties imposed on individuals for *market abuse* there are the following five levels (the percentage figures only apply where the *market abuse* was referable to the individual's employment):

(a) level 1 – 0%, profit multiple of 0;

(b) level 2 – 10%, profit multiple of 1;

(c) level 3 – 20%, profit multiple of 2;

(d) level 4 – 30%, profit multiple of 3; and

(e) level 5 – 40%, profit multiple of 4.

(9) The *FSA* will assess the seriousness of the *market abuse* to determine which level is most appropriate to the case.

(10) In deciding which level is most appropriate to a *market abuse* case, the *FSA* will take into account various factors which will usually fall into the following four categories:

(a) factors relating to the impact of the *market abuse*;

(b) factors relating to the nature of the *market abuse*;

(c) factors tending to show whether the *market abuse* was deliberate; and

(d) factors tending to show whether the *market abuse* was reckless.

(11) Factors relating to the impact of the *market abuse* include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the *market abuse*, either directly or indirectly;

(b) whether the *market abuse* had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk; and

(c) whether the *market abuse* had a significant impact on the price of *shares* or other *investments*.

(12) Factors relating to the nature of the *market abuse* include:

(a) the frequency of the *market abuse*;

(b) whether the individual abused a position of trust;

(c) whether the individual caused or encouraged other individuals to commit *market abuse*;

(d) whether the individual has a prominent position in the market;

(e) whether the individual is an experienced industry professional;

(f) whether the individual held a senior position with the firm; and

(g) whether the individual acted under duress.

(13) Factors tending to show the *market abuse* was deliberate include:

(a) the *market abuse* was intentional, in that the individual intended or foresaw that the likely or actual consequences of his actions would result in *market abuse*;

(b) the individual intended to benefit financially from the *market abuse*, either directly or indirectly;

(c) the individual knew that his actions were not in accordance with exchange rules, *share* dealing rules and/or the firm's internal procedures;

(d) the individual sought to conceal his misconduct;

(e) the individual committed the *market abuse* in such a way as to avoid or reduce the risk that the *market abuse* would be discovered;

(f) the individual was influenced to commit the *market abuse* by the belief that it would be difficult to detect;

(g) the individual's actions were repeated;

(h) for *market abuse* falling within section 118(2) of the *Act*, the individual knew or recognised that the information on which the *dealing* was based was *inside information*; and

(i) for *market abuse* falling within section 118(4) of the *Act*, the individual's behaviour was based on information which he knew or recognised was not generally available to those using the market, and the individual regarded the information as relevant when deciding the terms on which transactions in qualifying *investments* should be effected.

(14) Factors tending to show the *market abuse* was reckless include:

(a) the individual appreciated there was a risk that his actions could result in *market abuse* and failed adequately to mitigate that risk; and

(b) the individual was aware there was a risk that his actions could result in *market abuse* but failed to check if he was acting in accordance with internal procedures.

(15) In following this approach factors which are likely to be considered 'level 4 factors' or 'level 5 factors' include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, directly by the individual from the *market abuse* was significant;

(b) the *market abuse* had a serious adverse effect on the orderliness of, or confidence in, markets;

(c) the *market abuse* was committed on multiple occasions;

(d) the individual breached a position of trust;

(e) the individual has a prominent position in the market; and

(f) the *market abuse* was committed deliberately or recklessly.

(16) In following this approach factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

(a) little, or no, profits were made or losses avoided as a result of the *market abuse*, either directly or indirectly;

(b) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the *market abuse*; and

(c) the *market abuse* was committed negligently or inadvertently.

[**Note:** For the purposes of *DEPP* 6.5C, "firm" has the special meaning given to it in *DEPP* 6.5.1G.]

Step 3 – mitigating and aggravating factors

6.5C.3 G (1) The *FSA* 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 *market abuse*. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

(2) The following list of factors may have the effect of aggravating or mitigating the *market abuse*:

(a) the conduct of the individual in bringing (or failing to bring) quickly, effectively and completely the *market abuse* to the *FSA's* attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the individual showed during the investigation of the *market abuse* by the *FSA*, or any other regulatory authority allowed to share information with the *FSA*;

(c) whether the individual assists the *FSA* in action taken against other individuals for *market abuse* and/or in criminal proceedings;

(d) whether the individual has arranged his resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;

(e) whether the individual had previously been told about the *FSA's* concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;

(f) the previous disciplinary record and general compliance history of the individual;

(g) action taken against the individual by other domestic or international regulatory authorities that is relevant to the

market abuse in question;

(h) whether *FSA guidance* or other published materials had already raised relevant concerns, and the nature and accessibility of such materials; and

(i) whether the individual agreed to undertake training subsequent to the *market abuse*.

Step 4 – adjustment for deterrence

6.5C.4 G (1) If the *FSA* considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the *market abuse*, or others, from committing further or similar abuse then the *FSA* may increase the penalty. Circumstances where the *FSA* may do this include:

(a) where the *FSA* considers the absolute value of the penalty too small in relation to the *market abuse* to meet its objective of credible deterrence;

(b) where previous *FSA* action in respect of similar *market abuse* has failed to improve industry standards; and

(c) where the penalty may not act as a deterrent in light of the size of the individual's income or net assets.

Step 5 – settlement discount

6.5C.5 G The *FSA* and the individual 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 *FSA* and the individual concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.5D Serious financial hardship

6.5D.1 G (1) The *FSA's* approach to determining penalties described in *DEPP* 6.5 to *DEPP* 6.5C is intended to ensure that financial penalties are proportionate to the *breach.* The *FSA* recognises that penalties may affect persons differently, and that the *FSA* should consider whether a reduction in the proposed penalty is appropriate if the penalty would cause the subject of enforcement action serious financial hardship.

(2) Where an individual or firm claims that payment of the penalty proposed by the *FSA* will cause them serious financial hardship, the *FSA* will consider whether to reduce the proposed penalty only if:

(a) the individual or firm provides verifiable evidence that payment of the penalty will cause them serious financial hardship; and

(b) the individual or firm provides full, frank and timely disclosure of the verifiable evidence, and cooperates fully in answering any questions asked by the *FSA* about their financial position.

(3) The onus is on the individual or firm to satisfy the *FSA* that payment of the penalty will cause them serious financial hardship.

[**Note:** For the purposes of *DEPP* 6.5D, "firm" has the special meaning given to it in *DEPP* 6.5.1G.]

Individuals

6.5D.2 G (1) In assessing whether a penalty would cause an individual serious financial hardship, the *FSA* will consider the individual's ability to pay the penalty over a reasonable period (normally no greater than three years). The *FSA's* starting point is that an individual will suffer serious financial hardship only if during that period his net annual income will fall below £14,000 and his capital will fall below £16,000 as a result of payment of the penalty. Unless the *FSA* believes that both the individual's income and capital will fall below these respective thresholds as a result of payment of the penalty, the *FSA* is unlikely to be satisfied that the penalty will result in serious financial hardship.

(2) The *FSA* will consider all relevant circumstances in determining whether the income and capital threshold levels should be increased in a particular case.

(3) The *FSA* will consider agreeing to payment of the penalty by instalments where the individual requires time to realise his assets, for example by waiting for payment of a salary or by selling property.

(4) For the purposes of considering whether an individual will suffer serious financial hardship, the *FSA* will consider as capital anything that could provide the individual with a source of income, including savings, property (including personal possessions), *investments* and land. The *FSA* will normally consider as capital the equity that an individual has in the home in which he lives, but will consider any representations by the individual about this; for example, as to the exceptionally severe impact a sale of the property might have upon other occupants of the property or the impracticability of re-mortgaging or selling the property within a reasonable period.

(5) The *FSA* may also consider the extent to which the individual has access to other means of financial support in determining whether he

is able to pay the penalty without being caused serious financial hardship.

(6) Where a penalty is reduced it will be reduced to an amount which the individual can pay without going below the threshold levels that apply in that case. If an individual has no income, any reduction in the penalty will be to an amount that the individual can pay without going below the capital threshold.

(7) There may be cases where, even though the individual has satisfied the *FSA* that payment of the financial penalty would cause him serious financial hardship, the *FSA* considers the *breach* to be so serious that it is not appropriate to reduce the penalty. The *FSA* will consider all the circumstances of the case in determining whether this course of action is appropriate, including whether:

(a) the individual directly derived a financial benefit from the *breach* and, if so, the extent of that financial benefit;

(b) the individual acted fraudulently or dishonestly with a view to personal gain;

(c) previous *FSA* action in respect of similar *breaches* has failed to improve industry standards; or

(d) the individual has spent money or dissipated assets in anticipation of *FSA* or other enforcement action with a view to frustrating or limiting the impact of action taken by the *FSA* or other authorities.

Prohibition orders and withdrawal of approval

6.5D.3 G In cases against individuals, including *market abuse* cases, the *FSA* may make a *prohibition order* under section 56 of the *Act* or withdraw an individual's approval under section 63 of the *Act*, as well as impose a financial penalty. Such action by the *FSA* reflects the *FSA's* assessment of the individual's fitness to perform *regulated activity* or suitability for a particular role, and does not affect the *FSA's* assessment of the appropriate financial penalty in relation to a *breach.* However, the fact that the *FSA* has made a *prohibition order* against an individual or withdrawn his approval, as a result of which the individual may have less earning potential, may be relevant in assessing whether the penalty will cause the individual serious financial hardship.

Firms

6.5D.4 G (1) The *FSA* will consider reducing the amount of a penalty if a firm will suffer serious financial hardship as a result of having to pay the entire penalty. In deciding whether it is appropriate to reduce the penalty, the *FSA* will take into consideration the firm's financial circumstances, including whether the penalty would render the firm

insolvent or threaten the firm's solvency. The *FSA* will also take into account its regulatory objectives, for example in situations where *consumers* would be harmed or market confidence would suffer, the *FSA* may consider it appropriate to reduce a penalty in order to allow a firm to continue in business and/or pay redress.

(2) There may be cases where, even though the firm has satisfied the *FSA* that payment of the financial penalty would cause it serious financial hardship, the *FSA* considers the *breach* to be so serious that it is not appropriate to reduce the penalty. The *FSA* will consider all the circumstances of the case in determining whether this course of action is appropriate, including whether:

(a) the firm directly derived a financial benefit from the *breach* and, if so, the extent of that financial benefit;

(b) the firm acted fraudulently or dishonestly in order to benefit financially;

(c) previous *FSA* action in respect of similar *breaches* has failed to improve industry standards; or

(d) the firm has spent money or dissipated assets in anticipation of *FSA* or other enforcement action with a view to frustrating or limiting the impact of action taken by the *FSA* or other authorities.

Transfers of assets

6.5D.5 G Where the *FSA* considers that, following commencement of an *FSA* investigation, an individual or firm has reduced their solvency in order to reduce the amount of any disgorgement or financial penalty payable, for example by transferring assets to third parties, the *FSA* will normally take account of those assets when determining whether the individual or firm would suffer serious financial hardship as a result of the disgorgement and financial penalty.

Amend the following as shown.

6.6 Financial penalties for late and incomplete submission of reports

6.6.1 G (1) The *FSA* attaches considerable importance to the timely submission by *firms* of reports. This is because the information that they contain is essential to the *FSA's* assessment of whether a *firm* is complying with the requirements and standards of the *regulatory system* and to the *FSA's* understanding of that *firm's* business.

(2) *DEPP* 6.6.1G to *DEPP* 6.6.5G set out the *FSA's* policy in relation to financial penalties for late submission of reports and is in addition to the *FSA's* policy relating to financial penalties ~~including the factors~~

~~relevant to determining their appropriate level (see *DEPP* 6.5.2G)~~ as set out in *DEPP* 6.5 to *DEPP* 6.5D.

6.6.2 G In addition to the factors ~~relevant to determining the appropriate level of financial penalty (see *DEPP* 6.5.2G)~~ considered in Step 2 for cases against firms (*DEPP* 6.5A) and cases against individuals (*DEPP* 6.5B), the following considerations are relevant.

(1) In general, the *FSA's* approach to disciplinary action arising from the late submission of a report will depend upon the length of time after the due date that the report in question is submitted.

(2) If the *person* concerned is an individual, it is open to him to make representations to the *FSA* as to why he should not be the subject of a financial penalty, or why a lower penalty should be imposed. If he does so, the matters to which the *FSA* will have regard will include the matters set out in *DEPP* ~~6.5.2G(4) and *DEPP* 6.5.2G(5)~~ 6.5B. It should be noted that an administrative difficulty such as pressure of work does not, in itself, constitute a relevant circumstance for this purpose.

…

[**Note:** For the purposes of *DEPP* 6.6.2G, "firm" has the special meaning given to it in *DEPP* 6.5.1G.]

6.7 Discount for early settlement

…

6.7.2 G In appropriate cases the *FSA's* approach will be to negotiate with the *person* concerned to agree in principle the amount of a financial penalty having regard to the ~~factors set out in *DEPP* 6.5.2G~~ *FSA's* statement of policy as set out in *DEPP* 6.5 to *DEPP* 6.5D and *DEPP* 6.6. (This starting figure will take no account of the existence of the *settlement discount scheme* described in this section.) Such amount ("A") will then be reduced by a percentage of A according to the stage in the process at which agreement is reached. The resulting figure ("B") will be the amount actually payable by the *person* concerned in respect of the *breach*. However, where part of a proposed financial penalty specifically equates to the disgorgement of profit accrued or loss avoided then the percentage reduction will not apply to that part of the penalty.

…

Schedule 4 Powers Exercised

…

4.2	G	The following additional powers and related provisions have been exercised by the *FSA* to make the statements of policy in *DEPP*:	
			…
			Regulation 44 …
			Regulation 86 (Proposal to take disciplinary measures) of the *Payment Services Regulations*
			…

Annex B

Amendments to the Regulated Covered Bonds sourcebook (RCB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

4.2 Enforcement powers and penalties

…

Financial penalties

4.2.4 G The *FSA's* policy on imposing financial penalties (including the amount of any such penalties) under the *RCB Regulations* will be consistent with the policy as set out in *DEPP* and *EG* with appropriate modifications.

4.2.5 G When considering whether to impose a financial penalty, the amount of penalty, and whether to impose the penalty on the *issuer* or the *owner*, the *FSA* will have regard, where relevant, to:

(1) the statement on determining the appropriate level of a financial penalty set out in *DEPP* 6.5 to *DEPP* 6.5D;

(2) the particular arrangements between the *issuer* and the *owner*;

(3) the likely impact of the penalty on the interests of investors in a *regulated covered bond*; and

(4) the conduct of the *issuer* or the *owner*.

Annex C

Amendments to the Enforcement Guide (EG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

6 Publicity

Publicity during FSA investigations

…

6.4 The exceptional circumstances referred to above may arise where the matters under investigation have become the subject of public concern, speculation or rumour. In this case it may be desirable for the FSA to make public the fact of its investigation in order to allay concern, or contain the speculation or rumour. Where the matter in question relates to a *takeover bid*, the FSA will discuss any announcement beforehand with the *Takeover Panel*. Any announcement will be subject to the restriction on disclosure of *confidential information* in section 348 of the *Act*.

6.5 ~~There will also be cases where publicity is unavoidable. For example, investigations into suspected criminal offences may often lead the FSA into making enquiries amongst the general public which might attract publicity.~~ [deleted]

…

Publicity during, or upon the conclusion of criminal action (see chapter 12)

6.17 ~~Like civil proceedings, criminal court proceedings nearly always take place in public from the time they begin. However, the FSA will always be very careful to ensure that any FSA publicity does not prejudice the fairness of any subsequent trial.~~ The FSA will normally publicise the outcome of public hearings in criminal prosecutions.

6.17A When conducting a criminal investigation the FSA will generally consider making a public announcement when suspects are arrested, when search warrants are executed and when charges are laid. A public announcement may also be made at other stages of the investigation when this is considered appropriate.

6.17B The FSA will always be very careful to ensure that any FSA publicity does not prejudice the fairness of any subsequent trial.

...

7 Financial penalties and public censures

…

FSA's statements of policy

7.4 The FSA's statement of policy in relation to the imposition of financial penalties is set out in *DEPP* 6.2 (Deciding whether to take action), *DEPP* 6.3 (Penalties for market abuse) and *DEPP* 6.4 (Financial penalty or public censure). The FSA's statement of policy in relation to the amount of a financial penalty is set out in *DEPP* 6.5 to *DEPP* 6.5D.

…

Payment of financial penalties

7.6 Financial penalties must be paid within the period (usually 14 days) that is stated on the FSA's *final notice*. The FSA's policy in relation to reducing a penalty because its payment may cause a *person* serious financial hardship is set out in *DEPP* 6.5D.

7.7 ~~A *person* may ask the FSA to allow them to pay a financial penalty by instalments. However, the FSA will consider agreeing to payment of a financial penalty by instalments only where there is verifiable evidence of serious financial hardship or financial difficulties if the *person* was required to pay the full payment in a single instalment. This reflects the fact that the purpose of a penalty is not to render a *person* insolvent or to threaten solvency. The FSA will determine the appropriate level and number of instalments having regard to the overall circumstances of the case. However, in such cases, the full payment of the penalty will generally have to be made within one year from the date of the *final notice*.~~ [deleted]

…

19 Non-FSMA powers

…

The conduct of investigations under the Money Laundering Regulations

…

19.82 When imposing or determining the level of a financial penalty under the Regulations, the FSA's policy includes having regard, where relevant, to relevant factors in *DEPP* 6.2.1G and *DEPP* 6.5 to *DEPP* 6.5D. The FSA may not impose a penalty where there are reasonable grounds for it to be satisfied that the subject of the proposed action took all reasonable steps and exercised all due diligence to ensure that the relevant requirement of the *Money Laundering Regulations* would be met. In deciding whether a person has failed to comply with a requirement of the *Money Laundering Regulations*, the FSA must consider whether he followed any relevant guidance which was issued by a supervisory authority or other appropriate body; approved by the Treasury; and published in a manner approved by the Treasury. The Joint Money Laundering Steering Group Guidance satisfies this requirement.

…

Regulated Covered Bonds Regulations 2008

…

19.88 The FSA's approach to the use of its enforcement powers, and its statement of policy in relation to imposing and determining financial penalties under the *RCB Regulations*, are set out in *RCB* 4.2. The FSA's penalty policy includes having regard, where relevant, to ~~the relevant factors in *DEPP* 6.2.1G and~~ *DEPP* 6.5 to *DEPP* 6.5D and such other specific matters as the likely impact of the penalty on the interests of investors in the relevant bonds. The FSA's statement of procedure in relation to giving *warning notices* or *decision notices* under the *RCB Regulations* is set out in *RCB* 6. It confirms that the *RDC* will be the decision maker in relation to the imposition of financial penalties under the *RCB Regulations*, following the procedure outlined in *DEPP* 3.2 or, where appropriate, *DEPP* 3.3 and that decision notices given under the Regulations may be referred to the *Tribunal*.

…

Payment Services Regulations 2009

…

Imposition of penalties under the Payment Services Regulations

19.101 When imposing ~~or determining the level of~~ a financial penalty the *FSA's* policy includes having regard to the relevant factors in *DEPP* ~~6.2.1G and *DEPP* 6.5~~ 6.2, *DEPP* 6.3 and *DEPP* 6.4. The FSA's policy in relation to determining the level of a financial penalty includes having regard, where relevant, to *DEPP* 6.5 to *DEPP* 6.5D.

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The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: http://www.fsa.gov.uk