

SEE FINAL NOTICE ISSUED ON 27 MARCH 2015

DECISION NOTICE

To: **Robert Stephan Addison** **Arch Financial Products LLP**
Date of birth: **30 May 1969** **16 Berkeley Street**
Mayfair
London
W1J 8DZ

Date: **14 September 2012**

1. ACTION

1.1. For the reasons set out below, and pursuant to sections 56, 63 and 66 of the Financial Services and Markets Act 2000 (the “Act”), the FSA has decided:

- (1) to prohibit Mr Robert Stephan Addison, pursuant to section 56 of the Act, from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm;
- (2) to withdraw, pursuant to section 63 of the Act, the approval given to Mr Addison under section 59 of the Act to perform the CF4 (Partner) and CF30 (Customer) controlled functions in relation to Arch Financial Products LLP (“AFP” or the “Firm”); and

(3) to impose, pursuant to section 66 of the Act, a financial penalty of £200,000 on Mr Addison.

1.2. This action is in respect of breaches of Statements of Principle 1 and 7 of the FSA's Statements of Principle for Approved Persons by Mr Addison between July 2006 and March 2009 (the "Relevant Period").

2. SUMMARY OF REASONS

2.1. Mr Addison was a senior partner at AFP and was approved to hold the CF4 (Partner) and (until 10 November 2008) the CF10 (Compliance Oversight) controlled functions at the Firm. These controlled functions are significant influence functions. He was responsible for maintaining systems and controls and compliance procedures consistent with the regulatory requirements for the business and to provide the regulatory framework within which AFP operated. Mr Addison also had specific senior management responsibility with Mr Farrell for managing conflicts prior to 28 February 2008. Mr Farrell held the CF3 (Chief Executive) controlled function role at AFP and was responsible for the overall operation of AFP's business, as well as holding the CF4 (Partner) controlled function.

2.2. During the Relevant Period, AFP acted as the investment manager to two UK funds, the CF Arch cru Investment Funds (the "Investment Funds") and the CF Arch cru Diversified Funds (the "Diversified Funds") (together the "UK Funds"), and as the investment manager of 22 incorporated cell companies of Arch Guernsey ICC Limited (the "Guernsey cells") into which the UK Funds invested. The UK Funds are FSA authorised OEICs and NURSs. Mr Addison was a director of the Guernsey cells. The Guernsey cells also had two other non-AFP directors.

2.3. The structure set up by AFP gave rise to inherent conflicts of interests and therefore the clear risk of poor and/or unsuitable investment decisions. In particular there was a risk of conflict between the interests of the UK Funds and the Guernsey cells, between the interests of the sub-funds of the UK Funds and between the interests of the Guernsey cells. There was also a significant risk of conflict of interest between AFP and the UK Funds on the one hand, and between AFP and the Guernsey cells on the other.

- 2.4. Mr Addison knew that AFP earned structuring and transaction fees for arranging some transactions for the Guernsey cells; it also had its own investments in, or commercial arrangements with, some of the parties involved in the transactions.
- 2.5. Accordingly, Mr Addison was aware that this created a risk that AFP could structure transactions for the Guernsey cells in such a way as to maximise its own benefit, without sufficient regard to the interests of the Guernsey cells. The risk of such transactions being carried out was exacerbated by the fact that AFP had considerable discretion in its investment management role for both the Guernsey cells and the UK Funds.
- 2.6. As a senior partner exercising a significant influence over the Firm and as the person responsible for compliance oversight until 10 November 2008, Mr Addison should have ensured that the conflicts management process was appropriate to AFP's business.
- 2.7. However, in spite of his knowledge of the clear conflict risks that arose in AFP's business, Mr Addison failed to take sufficient steps to address the deficiencies in the conflict management process, and allowed AFP to continue to operate without effective operational, organisational and administrative arrangements to prevent conflicts of interests arising, or to manage any conflicts that did arise. Mr Addison failed to address this issue, with the result that the risk of inappropriate transactions taking place continued unchecked.
- 2.8. Further, during Mr Addison's tenure as Compliance Officer at AFP, and during the period when he had specific senior management responsibility (along with AFP's CEO, Mr Farrell) for conflicts management, four transactions took place which gave rise to obvious conflicts of interest through the risk that AFP or its related entities could make gains at the expense of the Guernsey cells.
- (1) AFP caused the Guernsey cells to purchase shares from Mr Farrell in AFP's parent company, Arch Group (UK) Limited ("AGL"), at a price determined by Mr Farrell with no independent verification of the price and inadequate contemporaneous recording of the conflict of interest. While Mr Addison and Mr Farrell disclosed to the non-AFP directors of the Guernsey cells that AFP

was going to direct the Guernsey cells to purchase newly issued shares in AGL to raise new capital for AGL, the non-AFP directors of the Guernsey cells were not informed that Mr Farrell was also going to be selling his personal shares in AGL to the Guernsey cells for a personal capital gain of £492,359. Nor were the non-AFP directors of the Guernsey cells informed as to the price per share at which the Guernsey cells were to be purchasing the shares. Mr Addison knew that the valuation for the AGL shares was not an independent valuation, and knew that the plan that was presented to the Guernsey cell directors did not accurately reflect the transaction that was ultimately executed.

- (2) In another transaction AFP caused the Guernsey cells to invest £20.2 million into a company (“Company A”) from which Company A paid AFP and a business associate a fee of £3 million each for undefined services. Mr Addison was AFP’s Chief Financial Officer (“CFO”), and so would have been aware of the £3 million paid to AFP. This represented 16% of AFP’s total income for the year ending 29 February 2008. The fee of £3 million was not disclosed to the non-AFP Guernsey cells’ directors. Further, no conflict documentation was prepared in respect of this transaction despite the clear and obvious conflict. As a director of the Guernsey cells, Mr Addison would have known that the £3 million fee had not been disclosed to all his fellow Guernsey cell directors before the transaction went ahead. Mr Addison had received external contemporaneous advice which made it clear that clear documentation for conflicts of interest was required. The only document which recognised the conflict of interest was prepared by Mr Farrell in January 2010 and did not mention the most important elements of the conflicts, for instance, the size of the fee.
- (3) AFP caused the Guernsey cells to invest in the UK Funds’ distributor, Cru Investment Management Ltd (“Cru”), which was a major business partner of AFP. Investing the Guernsey cells’ money in Cru improved AFP’s ability to negotiate favourable distribution terms with Cru and enabled AFP to benefit from increased fees under management as Cru performed its obligations under the distribution arrangement. Despite being aware of these conflicts, Mr

Addison failed to manage these conflicts of interest by, in particular, failing to disclose to the Guernsey cells' directors material factors in respect of the clear benefit gained by AFP and AFP's business partner.

- (4) AFP caused the Guernsey cells to invest in a company ("Company B") associated with Mr Farrell and AGL, which investment disproportionately benefited AGL (and consequently Mr Farrell) compared to the Guernsey cells. In particular, Mr Farrell directed the Guernsey cells to purchase certain share warrants from AGL's nominee company on the basis of a valuation prepared by Mr Farrell who was also the majority shareholder and director of AGL, which led to a profit of £49,999. Mr Farrell and AFP also continued to direct the Guernsey cells to invest in Company B at a time when there was a clear and obvious risk that further investment was likely primarily to benefit AGL (and Mr Farrell) rather than the Guernsey cells. Mr Addison was aware of the risk that AFP would put its associates' own interests ahead of the Guernsey cells, but recklessly allowed the transactions to go ahead without managing those conflicts of interest. He should have ensured that independent valuations were carried out before the transactions and disclosed the conflicts to the Guernsey cells' directors. He also failed to ensure that the management of the conflicts was contemporaneously recorded.

- 2.9. In addition, Mr Addison failed to mitigate the risk that non-public information relating to one client (the Guernsey cells) was available to those making decisions on behalf of the UK Funds, by ensuring that there was adequate separation of investment decision making between the UK Funds and the Guernsey cells.
- 2.10. Before December 2008, when AFP put Chinese walls in place, the same people were making decisions regarding the management of the UK Funds and the Guernsey cells, and the Guernsey cells' underlying investments. This created a risk that individuals making decisions at UK Fund level had confidential information about the Guernsey cells which other investors in the Guernsey cells and the market in general did not possess. This was particularly serious given that the Guernsey cells were publicly listed.

- 2.11. It was also Mr Addison's responsibility, as a Partner in the Firm with compliance oversight, to ensure that appropriate formal compliance monitoring was undertaken and the results of such monitoring presented for consideration by senior management on a regular basis. Mr Addison failed to take reasonable steps to ensure that compliance monitoring at AFP was adequately recorded and reported throughout the Relevant Period. There was no documented monitoring programme in place and put into practice until November 2008. Compliance monitoring results were not sufficiently recorded and AFP's records did not demonstrate that adequate reporting of such monitoring to senior management took place.
- 2.12. Accordingly, during the Relevant Period, Mr Addison's conduct in his roles as the holder of the CF10 and CF4 controlled functions fell short of the regulatory standards for approved persons.
- 2.13. Mr Addison acted recklessly and without integrity in respect of the four transactions undertaken by the Guernsey cells at AFP's instigation set out in paragraph 2.8 above, as he knew:
- (1) that he was responsible for ensuring that AFP complied with its regulatory obligations in managing those conflicts of interest;
 - (2) that AFP had a considerable amount of discretion in managing the UK Funds' and the Guernsey cells' investments; and
 - (3) that AFP and associated entities (and in one instance, Mr Farrell) had material interests and investments in, or commercial arrangements with, the firms the Guernsey cells invested in and that AFP and its associates stood to make gains out of those transactions.
- 2.14. Accordingly, Mr Addison was aware of the risk that AFP would cause the Guernsey cells to enter into transactions which would benefit AFP and its associates, to the detriment of the Guernsey cells. Notwithstanding that risk, he failed to manage effectively or at all these significant and serious conflicts of interest in breach of Statement of Principle 1.

2.15. In addition, in breach of Statement of Principle 7, Mr Addison failed to ensure that the business of the Firm for which he was responsible in his controlled functions complied with the relevant requirements and standards of the regulatory system by failing to take reasonable steps to ensure that:

- (1) there were adequate procedures in place at the Firm to manage conflicts of interest fairly and to ensure that these procedures were applied by the Firm;
- (2) there were restrictions in the access to non-public information about the Guernsey cells and an adequate separation between the investment decision makers for the UK Funds and the investment decision makers for the Guernsey cells; and
- (3) there was adequate compliance monitoring and the regular reporting of compliance issues to senior management.

2.16. The FSA views Mr Addison's failings as serious because:

- (1) Mr Addison's and AFP's failings had a significant impact on AFP discharging its obligations as investment manager;
- (2) there are (and were during the Relevant Period) over 6000 legal investors in the UK Funds (many of these are nominee holders for underlying beneficial investors, so the number of individual investors is much higher); and
- (3) AFP was the investment manager for assets under management in the UK Funds and the Guernsey cells totalling approximately £645 million at their peak in September 2008. The UK Funds have now been suspended.

3. DEFINITIONS

3.1. The definitions used in this Decision Notice are listed in Appendix 2.

4. FACTS AND MATTERS

Mr Addison's roles and experience

- 4.1. Mr Addison was a Partner in AFP, a Director of AGL, Arch Advisors (UK), and AIGHL (which replaced AGL as the parent company of AFP) and is a minority shareholder of AGL (then AIGHL).
- 4.2. Mr Addison performed the roles of Chief Operating Officer ("COO"), CFO and Compliance Officer at AFP from January 2006. He retained the COO role throughout the Relevant Period. The CFO role was taken on by another person in May 2008 and the Compliance Officer role was taken on by another person in December 2008. Mr Addison also had specific senior management responsibility with Mr Farrell for managing conflicts prior to 28 February 2008.
- 4.3. During the Relevant Period, Mr Addison held the following controlled functions:
- | | | |
|-----|-----------------------------|------------------------------------|
| (1) | CF4 (Partner) | 7 April 2006 to date |
| (2) | CF30 (Customer) | 1 November 2007 to date |
| (3) | CF10 (Compliance Oversight) | 7 April 2006 to 10 November 2008 |
| (4) | CF21 (Investment Adviser) | 18 January 2006 to 31 October 2007 |
| (5) | CF26 (Customer Trading) | 18 January 2006 to 31 October 2007 |
- 4.4. In addition to his roles at AFP, Mr Addison was also one of the three directors of Arch Guernsey ICC Limited and the Guernsey cells within that ICC from December 2006 until December 2009.

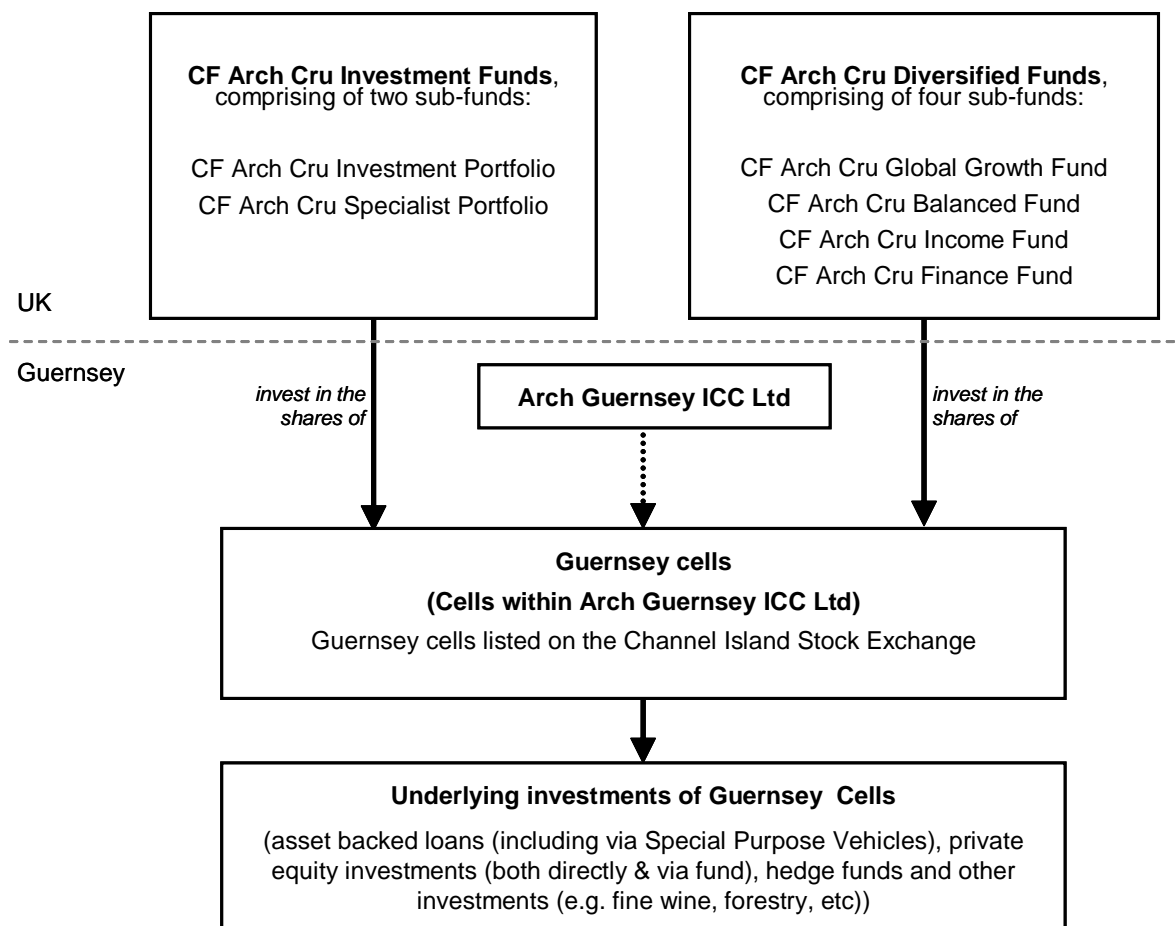
The UK Funds structure and Mr Addison's responsibilities

- 4.5. In January 2006, AFP approached an ACD to act in relation to an OEIC, the Investment Funds, which was a NURS. The Investment Funds were set up in January 2006 and were authorised by the FSA.

- 4.6. The Investment Funds were launched by AFP on 29 June 2006. These were the first UK OEICs investment managed by AFP. When the ACD had been appointed, it delegated the role of investment management of the Investment Funds to AFP pursuant to an agreement dated 5 July 2006.
- 4.7. AFP adopted an investment allocation strategy under which the Investment Funds, comprising two sub-funds - the CF Arch cru Investment Portfolio (the “Investment Portfolio”) and the CF Arch cru Specialist Portfolio (the “Specialist Portfolio”) – primarily invested in shares of the Guernsey cells. These Guernsey cells were established by AFP and incorporated in Guernsey. The Guernsey cells were listed on the CISX from January 2007; they were the first incorporated cell companies listed on the CISX. AFP was also appointed as investment manager of each of the Guernsey cells by the Guernsey cells’ directors, one of whom was also a partner in AFP. AFP began investing the scheme property of the Investment Funds in the Guernsey cells from January 2007.
- 4.8. In September 2007, AFP took on the investment management responsibilities for a second OEIC, the Diversified Funds, and appointed the same ACD, which delegated the role of investment management of the Diversified Funds to AFP pursuant to an agreement dated 26 September 2007.
- 4.9. The Diversified Funds had three sub-funds as at 26 September 2007: CF Arch cru Balanced Fund (the “Balanced Fund”); CF Arch cru Global Growth Fund (the “Global Growth Fund”); and CF Arch cru Income Fund (the “Income Fund”).
- 4.10. Having been appointed as investment manager to the Diversified Funds, from September 2007 AFP began to invest the assets of the three sub-funds of the Diversified Funds in the Guernsey cells. The sub-funds had previously been invested in corporate bonds, investment trusts and other OEICs. A further sub-fund of the Diversified Funds - the CF Arch cru Finance Fund (the “Finance Fund”) - was launched in October 2008 and from its launch AFP invested all of its non-cash scheme property in the Guernsey cells.
- 4.11. Under the investment management agreements, in its role as discretionary investment manager of the property of both the UK Funds and of the Guernsey cells, AFP had

discretion to deal in investments, effect transactions and take all day to day decisions as AFP considered appropriate in relation to the property of both the UK Funds and the Guernsey cells. However, under the investment management agreements relating to the management of the UK Funds (the “UK Funds IMAs”) AFP also had to conduct its investment management role within the investment objectives and restrictions set out in the prospectuses for the UK Funds and in accordance with the provisions of COLL which related to, amongst other matters, the requirement for prudent spread of risk.

- 4.12. As at March 2009, there were 22 Guernsey cells listed on the CISX into which the UK Funds had invested in the Relevant Period. A simplified structure of the UK Funds is shown in the following diagram:



- 4.13. The Rules in COLL 5.6 prevented the UK Funds’ scheme property being invested in significant concentrations of private market assets. However, subject to certain

concentration restrictions, it was permitted for the scheme property of the UK Funds to be invested in transferable securities admitted to an eligible market, which could include the shares of the Guernsey cells. The UK Funds were invested in the shares of the Guernsey cells, and the underlying investments of the Guernsey cells were predominantly comprised of assets such as long-term asset-backed loans, private finance and private equity, which would not fall to be characterised as transferable securities admitted to eligible markets.

- 4.14. Trading in the UK Funds was suspended on 13 March 2009, because of the ACD's concerns that there was insufficient liquidity in the sub-funds of the Investment Funds to meet anticipated redemptions. Dealings in the other sub-funds of the UK Funds were suspended at the same time because of concerns that the suspension of one sub-fund might trigger an unsustainable run of redemptions on the other sub-funds, and due to the illiquidity of the sub-funds' broadly similar underlying investments.
- 4.15. As CF4 of AFP throughout the Relevant Period and CF10 until November 2008, Mr Addison was responsible for managing the day-to-day operations and (until November 2008) compliance function of AFP, which generally comprised AFP's role as investment manager to the UK Funds and to the Guernsey cells.

Mr Addison's role in the management of conflicts of interest at AFP

- 4.16. Given the complexity of AFP's business and the many potential and actual conflicts, the processes in place to safeguard against inappropriate transactions taking place had to be robust. This was a key compliance risk which Mr Addison should have managed as Compliance Officer. Mr Addison was aware that the structure of the UK Funds and Guernsey cells gave rise to potential conflicts of interest, and in particular, the risk that inappropriate transactions could take place and the risk that AFP and its associates could profit from transactions at the expense of the investors in the UK Funds and Guernsey cells.
- 4.17. The fact that AFP was investment manager of both the UK Funds and the Guernsey cells gave rise to inherent conflicts of interest and therefore the risk of poor and/or unsuitable investment decisions. There was a clear and obvious risk of conflict between the interests of the UK Funds and the Guernsey cells and between the

interests of the sub-funds of the UK Funds and between the interests of the Guernsey cells. There was also a risk of conflict of interest between AFP and the UK Funds on the one hand, and between AFP and the Guernsey cells on the other. In particular:

- (1) AFP was investment manager for both the UK Funds and the Guernsey cells and earned fees in relation to the value and performance of the investments which AFP made. AFP's fees as investment manager at Guernsey cell level were higher and AFP earned more than at UK Fund level. There was therefore a risk that AFP would put its own interests above the interests of investors and invest the UK Funds in the Guernsey cells when this may not have been appropriate;
- (2) AFP received fees in transactions in which the Guernsey cells were involved. This created an incentive for AFP to undertake potentially inappropriate transactions for the Guernsey cells in order to gain transaction fees, or to structure transactions in such a way as to maximise transaction fees; and
- (3) AFP directed the Guernsey cells to invest capital in entities and/or transactions in which AFP or associated entities had an interest.

4.18. Principle 8 and the relevant rules (COB 7.1 until 31 October 2007, then SYSC 10 from 1 November 2007) required that AFP managed conflicts of interest fairly. However, throughout the Relevant Period AFP did not have effective operational and administrative arrangements in place to manage the serious potential and actual conflicts in its business fairly for which Mr Addison, as Compliance Officer and a senior partner, was responsible. Mr Addison did not ensure that AFP consistently recorded the conflicts arising or the steps taken to manage these conflicts.

4.19. AFP had high-level conflict of interest policies in place which set out some general principles of conflict management, but AFP did not follow these policies. Further, AFP received advice from external consultants as to the procedures it should follow to comply with the FSA's rules, but Mr Addison did not follow this advice. AFP was also required by SYSC 10.1.10 to have an adequate written conflicts of interest policy in place by 1 November 2007. However, Mr Addison only implemented a written

policy in August 2008, by which time the UK Funds' money had been invested in the Guernsey cells.

- 4.20. Up to 31 October 2007, under COB 7.1 AFP was required, in a situation of conflict, to take reasonable steps to ensure fair treatment for a customer and, if relying on disclosure of an interest to a customer to manage the conflict, be able to demonstrate that it has taken reasonable steps to ensure that the customer does not object to AFP's interest or conflict, before the transaction is undertaken. AFP could only have demonstrated that it had taken such steps through maintaining conflicts records.
- 4.21. From 1 November 2007, SYSC 10.1.6 required that AFP kept and regularly updated a record of the kinds of activity carried out by AFP in which a conflict of interest entailing a material risk of damage to one or more clients may arise or had arisen.
- 4.22. Mr Addison did not ensure that AFP always properly recorded any conflicts management analysis it carried out in respect of transactions. AFP only rarely recorded any conflicts management in respect of transactions entered into by the Guernsey cells. AFP recorded some, but not all, conflicts on a variety of internal documents, including deal tickets, records of proposals to its internal Investment Committees (Investment Committee Proposals ("ICPs")) or conflict file notes, or a combination of those documents. Further, many of these documents were created a number of months after the event.
- 4.23. Mr Addison failed to implement a clear or consistent procedure for conflict recording. No centralised single record of conflicts and how they had been managed was set up and maintained until after the Relevant Period by Mr Addison's successor. In certain cases, material details of the conflicts arising from transactions were omitted from the conflicts notes or other documents it did create (created either contemporaneously or after the event), the effect of which was to obscure the full extent of the conflicts. In other cases, AFP considered that certain conflicts were not significant or did not need to be recorded contemporaneously (either at all or to a degree which the FSA considers adequate) or which AFP's senior management considered they had managed through structuring. This is despite an email on 15 September 2007 by Mr Addison to most of AFP's staff which advised that AFP had to ensure, for the purposes of any

possible FSA visit to AFP, that there was a paper trail showing that it had identified and managed conflicts in a reasonable manner and that the onus was on AFP to demonstrate to the FSA that it had managed conflicts in a reasonable manner.

- 4.24. For AFP to comply with both COB 7.1 and SYSC 10 (and AFP's own internal guidance), AFP had to record conflicts and their management so that it could demonstrate that it had managed conflicts fairly. AFP's conflict management processes were not sufficient to comply with these requirements. AFP's record of conflicts was set out on various documents which were accessible by relevant AFP staff on what AFP described as a "need to know basis". However, it was not clear, when looking for a conflict record of a particular transaction, where to look, as it could be recorded on an ICP, a deal ticket or a specific conflict file note. Further, it was not always the case that a conflict and its management would be recorded in a note. AFP's conflict recording was said in some cases to be "*inherent*" in transaction structuring or transaction rationale, or "*obvious and well understood internally*", so did not need to be written down.
- 4.25. Further, from 1 November 2007 SYSC 9.1.3 required the storage of information in a way accessible for future reference by the FSA in particular in relation to each key stage of the processing of each transaction. AFP did not comply with this. Comprehensive centralised conflicts logs were not created until 2009.
- 4.26. Before the creation of a centralised conflicts log in 2009, AFP created various "conflicts of interest file notes", in which some, but not all, conflicts were recorded and some explanation was provided as to how these conflicts had been mitigated. However, nine of these conflict file notes, including one co-authored by Mr Addison, were created after the relevant transactions. For example, the note Mr Addison co-authored related to a conflict identified in 2007 but was not created until 2009. The nine conflict file notes were created in February 2009, following a request on 30 January 2009 from the ACD of the UK funds for provision of AFP's conflicts of interest policy and register.
- 4.27. Mr Addison was well aware of the importance of creating a paper trail in respect of conflicted transactions to demonstrate to the FSA or a third party how conflicts were

managed fairly at AFP. On 15 September 2007, Mr Addison sent an email to most of AFP's staff which stated that a paper trail was needed to show that AFP had identified and considered a potential conflict and that the conflict had been managed in a reasonable manner. Mr Addison said of this conflicts management paper trail "*Please give some thought when you do this as any FSA visit to Arch will concentrate on this and the onus is on us to demonstrate that we have done so [managed the conflict fairly]*". Mr Addison advised the AFP staff when considering the level of detail required for a conflict note that "*I would try and put myself in the mind of an external party looking at our records three years down the road*".

- 4.28. The time lag in some cases between the transaction and the creation of the file note created the risk that any potential damage arising from the conflict may have already occurred and the opportunity to mitigate effectively such conflicts would have passed. Other potential conflicts, which should have had a clear and detailed record of their existence and mitigation, had no such notes.
- 4.29. One of the other potential mechanisms open to AFP for managing its conflicts was through disclosure, for instance to the non-AFP directors of the Guernsey cells. However there is no record of prior disclosure to the Guernsey cell directors in every case where there was a conflict in AFP's conflicts records. In certain cases where disclosure was recorded as being made, the disclosure was not sufficiently detailed to enable the directors to reach an informed decision as to the conflict. Alternatively the relevant disclosure was made after the transaction had already taken place by which time the opportunity to manage the conflict and to avoid the risk of detriment had passed.
- 4.30. During the Relevant Period Mr Addison was responsible for ensuring that conflicts were managed properly. AFP caused the Guernsey cells to enter into a number of significant transactions in which AFP or associated entities made gains with the risk that these were at the expense of the Guernsey cells. Mr Addison acted recklessly in failing to ensure that such serious and obvious conflicts of interest were effectively recorded, managed, and/or disclosed as set out below:

AGL Shares

4.31. The Guernsey cells made debt and equity investments in AGL, AFP's parent company, in four transactions between February 2007 and February 2008. The investment into AGL in February 2007 was one of the first transactions AFP directed the Guernsey cells to make after the Guernsey cells were launched. Two serious and obvious conflicts arose from these transactions:

- (1) AFP, as investment manager to the Guernsey cells, arranged for the Guernsey cells to invest in equity and loan notes in its parent company; (which owned 97% of AFP throughout the Relevant Period); and
- (2) a large proportion of the AGL shares purchased by the Guernsey cells were purchased from Mr Farrell, the CEO of AFP, and majority owner of AGL, who made a capital gain of £492,359 on the sale of these shares to the Guernsey cells. Mr Farrell prepared the valuation which set the price at which the Guernsey cells purchased his shares and the new shares issued by AGL.

Details of the transaction

- 4.32. On 23 January 2007 AFP's internal Investment Committee approved the allocation of an investment in AGL equity and loan notes by the Guernsey cells. The Guernsey cells were then launched on the CISX.
- 4.33. On 15 February 2007, a business plan was co-presented to the non-AFP directors of the Guernsey cells by Mr Addison. In this business plan AFP proposed that the Guernsey cells invest £1 million in loan notes of AGL and £500,000 by way of new equity of AGL. Although it did not state the proposed price per share, the financial projections which accompanied the business plan indicated a conservative value of AGL for 2007/2008 as being between £15.375 million and £15.522 million.
- 4.34. Two weeks later on 27 February 2007, AFP directed the Guernsey cells to enter into a revolving discounted note facility with AGL of up to £660,000. On 28 February 2007, AFP directed the Guernsey cells to invest £510,000 in AGL comprising 5,268 newly issued AGL shares and then on 15 March 2007, AFP directed the Guernsey

cells to purchase 5,166 shares from Mr Farrell at a cost of £500,121. It was not stated in the business plan presented to the non-AFP directors by Mr Farrell and Mr Addison that Mr Farrell would make a personal gain from the transactions and that the Guernsey cells' investment funds would not be going into AGL, but directly to Mr Farrell. This serious conflict was further not disclosed by Mr Farrell or Mr Addison to the non-AFP Guernsey directors, before Mr Farrell sold his shares to the Guernsey cells.

- 4.35. The shares were sold at £96.81 per share valuing AGL at approximately £17.4 million. This valuation was recommended by Mr Farrell. No independent valuation was sought by AFP, despite the clear conflict of interest between the interests of AFP, Mr Farrell and the Guernsey cells. The Guernsey cells were also liable for stamp duty at 0.5% on the transfer from Mr Farrell to the Guernsey cells for which they would not otherwise have been liable to pay if, for instance, new shares in AGL had been issued. There is only documentary evidence of the Guernsey cells' directors approving the issuing of loan notes and not the equity transactions.
- 4.36. It was not until April 2007, nearly two months after the transaction, that a valuation file note was prepared by Mr Farrell which set out the rationale for the valuation of AGL at £17.45 million on which the share price of £96.81 was based and at which price the Guernsey cells had purchased his shares and the newly issued AGL shares. The valuation file note does not refer to the earlier projections and valuations presented to the Guernsey cell directors.
- 4.37. Despite the serious potential conflicts and the clear risk that Mr Farrell, through his valuation of the AGL shares and his own sale of these shares, could influence his own gain, AFP did not manage the conflict by obtaining an independent valuation of AGL.

Management of the conflict of interest: Documentation and disclosure

- 4.38. Mr Addison omitted to inform the non-AFP Guernsey cell directors that Mr Farrell was going to sell his shares to the Guernsey cells, instead of any new issue of shares.
- 4.39. One document identified that the transaction “*may be seen externally as conflict of interest*” and explained that this was mitigated by the “*Management of Conflict of*

Interest process”. The document was silent as to what this process involved and how it would mitigate the conflict. Furthermore this document was created in April 2007, after the initial transactions had taken place in February 2007.

4.40. Another document, a “*Note for the Investment Committee and Senior Management*” created in March 2007, after the transactions had taken place, recognised the conflict presented by the Guernsey cells purchasing shares in AGL. This note recorded that Mr Farrell would be selling his shares to the Guernsey cells (at a price of £96.81) as well as the Guernsey cells purchasing newly issued shares. The note states that on 15 February 2007, the directors of the Guernsey cells were informed of the investment and raised no objections to the investment or its rationale. However, there is no evidence that the presentation to the directors of the Guernsey cells on 15 February 2007 disclosed the following material facts:

- (1) that the rationale and associated benefits of the Guernsey cells investing into AGL, as set out in the business plan and as approved by the Guernsey cells’ directors, was not relevant because the Guernsey cells bought shares from Mr Farrell personally rather than subscribing for new shares in AGL. As a result, the purchase monies did not go into AGL (which may have benefited the Guernsey cells as AGL shareholders) but instead to Mr Farrell which provided no benefit to the Guernsey cells;
- (2) that the Guernsey cells were to be purchasing £500,121 worth of Mr Farrell’s shares in addition to the £510,000 equity investment in new shares and that Mr Farrell stood to gain personally from the transaction;
- (3) the share price to be paid by the Guernsey cells; and
- (4) that stamp duty at 0.5% would need to be paid by the Guernsey cells on the transfer.

4.41. Another conflict of interest file note documented the “*potential conflict of interest*” arising from members of the “*Guernsey Investment Management team owning AGL shares*” or holding AGL share options at the same time as the Guernsey cells’ investment in AGL. However, this file note was not created until February 2009.

4.42. No disclosure of any of the Guernsey cells' investments in AGL was made to the ACD or the depositaries of the UK Funds at the time. When the ACD was made aware of the Guernsey cells' investments in AGL, it instructed AFP to unwind the trades, which AFP did.

Mr Addison's involvement

4.43. Mr Addison was closely involved in the AGL transaction:

- (1) he was a shareholder in AGL;
- (2) he co-presented the business plan to the Guernsey cell directors; and
- (3) he signed the loan documentation and the deed of adherence in relation to the equity purchase on behalf of the Guernsey cells.

4.44. In respect of the AGL transaction, Mr Addison was aware that there was a conflict of interest between AFP, AGL and Mr Farrell on one hand and the Guernsey cells on the other. He knew that the business plan that was presented to the Guernsey cell directors did not accurately reflect the transaction that was ultimately executed. Mr Addison was reckless in allowing the transaction to go ahead without properly ensuring that the conflicts of interest were managed effectively, in particular where he knew that no independent valuation had been obtained (Mr Farrell's shares were sold on the basis of a valuation Mr Farrell devised). There is no evidence of disclosure by Mr Addison to the Guernsey cell directors that it was Mr Farrell's shares being sold, and no record on or around the time of the transaction in any conflict file note or ICP.

Investments in Company A

4.45. AFP received a significant fee from a transaction in which the Guernsey cells, through a linked transaction with an unlisted cell company also managed by AFP, loaned £20.2 million to a third party holding company, Company A, of which Mr Farrell, along with a business associate of his (the "Business Associate"), was a director. A third party also loaned £0.8 million to Company A.

- 4.46. On 29 October 2007, Company A purchased the shares of a group of companies for an agreed price of £15 million (the “Company A Acquisition”) using the £21 million indirectly invested by the Guernsey cells and the third party company.
- 4.47. The Board of Company A at the time of the Company A Acquisition comprised Mr Farrell and his Business Associate. On 29 October 2007 (the date of the Company A Acquisition), Mr Farrell and the Business Associate as the Board of Company A resolved to pay £6 million in “structuring fees”, being £3 million each to AFP and the Business Associate. Consequently, at the time of the acquisition, the Guernsey cells’ indirect investment into Company A was, in effect, being used to pay a significant fee to AFP.

Management of the conflict of interest: Documentation and disclosure

- 4.48. AFP’s £3 million fee was not contemporaneously disclosed to the independent non-AFP directors of the Guernsey cells.
- 4.49. There is no record of the rationale for the Company A Acquisition being recorded or discussed in any Investment Committee meetings, ICPs or conflicts notes, nor any record justifying the size of the fee. There is also no record of how the conflict arising from Mr Farrell’s position as a director of Company A from August 2007 was monitored and managed.
- 4.50. In August 2007, prior to the introduction of new FSA rules on conflicts of interest introduced in November 2007, AFP instructed external compliance consultants to advise on the management of conflicts of interest. The consultants advised AFP to document the reasons for undertaking a transaction through the unlisted cell company so that there was a clear paper trail of dealing with the conflict in a fair manner. This was not done, despite the clear specific advice, and despite Mr Addison sending an email to most of AFP’s staff on 15 September 2007 setting out how conflicts should be recorded and noting that when it came to demonstrating to the FSA that AFP had complied with rules in respect of conflict management, the onus was on AFP to demonstrate that it had complied with the rules.

- 4.51. No mention is made of the size of the fee paid to AFP in relation to the Company A Acquisition, even in a conflicts file note created by AFP, after the commencement of the FSA's investigation, to explain to the FSA conflicts management at AFP during the Relevant Period (the "January 2010 Conflicts File Note"). There is no mention in the section entitled "Specific Examples of Conflicts Management", in which the Company A Acquisition is referred to. This material fee being paid to AFP indirectly from the Guernsey cells is a significant and obvious conflict. A fair explanation and disclosure would highlight the fee paid to the investment manager as one of the conflicts to be managed and would set out the amount of the fee. Further, the January 2010 Conflicts Note states that Mr Farrell was appointed as a non-executive, unpaid director of Company A after the Company A Acquisition to represent the interests of the Arch investors and omits to mention that Mr Farrell was one of the original directors of Company A at the time of the acquisition, and was one of the directors who approved the £3 million payment to AFP.
- 4.52. The fee of £6 million for a transaction valued at £15 million equates to an effective commission rate of 40%. Furthermore, the fee received by AFP represented 16% of AFP's total income for the year ending 29 February 2008.

Mr Addison's involvement

- 4.53. Mr Addison was aware of the transaction with Company A. He instructed reporting accountants on the transaction and signed, on behalf of the unlisted cell company, initial loan documentation relating to the transaction. As CFO of AFP at the time, Mr Addison was aware that AFP was going to receive a substantial benefit by way of a £3 million transaction fee from transactions undertaken by the Guernsey cells at AFP's direction. He was also a director of the Guernsey cells, and as such would have known that the £3 million fee had not been disclosed to his fellow Guernsey cell directors before the transaction went ahead. Mr Addison was also aware of advice from external consultants to ensure that conflicts were properly documented.
- 4.54. Mr Addison was reckless in allowing the transaction to proceed in circumstances where he knew that the conflicts arising out of the transaction were not managed effectively, in that no disclosure was made of AFP's material fee arising out of the

transaction to the non-AFP directors of the Guernsey cells, and that no conflicts management records were prepared in respect of the transaction until January 2010 which was 2.5 years later and which were in any event misleading.

Investments in Cru Investment Management Limited (“Cru”)

- 4.55. Around the time of the transaction in which the Guernsey cells invested into AFP’s parent company AGL, just after the Guernsey cells were incorporated, the Guernsey cells made debt and equity investments in AFP’s major business associate, Cru, which exclusively marketed and distributed the UK Funds and some of the Guernsey cells. Over time, these investments amounted to £3.38 million. Cru’s income (which materially affected the value of Cru) came from a series of distribution agreements with AFP under which income was determined by the volume of investment brought into the UK Funds and into certain Guernsey cells. Cru’s directors were also members of an AFP committee which discussed investments to be made by the UK Funds and at Guernsey cell level.
- 4.56. Fees earned by AFP as investment manager were based on the value of AFP’s funds under management. By Cru performing its obligations under the distribution agreements, encouraging investment into the UK Funds and certain Guernsey cells and thereby increasing the funds under AFP’s management, AFP stood to gain from increased management fees and the opportunity to earn greater fees for structuring transactions with those funds. Furthermore, agreeing to invest the Guernsey cells’ money in Cru improved AFP’s ability to negotiate favourable distribution terms with Cru.
- 4.57. In January 2007 the Guernsey cells were launched. On 13 February 2007 (the date on which the distribution agreement between AFP and Cru was entered into) the Guernsey cells subscribed for £480,000 worth of A shares in Cru at £1 per share (equating to a 6.78% stake of the voting shares) and on 14 February 2007 provided the first tranche of debt funding of £780,000.
- 4.58. The transactions meant that although the Guernsey cells had contributed the substantial majority of the actual share capital of Cru, they had a small minority of the voting, ownership and dividend rights.

- 4.59. Further, following the first tranche of debt funding (in the amount of £780,000), which the non-AFP Guernsey cell directors were made aware of, the loan facility increased to over £3.5 million through the Relevant Period, but the non-AFP Guernsey cell directors were not informed of this increase.

Management of the conflict of interest: Documentation and disclosure

- 4.60. AFP recognised that there was a conflict in the Guernsey cells investing in Cru, given the commercial relationship between AFP and Cru. On 14 February 2007 (the day after the equity investment had taken place) AFP sent the Cru deal documentation to the Guernsey cell directors, but omitted to inform the AFP Guernsey cell directors of the full picture as there is no record of the Guernsey cell directors being informed of the fact that the Guernsey cells were effectively providing all of the finance for Cru.
- 4.61. Information in respect of the Guernsey cells' initial debt investments in Cru was also provided to the directors of the Guernsey cells (again, after the event). However there is no evidence that the directors were consulted on the subsequent material loan notes. This was despite the facility significantly increasing from £780,000 in February 2007 to over £3.5 million in February 2009.
- 4.62. Although AFP prepared a note for its senior management, recording that there could be the "*perception*" of a conflict of interest, this note was not actually created until March 2007, after the transaction was completed. The ICP for AFP's Investment Committee in respect of the Cru transaction, which indicates that Mr Addison was one of the analysts proposing the transaction, included some consideration of conflicts but was not prepared by Mr Addison until July 2008.
- 4.63. The January 2010 Conflicts File Note, which was prepared for the FSA after the commencement of the FSA investigation, states "*The percentage of Cru acquired was small (~6%) and achieved at a cheap price at the time*".
- 4.64. AFP caused the Guernsey cells to invest in Cru, which transaction benefited AFP's business partner. This would also have had the effect of improving AFP's ability to negotiate favourable terms with Cru in the distribution agreement. However, AFP recklessly failed effectively to manage the conflicts arising out of this transaction.

Mr Addison's involvement

- 4.65. In July 2008, Mr Addison prepared (and was recorded as an “analyst” on) an ICP for the Cru transaction. This document includes some information about conflicts management but was created 18 months after the transaction. Mr Addison was also responsible for sending loan and equity documentation to the other directors of the Guernsey cells and making presentations to them after the initial equity investment was made. He also signed, on behalf of the Guernsey cells, the loan documentation in May 2007 and September 2007.
- 4.66. In respect of the Cru transaction, Mr Addison was aware that the transaction presented conflicts. He stated in interview that he wanted to make sure that the non-AFP directors were aware of the Cru transaction given that it was “*close to home*”. He was also aware that by increasing Cru funds under AFP’s management, AFP stood to gain increased management fees and that this gave rise to a conflict, as this conflict is identified in the Cru ICP.
- 4.67. Mr Addison was reckless in allowing the Guernsey cells to acquire shares in Cru without ensuring that all conflicts were managed effectively, for example by ensuring that there was clear disclosure prior to the transaction taking place to the non-AFP directors of the Guernsey cells, and ensuring that there was disclosure of the later increases in the size of the loan facility.
- 4.68. In particular, Mr Addison failed to address the conflict between his role as a director of the Guernsey cells, the need for independence as Compliance Officer, and his role in AFP as an analyst in respect of the transaction.

Investments in Company B

- 4.69. The Guernsey cells made debt and equity investments to the value of £6.4 million in a third party company, Company B, in which AFP’s parent company and associates had shareholdings and other interests. For instance, Mr Farrell was the non-executive chairman of the board of Company B and Mr Addison would have been aware of this.

Equity Investments

4.70. Certain Arch entities, the Guernsey cells and the directors of Company B entered into a Property Advisory Agreement dated 21 September 2007 whereby AGL and the Guernsey cells invested in the equity of Company B. Under this Property Advisory Agreement:

- (1) certain Guernsey cells would purchase 15% of Company B from Company B's directors at a cost of £3.75 million;
- (2) AGL shareholders would obtain 5% of Company B by swapping this with 2% of AGL's shares;
- (3) an affiliate of AGL, which acted as nominee holder for AGL, paid £1 for equity warrants in Company B; and
- (4) AGL would share property management fees with Company B, arising from properties owned directly or indirectly by those Guernsey cells investing into Company B.

4.71. There were a number of obvious conflicts of interest arising from the transactions with Company B:

- (1) The Guernsey cells paid £237.49 per share (£3.75 million) to acquire an equity stake in Company B. The Company B valuation which set this price was based on Company B's own profit forecasts, which were not independently verified;
- (2) AGL obtained its shareholding in Company B through a share swap. In order to obtain 5% of Company B, AGL's shareholders swapped 2% of AGL's equity. The AGL valuation was prepared by AFP and was not independently verified. Therefore the share swap was carried out on the basis of two non-independent valuations. While the price per share paid by AGL to Company B was the same as that paid by the Guernsey cells, the Guernsey cells paid cash for their shareholding and therefore provided capital to Company B, whereas AGL on the other hand paid in illiquid

unlisted shares in itself, a private company which had not been independently valued.

- (3) As noted above, under the Property Advisory Agreement, an affiliate company of AGL obtained equity warrants in Company B for £1, which it held as nominee for AGL. However, this affiliate subsequently sold these warrants to the Guernsey cells for £50,000. The investment proposal prepared in respect of the Guernsey cells' purchase of these warrants identified a conflict of interest arising as a result of AGL being the seller, but it did not mention the amount that AGL (and Mr Farrell as majority shareholder) was set to gain from the Guernsey cells from this transaction. The investment proposal stated that the price of the warrants was "*clearly favourable*" to the Guernsey cells, despite the lack of independent valuation for these warrants as it was Mr Farrell, the majority shareholder in AGL, who recommended the price at which the warrants should be sold, to the portfolio managers. The price led to a profit, in cash, of £49,999 for AGL/its affiliate.
- (4) Under the Property Advisory Agreement, AGL was entitled to receive 50% of the management fees of properties that were purchased by the Guernsey cells (through certain special purpose vehicles) and subsequently managed by Company B. AGL would benefit from the management fees if the Guernsey cells' adviser, an affiliate of AFP, advised the Guernsey cells to purchase properties recommended by Company B rather than by third parties who made recommendations to the Guernsey cells.

Debt

- 4.72. By March 2008, Mr Farrell had been appointed as a board member of Company B. Despite receiving warnings from this date onwards about Company B's financial difficulties, AFP continued to arrange for one of the Guernsey cells to make further loans to Company B.
- 4.73. In November and December 2008, debt investments were made by a different Guernsey cell. This potentially benefited AGL, as a shareholder in Company B as

well as the other two Guernsey cells, who were also shareholders in Company B but there is no evidence that this course of action benefited the Guernsey cell making the debt investment. This conflict was not considered or documented by AFP.

Management of the conflict of interest: Documentation and disclosure

- 4.74. AFP failed to take reasonable steps to manage the conflict of interest between its parent's interests and those of the Guernsey cells (in earning the management fees under the Property Advisory Agreement) giving rise to a risk of damage to the interests of the Guernsey cells. For instance, although the conflict of interest was acknowledged in one of the later ICPs there is no evidence that the conflict was properly managed at the time.
- 4.75. With the exception of a loan facility agreement of £850,000 approved in November 2008, none of these investments were disclosed to and approved by the non-AFP directors of the Guernsey cells, despite the significant and obvious conflicts arising out of the investments in Company B.
- 4.76. The Guernsey cells' investments in Company B were not recorded in AFP's Investment Committee minutes until 2009, although elements of the transactions were recorded in a note setting out AFP's review in September 2008 of potential conflicts arising from Guernsey cell investments where it also held a stake. In respect of the equity investment the mitigation set out in this document is that "*AGL and Fund dealt on same terms. No cherry picking or optionality in favour of either party*". While it is the case that both the Guernsey cells and AGL paid the same price per share, the Guernsey cells paid £3.75 million cash for their investment, whereas AGL provided equity in itself (being unlisted shares in a private company) based on a non-independent valuation. This was not highlighted in the conflict record, particularly in the section dealing with mitigation or management of conflicts.
- 4.77. A "*Conflicts of Interest File Note*" was produced in respect of the initial transaction in Company B. This identified a conflict of interest arising as a result of the Guernsey cells and AGL co-investing in Company B and listed a number of mitigating factors. However, this note was not created until 23 February 2009.

Mr Addison's involvement

- 4.78. Mr Addison signed the original property advisory agreement with Company B. Mr Addison knew of the conflicts of interest arising from the Property Advisory Agreement and from the loans advanced later to Company B by the Guernsey cells. Being aware of the risk that AFP would put its own interests or those of its affiliates ahead of the Guernsey cells, he was reckless in permitting the transactions to go ahead without ensuring that the conflicts were managed effectively, for instance by ensuring that independent valuations were undertaken in respect of both Company B and AGL to ensure that the investments were on the same terms, and that an independent valuation of the warrants was undertaken. As Compliance Officer he should have ensured that appropriate disclosure was made to the non-AFP Guernsey cell directors, and that the conflicts had been recorded in a centralised conflicts register and reflected in a conflicts file note (at least for the initial investments) or similar document.

Separation of decision making between the UK Funds and Guernsey cells

- 4.79. Prior to December 2008, when separate Investment Committees were formed to manage the UK Funds and Guernsey cells, the same individuals were involved in making investment decisions at both UK Funds level and at Guernsey cell level. This meant that there was no effective safeguard against the risk of sharing of confidential information and knowledge between those involved in making investment decisions for one set of AFP's clients at UK Funds level and those involved in making investment decisions for another set of AFP's clients at Guernsey cell level. There was a risk that individuals who were involved in making decisions at both levels, when making decisions at UK Funds level, had knowledge of non-public information about the Guernsey cells which other external investors in the Guernsey cells, and the market in general, did not possess. In addition, AFP provided the Guernsey cells' market maker with indicative prices at which it would be prepared to buy and sell shares in the Guernsey cells.
- 4.80. While external investors would only have known the net asset value ("NAV") of the Guernsey cells as published on the CISX, AFP individuals had access to more up to date information in respect of the detail which supported the NAV. There was a risk

that this additional information would enable AFP to make more informed decisions on behalf of the UK Funds. AFP placed those individuals responsible for making investment decisions for the UK Funds and providing indicative prices to the market maker of the Guernsey cells in the position of having to disregard the non-public information about the Guernsey cells in carrying out their duties for the UK Funds. This was not appropriately controlled.

- 4.81. The Guernsey cells were set up as independent closed-end investment companies, listed on the CISX, which were intended to be marketed to external investors from at least 13 February 2007. The external investors' interests were not necessarily the same as those of the UK Funds' interests. AFP should have recognised and managed the conflict between the interests of the Guernsey cells and the UK Funds from the outset, by having appropriate procedures in place to ensure that the investment decision making was entirely separate.
- 4.82. Mr Addison was aware of these risks. He was involved in the original creation of the structure involving the UK funds and the Guernsey cells. In his capacity as Compliance Officer at AFP, it was his responsibility to take reasonable steps to ensure that there was an effective separation between decision making for the UK Funds and decision making for the Guernsey cells so as to prevent the use of non-public information. This inadequate lack of separation was a key compliance risk which Mr Addison ought to have properly mitigated from January 2007, when AFP took on the role of investment manager to the Guernsey cells.

Compliance Monitoring

- 4.83. During the Relevant Period, the UK Funds grew from two sub-funds to six sub-funds, overall staff numbers increased from 11 in July 2006 to 61 in November 2008 and the total value of funds under management reached £645 million in September 2008, increasing the potential for conflicts and increasing the complexity and volume of potential regulatory and compliance risks. This generated significant risks to AFP's business and to the UK Funds in terms of ensuring that adequate compliance procedures and conflicts controls were in place.

- 4.84. Compliance monitoring at AFP was informal, with no documented framework throughout Mr Addison's tenure as compliance officer. There was no comprehensively documented monitoring programme in place until November 2008. Instead, between 2006 and November 2008, Mr Addison conducted informal monitoring when he thought this was necessary. Although these informal steps may have been a useful component of a monitoring plan, they should have been conducted alongside more formal documented monitoring with a clear audit trail of work carried out and results. This is particularly important given the compliance risks and the nature, scale and complexity of AFP's business.
- 4.85. Compliance monitoring results were not properly recorded and AFP's records do not demonstrate that adequate reporting of such monitoring to senior management took place. If such monitoring had been effectively carried out, it may have identified deficiencies in AFP's management and recording of conflicts of interest and other failings at AFP.
- 4.86. Further, prior to August 2008 there is insufficient evidence to demonstrate that AFP effectively and regularly discussed the compliance issues that affected the Firm and/or the UK Funds at senior boards or committees. This was particularly important given the increasing complexity of potential regulatory and compliance risks over time.
- 4.87. As Compliance Officer Mr Addison was responsible for conducting such monitoring. AFP's own compliance manuals from March 2005 stated that he was responsible for providing quarterly reports on the operation of AFP's compliance systems and controls and, from February 2008, reporting the results of compliance monitoring tests undertaken and whether compliance monitoring was being conducted to schedule. This did not occur.

5. FAILINGS

- 5.1. The regulatory provisions relevant to this Decision Notice are referred to in Appendix 1.
- 5.2. During the Relevant Period, Mr Addison's conduct fell short of the FSA's regulatory standards for approved persons.

- 5.3. Mr Addison acted recklessly and without integrity in breach of Statement of Principle 1 in respect of the four transactions undertaken by the Guernsey cells at AFP's instigation set out in paragraph 2.8 above, as he knew of the risk that AFP would cause the Guernsey cells to enter into transactions which would benefit AFP and its associates, to the detriment of the Guernsey cells, and notwithstanding that risk, failed to manage effectively or at all these significant and serious conflicts of interest.
- 5.4. As a senior partner exercising a significant influence over AFP and the person responsible for compliance oversight until 10 November 2008, Mr Addison was responsible for ensuring that the conflicts management process was appropriate to AFP's business.
- 5.5. Mr Addison was aware of the clear conflict risks that arose in AFP's business, but failed to take sufficient steps to address deficiencies in the conflict management process. He allowed AFP to continue to operate without effective operational, organisational and administrative arrangements to prevent conflicts of interests arising, or to manage any conflicts that did arise.
- 5.6. In particular, during Mr Addison's tenure as Compliance Officer at AFP, four transactions took place which gave rise to obvious conflicts of interest through the risk that AFP or its related entities could make gains at the expense of the Guernsey cells. Mr Addison acted recklessly and without integrity in failing to address these conflict issues, with the result that the Guernsey cells entered into four transactions about which the non-AFP directors of the Guernsey cells were not given complete information, including key information relating to fees payable and the basis of the valuation of assets before the directors approved the transactions.
- 5.7. Mr Addison breached Statement of Principle 7 in that he did not take reasonable steps to ensure that the business of the Firm for which he was responsible in his controlled function complied with the relevant requirements and standards of the regulatory system, because he failed to take reasonable steps to ensure that:
- (1) there were adequate procedures in place to recognise and manage conflicts of interest at AFP;

- (2) non-public information was controlled and that there was adequate separation between the investment decision making for the UK Funds and the investment decision making for the Guernsey cells; and
 - (3) there were adequate, formal and independent compliance arrangements in place, in particular with regard to compliance monitoring; and the regular reporting of compliance issues to senior management.
- 5.8. Mr Addison failed to ensure that there was explicitly recorded consideration of conflict risk within the decision making structure at a transactional level, particularly given the specific advice that was provided to AFP in August 2007. Transactions should have been adequately documented, with transparency on the nature of the risks being run with a record of how the Firm reached a decision on the transaction. Mr Addison failed to ensure that this was done on a contemporaneous basis in respect of those transactions with potential conflicts of interest.
- 5.9. Mr Addison also failed to ensure that where a conflict arose and could only be managed through disclosure, that the relevant parties were provided with full and sufficient information, prior to the transaction taking place, to enable them to give informed consent to the transaction taking place.
- 5.10. From 1 November 2007, Mr Addison failed to ensure that there was a written conflicts policy in place as required by SYSC 10 and that records kept under this policy were accessible under SYSC 9.1.3.
- 5.11. Mr Addison failed to ensure that AFP had adequate systems for segregating and controlling the Firm's access to and use of non-public information about the Guernsey cells. Prior to December 2008, the same individuals were in charge of making investment decisions at both UK Funds level and at Guernsey cell level. This meant that there was no effective safeguard against the risk of information being shared between those involved in making investment decisions at UK Funds level and those involved in making investment decisions at Guernsey cells level. Given that AFP was marketing the Guernsey cells to external investors from at least February 2007, AFP should have had segregation in place from the outset to manage the risk of non-public

information being used by decision makers for the UK Funds. As compliance officer, Mr Addison was aware of this issue, yet failed to introduce controls over it.

- 5.12. Mr Addison failed to ensure that AFP had effective compliance monitoring procedures in place and failed to ensure that the results of compliance monitoring were adequately recorded and reported to senior management. Given the complexity of AFP's business and the risks it faced, and as stated in its own compliance monitoring manuals, AFP should have had a formal compliance monitoring programme, including regular reporting to senior management. Mr Addison failed in this regard.

6. SANCTION

- 6.1. The FSA's policy on the imposition of financial penalties and public censures is set out in Chapter 6 of the FSA's Decision Procedure & Penalties Manual ("DEPP"), which forms part of the FSA Handbook and came into force on 28 August 2007. It was previously set out in Chapter 13 of the Enforcement Manual ("ENF"). The FSA has had regard to both DEPP and ENF as both manuals applied at separate times during the Relevant Period. Both manuals set out the factors that may be of particular relevance in determining whether it is appropriate to impose a financial penalty. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

Deterrence

- 6.2. The principal purpose of disciplinary action is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour. Mr Addison earned approximately £267,000 at AFP between March 2006 and March 2009.

The nature, seriousness and impact of the breach

- 6.3. In determining the appropriate sanction, the FSA has had regard to the seriousness of the contraventions, including the nature of the breaches, the number and duration of the breaches, and the number of customers who were exposed to the risk of loss. The FSA considers that the breaches identified in this case are of a serious nature.

- 6.4. In particular, it is noted that AFP was the investment manager for assets under management in the UK Funds and the Guernsey cells totalling approximately £645 million at their peak.

The extent to which the breach was deliberate or reckless

- 6.5. In relation to Mr Addison's behaviour in breach of Statement of Principle 1, the FSA considers that Mr Addison recklessly contravened regulatory requirements and in so doing lacks integrity.

The size, financial resources and other circumstances of the person on whom the penalty is to be imposed

- 6.6. Having reviewed the material provided by Mr Addison regarding his financial position, the FSA does not consider that payment of the financial penalty will cause Mr Addison serious financial hardship or financial difficulties.

Disciplinary record and compliance history

- 6.7. Mr Addison has not previously been the subject of disciplinary action by the FSA.

Other action taken by the FSA

- 6.8. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other approved persons for similar behaviour. However, the FSA has also had regard to the principal purpose for which it imposes sanctions, namely, to promote high standards of regulatory conduct.

Conclusion

- 6.9. For the reasons set out above, the FSA considers that Mr Addison is guilty of misconduct and, in all the circumstances, including the seriousness of the breaches and the risks they posed to the FSA's statutory objectives of market confidence and the protection of consumers, it is appropriate to impose on him a financial penalty of £200,000.

6.10. Further, the FSA considers that Mr Addison lacks integrity and competence and capability, and is therefore not a fit and proper person to perform functions in relation to any regulated activity. It is therefore appropriate to withdraw Mr Addison's approval to perform controlled functions in relation to AFP and to make an order prohibiting him from performing any function in relation to any regulated activity carried on by any authorised or exempt person or exempt professional firm.

7. REPRESENTATIONS AND FINDINGS

7.1. Below is a brief summary of the key written and oral representations made by Mr Addison and how they have been dealt with. In making the decision which gave rise to the obligation to give this Decision Notice, the FSA has taken into account all of Mr Addison's representations, whether or not set out below.

General points

7.2. Mr Addison made representations that:

- (1) he had not breached any of the FSA's Statements of Principle. In particular, Mr Addison denied that he had ever acted with a lack of integrity;
- (2) the FSA was time-barred from imposing a financial penalty on him. The FSA knew of his misconduct no later than March 2009. At that time section 66(4) of the Act imposed a two-year time limit on the FSA to issue a Warning Notice if it proposed to impose a financial penalty on Mr Addison. Since the Warning Notice had been issued on 22 February 2012, the FSA was accordingly out of time to impose a financial penalty on him. It would therefore be unlawful and unfair for the FSA to impose a financial penalty on him; and
- (3) the alleged failings, which were denied, were only relevant in relation to his CF10 (Compliance Oversight) function. They were not materially relevant to his CF4 (Partner) function.

7.3. The FSA has found that:

- (1) Mr Addison did breach the FSA's Statements of Principle, as set out in this Decision Notice, including breaching Statement of Principle 1 by acting with a lack of integrity;
- (2) Section 66(4) of the Act was amended on 8 June 2010 (at which time the FSA was not time-barred from taking action against Mr Addison under section 66 of the Act) such that the relevant time limit is now three years, rather than two. Since the FSA issued the Warning Notice prior to March 2012, it is neither unlawful nor unfair for the FSA to impose a financial penalty on Mr Addison; and
- (3) aside from his compliance role, Mr Addison was a senior partner exercising a significant influence over AFP. His failings constituted a failure to satisfy the standards required of him in that capacity. In particular, his recklessness in relation to the four specific transactions set out in this Decision Notice constituted a failure to act with integrity.

Management of conflicts of interest

7.4. Mr Addison made representations that:

- (1) he was always conscious of conflicts of interest issues and maintained effective oversight and management of the risk of conflicts of interest in accordance with the applicable rules and principles. AFP always endeavoured to deal with conflicts appropriately and fairly. AFP maintained written records of conflict management appropriately, and had compliance manuals and arrangements in place throughout the Relevant Period. These were adhered to;
- (2) no poor or unsuitable investment decisions had been made as a result of conflicts of interest (or at all). No causal link had been (or could be) established between Mr Addison's alleged failings and the losses

suffered by investors. Therefore the risk alleged had to be regarded as effectively managed;

- (3) AFP never put its interests above the interests of investors. It only took investment decisions where the investment objectives and policies of the UK Funds and sub-funds warranted it, and in accordance with AFP's contractual and regulatory obligations. Any potential benefit received by AFP or its associates was incidental to the proposed benefit to the Guernsey cells and any risk of a conflict was carefully considered before any investment decision was actioned. AFP would not have given the substantial rebates to clients that it did, if it had been motivated to act in its own interests at the expense of its clients;
- (4) where AFP directed the Guernsey cells to invest in entities in which AFP or its associated entities had an interest, AFP carefully considered its obligations and ensured that any conflict was effectively managed, for instance by ensuring valuations were prudently calculated, disclosures of interests were made, and/or Mr Farrell and Mr Addison did not take part in the investment decisions concerned;
- (5) there was a clear alignment of interests or 'community of interest' from the outset between the Guernsey cells and the UK Funds, since the Guernsey cells were set up specifically to implement the UK Funds' strategic asset allocation and investment strategy. The Guernsey cells were essentially just an investment wrapper - any benefit to the Guernsey cells was a benefit to the UK Funds;
- (6) although for much of the Relevant Period there was no single document or table labelled as a centralised conflicts register, conflicts were properly and appropriately recorded and recognised in a variety of documents, and the relevant information could always be found as needed. Taken as a whole this system was sufficient for AFP to meet its regulatory obligations. Further, in mid-2008 AFP introduced a firm-wide risk matrix;

- (7) not all conflicts were required to be recorded. Potential conflicts were always taken into account, even if not explicitly documented – for instance, where they were a recurring feature of transactions. Disclosure where warranted was made appropriately, even if the records only summarised it. Further, where any documents were created after the event, this was only done based on existing sources of prior or contemporaneous information and the recollection of those involved and/or confirmation by them. Conflicts were always managed at the time - a delay in the recording of a conflict did not affect the management of that conflict; and
- (8) AFP's discretion under the investment management agreements meant that it was not required to, for instance, disclose information to the Guernsey cell directors even where a conflict existed. Where it did so this was because it chose to, not because it was required to.

7.5. The FSA has found that:

- (1) as set out in this Decision Notice, AFP did not manage conflicts of interest fairly. Its records and arrangements with regard to conflicts of interest were inadequate;
- (2) irrespective of whether poor or unsuitable investment decisions were made, or losses caused, as a result, AFP's failure to manage conflicts of interest fairly constituted a serious breach of its regulatory obligations, and Mr Addison's role in that failure constituted a breach of his own regulatory obligations;
- (3) simply because a given transaction has a commercial rationale does not mean that any conflicts of interest have been fairly managed. Further, the partial rebating of fees over time is not an answer to a conflict of interest relating to fees. A subsequent rebate does not cleanse an initial conflict of interest, and cannot constitute fair management of a conflict if the transaction should not have been carried out in the first place;

- (4) as set out in this Decision Notice, AFP repeatedly failed to manage conflicts of interest fairly, including failing to obtain independent valuations where these were necessary, failing to make full disclosure to the Guernsey cell directors as appropriate, and allowing Mr Farrell and/or Mr Addison to be involved in making investment decisions where this was inappropriate;
- (5) the ‘community of interest’ between the Guernsey cells and the UK Funds was insufficient to constitute or ensure fair management by AFP of conflicts. The mere fact of a broad alignment of interests does not exclude the possibility of conflicts occurring, and does not mean that conflicts will be managed fairly. Even if the Guernsey cells were just ‘wrappers’, this does not mean that AFP could not have acted in its own interests to the detriment of investors. Further, the interests of the Guernsey cells and the UK Funds were no longer aligned once there were external investors in the Guernsey cells;
- (6) during the Relevant Period AFP did not have a centralised record of conflicts information whereby the information was readily accessible, and other documents were not used consistently to record conflicts;
- (7) conflict notes were not always created including where, in the view of the FSA, they should have been. The recording of conflicts is an important aspect of conflict-management as it enables a firm not only to demonstrate that it has actively managed conflicts in an appropriate manner but also to manage those identified conflicts over time. AFP’s approach to creating documents after the event ran the risk of undue reliance on individuals’ subjective recollections and judgment. In any event, on the basis of the records available, the FSA considers that AFP did not manage all conflicts contemporaneously; and
- (8) while AFP may have had discretion under the investment management agreements to make investment decisions, FSA-authorised firms cannot

contract out of their conflict management and conflict recording obligations.

Specific transactions

7.6. In relation to all four transactions, Mr Addison made representations that:

- (1) he accepted that there was a risk of potential conflicts, which had been recognised at the time, but maintained that such risk and any potential conflicts were managed fairly and in accordance with the relevant regulatory obligations;
- (2) neither AFP nor any related person or entity stood to make gains ‘at the expense of’ the Guernsey cells – the Guernsey cells received full value for their investments. Each of the transactions was entered into properly and in accordance with the investment objectives and policies of the UK Funds and the Guernsey cells concerned, and in accordance with the relevant rules and principles;
- (3) appropriate disclosure of interests had been made to the Guernsey cell directors in relation to each transaction, although this may not always have been recorded in writing; and
- (4) in each case the decision to invest had been taken by the appropriate persons - such as the portfolio managers – not by Mr Farrell or Mr Addison.

7.7. The FSA has found that:

- (1) the transactions involved not just a risk of potential conflicts of interest, but actual conflicts of interest which were not fairly managed. The FSA considers that a person of Mr Addison’s extensive experience acting with integrity could not have concluded that the areas of conflict identified in this Decision Notice were (a) areas of potential rather than actual risk and (b) appropriately identified and addressed by the measures taken;

- (2) as a result of AFP's failure to manage conflicts fairly, there was a clear risk that AFP and/or related persons would make gains at the expense of the Guernsey cells. The fact that the transactions may have had a commercial rationale and been entered into in accordance with the appropriate objectives and policies did not mean that conflicts were managed fairly. The conflicts identified in this Decision Notice were not fairly managed, and AFP therefore breached relevant rules and principles, and Mr Addison breached the Statements of Principle;
- (3) in relation to each of the transactions, as set out in this Decision Notice, disclosure of all relevant facts was not made to the Guernsey cell directors as appropriate; and
- (4) in relation to each of the transactions, as set out in this Decision Notice, Mr Farrell and Mr Addison were involved in the decision to invest.

AGL Shares

7.8. Mr Addison also made representations in relation to this specific transaction that:

- (1) AFP disclosed all relevant facts to the Guernsey cell directors. By March 2007 the Guernsey cell directors were aware that Mr Farrell was the seller of some of the shares, and knew the basis of the valuation, and they did not raise any objections at the time or subsequently; and
- (2) the valuation provided by Mr Farrell was reasonable and supported by the financial condition and results of AGL. Further, it was supported by a third party valuation. An independent valuation was therefore not necessary, and would have been a waste of money by the Guernsey cells, especially when the sale by Mr Farrell was at the same price as the acquisition of new equity by the Guernsey cells. The level of stamp duty was known and was not material.

7.9. The FSA has found that:

- (1) there are limited records of the disclosure made to the Guernsey cell directors. On the basis of the relevant material, the FSA considers that the Guernsey cell directors were not made aware of all relevant facts, including that Mr Farrell was a seller of AGL shares and that he had provided the valuation; and
- (2) the price of the shares was based on the valuation produced by Mr Farrell who was the principal beneficiary of each share sale. The third party valuation was based on information provided by AFP, and produced later, and therefore could not have influenced conflict management at the time. In light of the two serious conflicts arising from the transaction, an independent valuation should have been obtained. Further, the stamp duty was a relevant consideration.

Investments in Company A

7.10. Mr Addison also made representations in relation to this specific transaction that:

- (1) AFP's role, for which it was paid a fee, was to seek to reduce the purchase price paid. AFP was successful in doing so;
- (2) the Guernsey cell directors were made aware of all relevant facts, including regarding AFP's fee; and
- (3) AFP followed the advice of the external compliance consultants in relation to the recording of the conflicts of interest – ICP documents record the conflict management considerations.

7.11. The FSA has found that:

- (1) the relevant material does not support the £21m valuation, and the basis of AFP's £3m fee is unclear;

- (2) the Guernsey cell directors were not made aware of all relevant facts. In particular, there is no record of them being informed of the amount of AFP's fee; and
- (3) AFP did not adequately follow the advice of the external compliance consultants. AFP did not record the rationale for the structuring of the transaction, or any consideration of the wider conflict of interest issues as opposed to the commercial rationale for the transaction.

Investments in Cru

7.12. Mr Addison also made representations in relation to this specific transaction that:

- (1) he was not involved in the original decision to invest in Cru, and therefore the transaction presented no conflict of interests for him. Further, he was not in fact an analyst on the transaction, and he only signed documentation as a director of the Guernsey cells as a matter of expediency;
- (2) AFP was not required to inform the Guernsey cell directors each time the loan facility was increased. AFP exercised its discretion appropriately; and
- (3) investments in Cru did not increase the funds under management on the basis of which AFP's fees were calculated.

7.13. The FSA has found that:

- (1) Mr Addison was involved in the subsequent increases in the loan amounts. He was recorded as an "analyst" in a document that he himself produced, and took the responsibility of signing documents related to the transaction in his role as a director of the Guernsey cells. The transaction clearly therefore presented a conflict of interests for him, which he failed to address;

- (2) the decision to significantly increase debt investment without recourse to the Guernsey cell directors gave rise to further conflicts of interest that needed to be managed. Further, the later debt investments were on different terms; and
- (3) there was the potential for investments in Cru to grow the UK Funds, the size of which determined AFP's fees, thus presenting the risk of a conflict.

Investments in Company B

7.14. Mr Addison also made representations in relation to this specific transaction that:

- (1) there was no requirement for profit forecasts to be independently verified to be relied upon. The valuations used were reasonable, and Mr Addison rejected the assertion that independent valuations should have been obtained. These would have cost the Guernsey cells money and would have been unnecessary;
- (2) AFP never took any increased property management fees; and
- (3) the further investment by the Guernsey cell was beneficial for both the Guernsey cell investing and to protect the existing investment of other Guernsey cells as it gave Company B capital with which to turn its business around.

7.15. The FSA has found that:

- (1) the valuation based on Company B's own unverified profit forecasts was inadequate in the circumstances. Taking into account the clear conflict, independent figures should have been obtained;
- (2) the fact that AFP did not take any increased fees does not mean that the conflict was fairly managed at the time; and
- (3) AFP did not manage the conflict between the investing Guernsey cell and those Guernsey cells that had already invested. There was a clear risk

to the funds of the investing Guernsey cell, which was not already invested in Company B.

Separation of decision making

7.16. Mr Addison made representations that:

- (1) AFP's investment decision making structure was not flawed. Mr Addison did not accept that the decision making processes had to be entirely separate; AFP was only required to ensure that no information was used inappropriately in investment decisions and any conflicts were managed fairly. It had appropriate systems and controls in place which were capable of managing the remote risk that existed. Where individuals had material non-public information they considered it and never used that information improperly. When the risk grew in the third quarter of 2008, AFP took clear and formal steps and introduced Chinese walls to effectively manage the risk; and
- (2) in any event, deals were only carried out where there was a clear rationale for them and they were in line with the investment strategy.

7.17. The FSA has found that:

- (1) AFP's process was insufficient – in particular, relying on those individuals who had material non-public information about the Guernsey cells, and who made investment decisions on behalf of the UK Funds, not to use that information in their investment decisions was an inadequate process. AFP was therefore exposed to the risk that its decisions as investment manager to the UK Funds could be influenced by its access to material non-public information. AFP did not begin to address this issue until late 2008 and even at that time there remained a number of individuals 'over the wall' i.e. individuals with material non-public information about the Guernsey cells who were involved in making investment decisions on behalf of the UK Funds; and

- (2) the rationale given in the deal tickets and the fact that the share sales and purchases were within the broad and high-level strategic asset/risk allocation of the particular funds do not demonstrate whether material non-public information was used – these matters therefore could not have assisted AFP in concluding that material non-public information was not being used in making investment decisions on behalf of the UK Funds.

Compliance monitoring

7.18. Mr Addison made representations that:

- (1) the compliance monitoring undertaken by AFP during the Relevant Period was not inadequate in any material fashion. Its risk compliance monitoring was risk-responsive and tailored to the specific needs of AFP throughout the Relevant Period. Mr Addison undertook regular monitoring alongside more ad hoc monitoring and review as needed. This included the monitoring of all financial promotions, compliance with COLL, and awareness and appropriateness of the conflicts of interest policy;
- (2) the allegation that there was no documented compliance monitoring programme in place until November 2008 was incorrect – there was such a programme which was in place and adhered to. There was a formal written compliance monitoring programme in place throughout the Relevant Period. Although not all elements of it were fully implemented, there was substantive compliance with that programme;
- (3) compliance results were sufficiently recorded and reported to senior management. The senior management team at AFP was relatively small and most of the team were involved in the consideration of conflicts matters. The need for evidencing formalised reporting measures was therefore reduced. Compliance was a standing agenda item at board

meetings and senior committee discussions and when there was a topic warranting a discussion this would be discussed; and

- (4) records were made appropriately throughout the Relevant Period, albeit not in one centralised location. All staff knew the procedures and how to access all relevant information as necessary.

7.19. The FSA has found that:

- (1) the monitoring procedures in place were not adequate to detect the relevant compliance risks given the nature, scale and complexity of AFP's business. In particular, AFP did not operate a formal compliance monitoring programme for most of the Relevant Period and instead sought to rely on informal and ad hoc measures. The examples given of monitoring by Mr Addison are limited in number and scope. They do not demonstrate a sufficient programme;
- (2) there was a Compliance Procedures Manual in place from February 2008 but it was not adhered to until November 2008, and then only in part. In the case of a complex business such as AFP, a detailed and documented compliance monitoring programme is required at all times to ensure that critical risks are identified and managed in accordance with the relevant regulatory obligations. Without it AFP did not have the necessary structural controls in place to identify, mitigate and manage the risks inherent in its business;
- (3) compliance related matters may have been discussed to some extent, however the results of the monitoring conducted, and the subsequent risks and issues that affected the Firm over time, were not reported; and
- (4) AFP's lack of a centralised records system, as well as the inconsistent use of documents to record compliance matters, meant that information was not always readily accessible.

Sanction

7.20. Mr Addison made representations that:

- (1) AFP consistently acted in accordance with its contractual and regulatory obligations, as did Mr Addison. Even if the alleged failings had occurred, which was denied, they had not had a significant impact on AFP discharging its obligations. In particular, there was no allegation that AFP actually caused or contributed to any actual losses to investors, as a result of the failings alleged. Further, and as a result, the total number of investors was not relevant to the seriousness of the matters alleged. Therefore even on the basis of the FSA's allegations against Mr Addison, which were denied, the penalty was disproportionate;
- (2) to the extent that the FSA found there to have been failings on the part of Mr Addison, and thereby AFP, it should be recognised that AFP had not acted in a predatory way and had always tried to grapple with issues and act fairly, such as in its rebating of millions of pounds of fees;
- (3) taking into account the sanctions imposed by the FSA on other individuals in previous cases, the penalty against Mr Addison was too high; and
- (4) the imposition of the penalty would cause him serious financial hardship.

7.21. The FSA has found that:

- (1) as set out in this Decision Notice, Mr Addison's failings were very serious. Further, they include integrity issues. Key risks were not managed – these were not isolated instances, but constituted a pattern which persisted over a significant period of time. In addition, in the FSA's view the number of investors who could potentially have been affected by Mr Addison's failings is a relevant factor – the large number of investors who were subject to that risk increased the seriousness of Mr Addison's failings;

- (2) all of the relevant circumstances have been taken into account in determining the appropriate penalty. The FSA accepts that Mr Addison did not breach the Statements of Principle deliberately, and that his failings could have been more serious. However, he demonstrated a serious lack of competence and, in relation to the four specific transactions, acted recklessly;
- (3) the sanctions imposed by the FSA on other individuals in previous cases have been taken into account, but are useful as a guide only. In any event, the FSA considers that the penalty against Mr Addison is consistent with the penalties imposed in previous cases, taking into account the seriousness of Mr Addison's misconduct; and
- (4) the payment of the financial penalty will not cause Mr Addison serious financial hardship in the FSA's view.

Third party representations

7.22. Below is a brief summary of the key representations made by AGL, a third party identified in the reasons above and to whom in the opinion of the FSA the matter is prejudicial, and how they have been dealt with. In making the decision which gave rise to the obligation to give this Decision Notice, the FSA has taken into account all of AGL's representations, whether or not set out below.

7.23. AGL made representations that it rejected any and all insinuations of impropriety on the part of AGL.

7.24. The FSA has found that the relevant facts and matters, including those in relation to AGL, are as set out in this Decision Notice.

8. PROCEDURAL MATTERS

Decision maker

8.1. The decision which gave rise to the obligation to give this Decision Notice was made by the Regulatory Decisions Committee.

- 8.2. This Decision Notice is given to Mr Addison under sections 57, 63 and 67 of the Act and in accordance with section 388 of the Act. It is given to AFP under section 63 of the Act. The following statutory rights are important.

9. The Tribunal

- 9.1. Mr Addison and AFP have the right to refer the matter to which this Decision Notice relates to the Upper Tribunal (the “Tribunal”). Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, a person has 28 days from the date on which this Decision Notice is given to him to refer the matter to the Tribunal. A reference to the Tribunal is made by way of a signed reference notice (Form FTC3) filed with a copy of this Decision Notice. The Tribunal’s address is: The Upper Tribunal, Tax and Chancery Chamber, 45 Bedford Square, London WC1B 3DN (tel: 020 7612 9700; email financeandtaxappeals@tribunals.gsi.gov.uk). Further details are contained in “Making a Reference to the UPPER TRIBUNAL (Tax and Chancery Chamber)” which is available from the Upper Tribunal website:

<http://www.tribunals.gov.uk/financeandtax/FormsGuidance.htm>

- 9.2. A copy of the reference notice (Form FTC3) must also be sent to the FSA at the same time as filing a reference with the Tribunal. A copy of the reference notice should be sent to Stephen Robinson at the FSA, 25 The North Colonnade, Canary Wharf, London E14 5HS.

10. Access to evidence

- 10.1. Section 394 of the Act applies to this Decision Notice. The person to whom this Decision Notice is given has the right to access:
- (1) the material upon which the FSA has relied in deciding to give this Decision Notice; and
 - (2) the secondary material which, in the opinion of the FSA, might undermine that decision.

11. Third party rights

- 11.1. A copy of this Decision Notice is being given to AGL as a third party identified in the reasons above and to whom in the opinion of the FSA the matter is prejudicial. AGL has similar rights of representation and access to material in relation to the matter which identifies it.

12. Confidentiality and publicity

- 12.1. This Decision Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). The effect of section 391 of the Act is that no person to whom this Decision Notice is given or copied may publish the Decision Notice or any details concerning it unless the FSA has published the Decision Notice or those details. The FSA may publish such information about the matter to which a Decision Notice or Final Notice relates as it considers appropriate. The facts and matters contained in this Decision Notice may therefore be made public.

13. FSA contact

- 13.1. For more information concerning this matter generally, contact Stephen Robinson at the FSA (direct line: 020 7066 1338).

Andrew Long

Acting Chairman, Regulatory Decisions Committee

Appendix 1 Relevant Statutory provisions, Regulatory requirements and FSA Guidance

14. Statutory provisions

- 14.1. The FSA's statutory objectives are set out in section 2(2) of the Act. In this case the most relevant statutory objectives are the protection of consumers and maintaining market confidence.
- 14.2. Section 56 of the Act provides that the FSA may make an order prohibiting and individual from performing any function in relation to all regulated activities.
- 14.3. Section 63 of the Act provides that the FSA may withdraw an approval given under section 59.
- 14.4. Section 66 of the Act provides that the FSA may take action against a person if it appears to the FSA that he is guilty of misconduct and the FSA is satisfied that it is appropriate in all the circumstances to take action against him. Misconduct includes failure, while an approved person, to comply with a statement of principle issued under section 64 of the Act. The action that may be taken by the FSA includes the imposition of a penalty on the approved person of such amount as it considers appropriate.

15. Handbook provisions

- 15.1. In exercising its power to impose a financial penalty, the FSA must have regard to relevant provisions in the FSA Handbook of rules and guidance ("the FSA Handbook"). The main provisions relevant to the action specified above are set out below.

Statements of Principle and the Code of Practice for Approved Persons ("APER")

- 15.2. APER sets out the Statements of Principle as they relate to approved persons and descriptions of conduct which, in the opinion of the FSA, do not comply with a Statement of Principle. It further describes factors which, in the opinion of the FSA, are to be taken into account in determining whether or not an approved person's conduct complies with a Statement of Principle.

- 15.3. Statement of Principle 1 states that: *“An approved person must act with integrity in carrying out his controlled function”*
- 15.4. Statement of Principle 7 states that: *“An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system”*.
- 15.5. APER 3.1.3G states that when establishing compliance with or a breach of a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour to be expected in that function.
- 15.6. APER 3.1.4G provides that an approved person will only be in breach of a Statement of Principle where he is personally culpable, that is in a situation where his conduct was deliberate or where his standard of conduct was below that which would be reasonable in all the circumstances.
- 15.7. APER 3.1.6G provides that APER (and in particular the specific examples of behaviour which may be in breach of a generic description of conduct in the code) is not exhaustive of the kind of conduct that may contravene the Statements of Principle.
- 15.8. APER 4.1, although not an exhaustive list provides specific examples of behaviour or conduct which may contravene Statement of Principle 1. In particular APER 4.1.2E provides that APER 4.1.3E - 4.1.13E describe examples of conduct, which in the opinion of the FSA, do not comply with Statement of Principle 1.
- 15.9. APER 4.1.13E states “Deliberately failing to disclose the existence of a conflict of interest in connection with a client falls within APER 4.1.2E”
- 15.10. APER 4.1.3E states: *“Deliberately misleading (or attempting to mislead) by act or omission:*
- (1) *a client; or*

(2) *his firm (or its auditors or an actuary appointed by his firm under SUP 4 (Actuaries)); or*

(3) *the FSA;*

falls with APER 4.1.2 E”

15.11. The relevant provision of APER 4.1.4E states: “*Behaviour of the type referred to in APER 4.1.3E includes but is not limited to, deliberately:*

(1) *falsifying documents;...*

(2) *providing false or inaccurate documentation or information,...*”

15.12. APER 3.1.8G provides, in relation to applying Statements of Principle 5 to 7, that the nature, scale and complexity of the business under management and the role and responsibility of the individual performing a significant influence function within the firm will be relevant in assessing whether an approved person’s conduct was reasonable.

15.13. APER 3.3.1E states that in determining whether or not the conduct of an approved person performing a significant influence complies with Statements of Principle 5 to 7, the following are factors which, in the opinion of the FSA, are to be taken into account:

(1) whether he exercised reasonable care when considering the information available to him;

(2) whether he reached a reasonable conclusion which he acted on;

(3) the nature, scale and complexity of the firm’s business;

(4) his role and responsibility as an approved person performing a significant influence function; and

(5) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.

16. Other relevant regulatory provisions

Fit and proper test for Approved Persons

- 16.1. The part of the FSA Handbook entitled “FIT” sets out the Fit and Proper Test for Approved Persons. The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.
- 16.2. FIT 1.3.1G provides that the FSA will have regard to a number of factors when assessing a person’s fitness and propriety, including their honesty, integrity and reputation, and their competence and capability.
- 16.3. As set out in FIT 2.1, in determining a person’s honesty, integrity and reputation, the FSA will have regard to matters including but not limited to:
 - (1) whether the person has contravened any of the requirements and standards of the regulatory system (FIT 2.13G(5)); and
 - (2) whether, in the past, the person has been candid and truthful in all his dealings with any regulatory body and whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system (FIT 2.13G(13)).
- 16.4. As set out in FIT 2.2, in determining a person’s competence and capability, the FSA will have regard to matters including but not limited to:
 - (1) whether the person satisfies the relevant FSA training and competence requirements in relation to the controlled function the person performs or is intended to perform; and
 - (2) whether the person has demonstrated by experience and training that the person is able, or will be able if approved, to perform the controlled function.

Enforcement Guide (“EG”)

- 16.5. The FSA’s policy on exercising its enforcement power is set out in the EG, which came into effect on 28 August 2007. It was previously set out in ENF.

FSA’s policy for exercising its power to make a prohibition order and withdraw a person’s approval

- 16.6. The FSA's approach to exercising its powers to make prohibition orders and withdraw approvals is set out at Chapter 9 of EG.
- 16.7. EG 9.1 states that the FSA’s power to make prohibition orders under section 56 of the Act helps it work towards achieving its regulatory objectives. The FSA may exercise this power where it considers that, to achieve any of those objectives, it is appropriate either to prevent an individual from performing any functions in relation to regulated activities or to restrict the functions which he may perform.
- 16.8. EG 9.4 sets out the general scope of the FSA’s powers in this respect, which include the power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual’s lack of fitness and propriety is relevant. EG 9.5 provides that the scope of a prohibition order will vary according to the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk posed by him to consumers or the market generally.
- 16.9. In circumstances where the FSA has concerns about the fitness and propriety of an approved person, EG 9.8 to 9.14 provides guidance. In particular, EG 9.8 states that the FSA may consider whether it should prohibit that person from performing functions in relation to regulated activities, withdraw that person’s approval or both. In deciding whether to withdraw approval and/or make a prohibition order, the FSA will consider whether its regulatory objectives can be achieved adequately by imposing disciplinary sanctions.
- 16.10. EG 9.9 states that the FSA will consider all the relevant circumstances when deciding whether to make a prohibition order against an approved person and/or to withdraw

that person's approval. Such circumstances may include, but are not limited to, the following factors:

- (1) whether the individual is fit and proper to perform functions in relation to regulated activities, including in relation to the criteria for assessing the fitness and propriety of an approved person in terms of competence and capability as set out in FIT 2.2;
- (2) the relevance and materiality of any matters indicating unfitness;
- (3) the length of time since the occurrence of any matters indicating unfitness;
- (4) the particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates;
- (5) the severity of the risk which the individual poses to consumers and to confidence in the financial system; and
- (6) the previous disciplinary record and general compliance history of the individual.

16.11. EG 9.12 provides a number of examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order or withdraw the approval of an approved person. The examples include serious breaches of the Statements of Principle, and serious lack of competence.

Decision Procedure and Penalties Manual ("DEPP")

16.12. Guidance on the imposition and amount of penalties is set out in Chapter 6 of DEPP, which forms part of the FSA Handbook and came into force on 28 August 2007. It was previously set out in Chapter 13 of ENF, to which the FSA has had regard in addition to DEPP as both manuals applied at separate times during the Relevant Period.

16.13. DEPP 6.1.2G provides that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who

have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour. Financial penalties are tools that the FSA may employ to help it to achieve its regulatory objectives.

16.14. DEPP 6.5.1G(1) provides that the FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned.

16.15. DEPP 6.5.2 sets out a non-exhaustive list of factors that may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act. The following factors are relevant to this case:

Deterrence: DEPP 6.5.2G(1)

16.16. When determining the appropriate level of financial penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

The nature, seriousness and impact of the breach in question: DEPP 6.5.2G(2)

16.17. The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached, which can include considerations such as the duration and frequency of the breach, whether the breach revealed serious or systemic weaknesses in the person's procedures or of the management systems or internal controls relating to all or part of a person's business, the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the breach and the loss or risk of loss caused to consumers, investors or other market users.

The extent to which the breach was deliberate or reckless: DEPP 6.5.2G(3)

16.18. The FSA will regard as more serious a breach which is deliberately or recklessly committed, giving consideration to factors such as whether the person has given no

apparent consideration to the consequences of the behaviour that constitutes the breach. If the FSA decides that the breach is deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case.

Whether the person on whom the penalty is to be imposed is an individual: DEPP 6.5.2G(4)

- 16.19. When determining the amount of penalty to be imposed on an individual, the FSA will take into account that individuals will not always have the resources of a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than on a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individual are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level.

The size, financial resources and other circumstances of the person on whom the penalty is to be imposed: DEPP 6.5.2G(5)

- 16.20. The FSA may take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the person were to pay the level of penalty appropriate for the particular breach.

Conduct following the breach: DEPP 6.5.2G(8)

- 16.21. The FSA may take into account the degree of co-operation the person showed during the investigation of the breach by the FSA.

Other action taken by the FSA (or a previous regulator): DEPP 6.5.2G(10)

- 16.22. The FSA seeks to apply a consistent approach to determining the appropriate level of penalty. The FSA may take into account previous decisions made in relation to similar misconduct.

FSA guidance and other published materials: DEPP 6.5.2G(12)

- 16.23. The FSA will consider the nature and accessibility of the guidance or other published materials when deciding whether they are relevant to the level of penalty and, if they are, what weight to give them in relation to other relevant factors.

Appendix 2 Definitions

- (1) “ACD” means authorised corporate director
- (2) the “Act” means the Financial Services and Markets Act 2000
- (3) “AFP” (or the “Firm”) means Arch Financial Products LLP
- (4) “AGL” means Arch Group (UK) Limited
- (5) “AIGHL” means Arch International Group Holdings Limited
- (6) “APER” means the Statements of Principle and the Code of Practice for Approved Persons
- (7) the “Balanced Fund” means the CF Arch cru Balanced Fund
- (8) the “Business Associate” is defined in paragraph 4.45 of this Decision Notice
- (9) “CISX” means the Channel Islands Stock Exchange
- (10) “COLL” means the Collective Investment Schemes Sourcebook in the FSA Handbook, which has been in place since 1 April 2004
- (11) “Company A” is defined in paragraph 2.8(2) of this Decision Notice
- (12) The “Company A Acquisition” is defined in paragraph 4.46 of this Decision Notice
- (13) “Company B” is defined in paragraph 2.8(4) of this Decision Notice
- (14) “Cru” means Cru Investment Management Ltd
- (15) “DEPP” means the FSA’s Decision Procedure and Penalties Manual
- (16) the “Diversified Funds” means the CF Arch cru Diversified Funds
- (17) “EG” means the Enforcement Guide
- (18) “ENF” means the Enforcement Manual
- (19) the “Finance Fund” means the CF Arch cru Finance Fund

- (20) the “FSA” means the Financial Services Authority
- (21) the “Global Growth Fund” means the CF Arch cru Global Growth Fund
- (22) “ICPs” means Investment Committee Proposals
- (23) the “Income Fund” means the CF Arch cru Income Fund
- (24) the “Investment Funds” means the CF Arch cru Investment Funds
- (25) the “Investment Portfolio” means the CF Arch cru Investment Portfolio
- (26) the “January 2010 Conflicts File Note” is defined in paragraph 4.51 of this Decision Notice
- (27) “OEIC” means Open Ended Investment Company
- (28) “NAV” means net asset value
- (29) “NURS” means a Non-UCITS Retail Scheme
- (30) “Relevant Period” means July 2006 to March 2009 inclusive
- (31) the “Specialist Portfolio” means the CF Arch cru Specialist Portfolio
- (32) the “Tribunal” means the Upper Tribunal (Tax and Chancery Chamber)
- (33) the “UK Funds” means the “Investment Funds” and the “Diversified Funds” together