

SEE FINAL NOTICE ISSUED ON 27 MARCH 2015

DECISION NOTICE

To: **Robin Farrell** **Arch Financial Products LLP**
Date of birth: **16 Berkeley Street**
17 July 1967 **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 Robin Farrell, 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 Farrell under section 59 of the Act to perform the CF3 (Chief Executive), 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 £650,000 on Mr Farrell.

- 1.2. This action is in respect of breaches of Statements of Principle 1, 6 and 7 of the FSA's Statements of Principle for Approved Persons by Mr Farrell between July 2006 and March 2009 (the "Relevant Period").

2. SUMMARY OF REASONS

- 2.1. As the holder of CF3 (Chief Executive) at AFP throughout the Relevant Period, Mr Farrell was responsible for the overall operation of AFP's business, including its compliance with regulatory requirements. He was an experienced investment and market professional. He also held CF4, CF8, CF11 and CF30 (previously CF21 and CF27) during the Relevant Period and was held out as AFP's Head of Investments.
- 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 OEIC and NURSSs. The Guernsey cell companies had three directors, two non-AFP directors and Mr Addison (the Chief Financial Officer, Chief Operating Officer and Compliance Officer of AFP) was the third director.
- 2.3. Mr Farrell was instrumental in the Firm setting up a fund structure which allowed the adoption of an investment allocation strategy whereby the majority of the UK Funds' scheme property was invested in the Guernsey cells.
- 2.4. The investment strategy of allocating the majority of the UK Funds' investments to buy shares in the Guernsey cells had obvious inbuilt liquidity risks in that there was a very limited external secondary market for the Guernsey cell shares (most of which were owned by the UK Funds). Mr Farrell in his role as CEO of AFP did not take sufficient steps to manage these liquidity risks.
- 2.5. 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.

- 2.6. 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. This created a risk that AFP would structure transactions for the Guernsey cells in such a way as to maximise its own benefit. 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.
- 2.7. However, in spite of the significant and apparent conflict risks, AFP did not maintain or operate effective operational, organisational and administrative arrangements to prevent conflicts of interests arising and failed to take reasonable steps to prevent such conflicts giving rise to material risks of damage. AFP had no consistent procedure for conflict management or recording of conflict management.
- 2.8. In his role as CEO, and having been given specific management responsibility for conflict management in February 2008, Mr Farrell was responsible for AFP's conflicts management processes and did not maintain or operate organisational and administrative arrangements to prevent conflicts of interest arising and giving rise to material risks of damage. Further, in respect of four particular transactions described below, Mr Farrell recklessly failed to follow both the FSA's regulatory requirements for conflicts management and AFP's own internal conflicts management rules.
- 2.9. As CEO of AFP Mr Farrell was also responsible for ensuring that AFP had adequate processes in place to ensure that non-public information relating to one set of clients (the Guernsey cells) was segregated from other sets of clients (the UK Funds) as part of its conflict management and investment decision making processes. However, Mr Farrell failed to take reasonable steps to ensure that there was adequate separation

between the investment decision makers of the Guernsey cells and those of the UK Funds.

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. Therefore, there was a risk that individuals making decisions at UK Funds 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. During the Relevant Period, Mr Farrell's conduct in his role as the holder of CF3 (Chief Executive) fell short of the regulatory standards for approved persons in that:

(1) in respect of four transactions undertaken by the Guernsey cells at AFP's instigation, Mr Farrell acted without integrity by recklessly failing to manage effectively or at all the significant and serious conflicts of interest, which constitutes a breach of Statement of Principle 1:

(a) Mr Farrell and 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 Farrell and Mr Addison 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, the non-AFP directors of the Guernsey cells were not informed that Mr Farrell was 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;

(b) in another transaction Mr Farrell and 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. 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 cell directors. Further, no conflict documentation was prepared in respect of this transaction despite the clear and obvious conflict and despite AFP receiving external advice at the time telling AFP 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 for the FSA and was misleading in that it did not mention the most important conflict being the size of the fee paid to AFP in relation to the transaction;

- (c) AFP and Mr Farrell 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. Mr Farrell recklessly failed to manage these conflicts of interest by, in particular, failing to disclose to the non-AFP Guernsey cells' directors material factors in respect of the clear benefit gained by AFP and AFP's business partner from the Guernsey cells' investments and in failing contemporaneously to record conflicts and conflict management; and
- (d) AFP and Mr Farrell caused the Guernsey cells to invest in a company 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 for AGL. 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 Farrell recklessly failed to manage these conflicts of interest, and there is no evidence that he disclosed the conflicts to the non-AFP Guernsey cells' directors, or that the conflicts were contemporaneously recorded.

- (2) Accordingly, Mr Farrell 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.
- (3) Mr Farrell was also instrumental in AFP setting up a structure and allowing the implementation of an investment allocation strategy which contained significant and in-built liquidity risks, which Mr Farrell and AFP failed to manage. The setting up of this structure displayed a lack of due care, skill and diligence particularly in respect of the requirement for NURSs to be managed in accordance with the appropriate requirements, notably the requirement for the scheme property of a NURS to aim to provide a prudent spread of risk. This constitutes a breach of Statement of Principle 6.
- (4) Mr Farrell was responsible for the management of conflicts of interest at AFP but he failed to take reasonable steps to ensure that there were adequate procedures to manage conflicts of interest. This constitutes a breach of Statement of Principle 7; and
- (5) Mr Farrell failed to take reasonable steps to ensure that there were restrictions in the access to non-public information about the Guernsey cells and that there was an adequate separation between the investment decision makers for the UK Funds and the Guernsey cells. This constitutes a breach of Statement of Principle 7.

2.12. The FSA views Mr Farrell's failings as serious because:

- (1) his failings had a significant impact on AFP discharging its obligations as investment manager;
- (2) there are (and were during the Relevant Period) over 6000 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

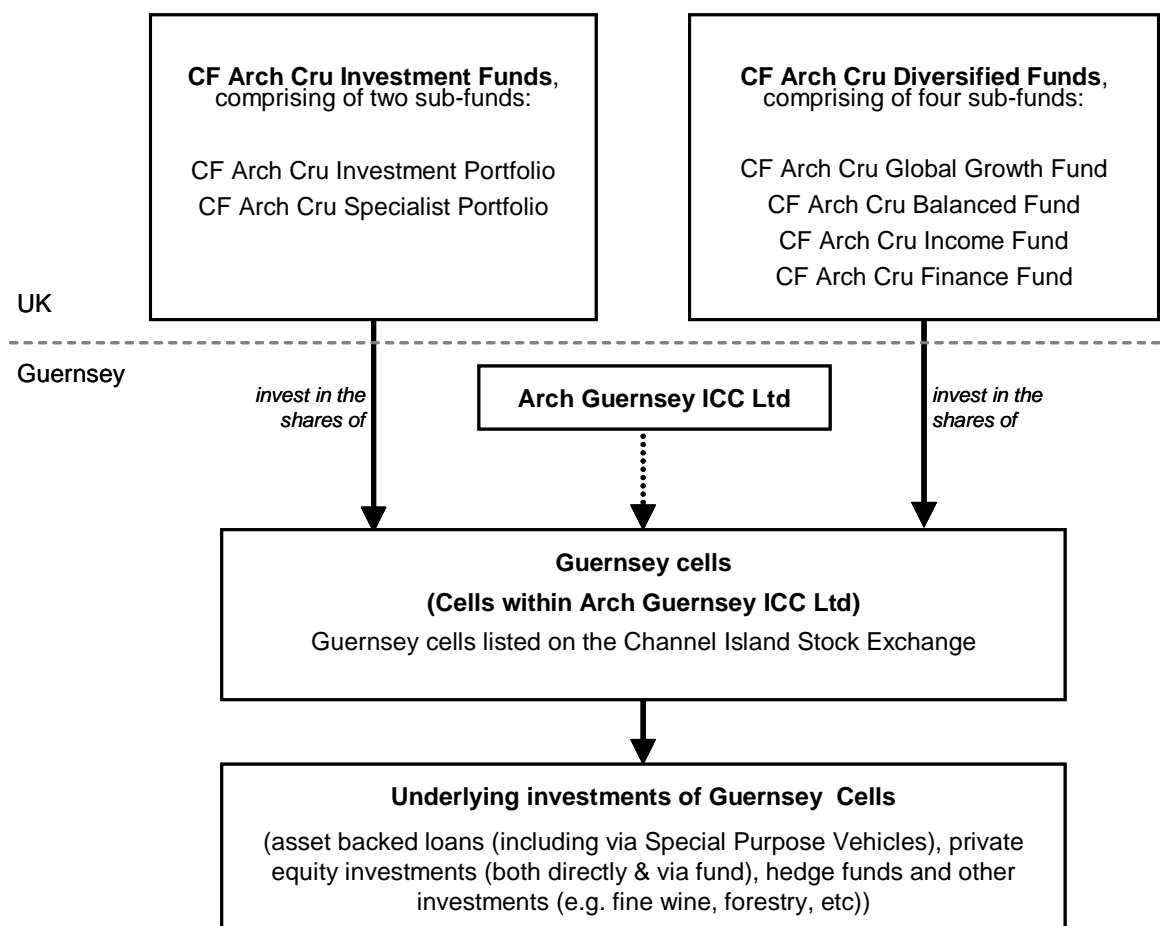
Mr Farrell's roles and experience

- 4.1. Mr Farrell is an experienced investment professional having a broad experience across alternative and traditional asset management, risk management and trading. Throughout the Relevant Period, Mr Farrell was a partner at AFP and held the CF3 (Chief Executive) Function. Accordingly, he was responsible for the overall operation of all of AFP's business, including its compliance with regulatory requirements. As at 28 February 2010 Mr Farrell and his wife held 82.6% of AIGHL, AFP's ultimate parent company.
- 4.2. Mr Farrell was also held out as Chief Investment Officer and Head of Investments at AFP until at least July 2008 and held CF4, CF8, CF11 and CF30 (previously CF21 and CF27) during the Relevant Period. Mr Farrell also had specific responsibility (in addition to his overall responsibility for AFP's business) for the management of conflicts, and the management of the risk of "poor investment decisions" from February 2008.

The UK Funds structure and Mr Farrell's responsibilities

- 4.3. In January 2006, AFP approached an ACD to act in relation to an OEIC, the Investment Fund, which was a NURS. The Investment Funds were set up in January 2006 and were authorised by the FSA.
- 4.4. 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.
- 4.5. Mr Farrell and other managers at AFP set up a structure whereby AFP adopted an investment allocation strategy under which the Investment Funds, comprising two sub-funds - the Investment Portfolio and 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.
- 4.6. 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.
- 4.7. The Diversified Funds had three sub-funds as at 26 September 2007: the Balanced Fund, the Global Growth Fund, and the Income Fund.
- 4.8. 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 Finance Fund - was launched in October 2008 and from its launch AFP invested all of its non-cash scheme property in the Guernsey cells.

- 4.9. 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.
- 4.10. 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:



- 4.11. 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.
- 4.12. 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.

Liquidity and spread of risk

- 4.13. As well as investing in eligible securities and investing in accordance with the quantitative investment limits set out, under the terms of its investment management agreement with the ACD, AFP was also obliged to ensure that, taking account of the investment objectives and policy of the UK Funds, the scheme property of each of the UK Funds aimed to provide a prudent spread of risk. AFP failed to do this.
- 4.14. The UK Funds invested primarily in the Guernsey cells' shares. For example, the Investment Portfolio, which was the largest of the sub-funds of the UK Funds, had 81% exposure to the Guernsey cells at 2 April 2007. This exposure dropped to 64% in July 2007, but then went back up to 85% on 1 October 2007. At 31 June 2008, the percentage was 90% and after this the percentage remained at over 90% until the UK Funds' suspension on 13 March 2009, when the percentage was 97%. After March 2008, no purchases of non-Guernsey cell assets were made by the UK Funds.
- 4.15. Not only were the UK Funds predominantly invested in the Guernsey cells, the UK Funds and other Guernsey cells were majority owners of most of the Guernsey cells.

Trading in the shares of the Guernsey cells took place through the Guernsey cells' market maker. This included trades by the UK Funds and between the Guernsey cells. Secondary market transactions involving non-AFP related parties were limited. For example, of the total number of trades in the Guernsey cells' shares during the trading period from 12 February 2007 to 29 April 2009, buy trades and sell trades involving an external (i.e. non AFP related counterparty) totalled around £19 million and £25 million respectively. Buy trades and sell trades with AFP-related counterparties were around £161 million and £155 million respectively.

- 4.16. AFP's allocation strategy for the UK Funds resulted in a concentration of the UK Funds' scheme property in the Guernsey cells' shares and the UK Funds' majority or complete ownership of many of the Guernsey cells. UK Fund investors were exposed to the risk that the UK Funds would not be able to liquidate their holdings in the Guernsey cells in the secondary market to meet redemption requests at times of net outflows from the UK Funds in the four-day settlement period which would be required. This risk crystallised and resulted in the suspension of the UK Funds in March 2009.
- 4.17. AFP did not take sufficient action to increase the UK Funds' liquidity (for example, the Investment Portfolio (the largest of the sub-funds) held less than 10% of its scheme property as ready, realisable assets (such as cash) between 30 June 2008 and suspension) and instead continued to invest in the Guernsey cells. At 1 October 2008 the UK Funds collectively held £34.2 million in cash, which equated to approximately 8% of their scheme property. Between 1 October 2008 and 31 December 2008, £8.8 million of net inflows were invested in the UK Funds. AFP did not keep this cash within the UK Funds to bolster their cash balances, but instead continued to invest in the shares of the Guernsey cells, eroding the cash buffer still further, such that by 1 January 2009, the UK Funds held just £22.8 million (approximately 6%) of their scheme property as cash at a time when the condition of the global economy was worsening.
- 4.18. AFP could have tried to obtain additional cash reserves from its investments in the Guernsey cells through, for example, requesting that the Guernsey cells undertook share buy-backs or other corporate actions. However, this would have depended on

such action being taken by the directors of the Guernsey cells, an independent body, when it may not have been in the best interests of the Guernsey cells and, in any event, the Guernsey cells might not have had sufficient liquidity.

- 4.19. Mr Farrell, as CEO of AFP, a member of its investment committees and held out as its Head of Investments, would have been aware of the concentration of the UK Funds' investments in the Guernsey cells and the extent of the external market for the shares in the Guernsey cells. Mr Farrell knew that there was a limited external market for the Guernsey cells' shares but he did not take adequate steps to manage the risks created by this structure. Accordingly Mr Farrell's actions in creating the structure and the steps taken to manage the UK Funds showed a lack of due skill, care and diligence with regard to the requirement for a prudent spread of risk in retail funds.

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

- 4.20. 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. In addition to Mr Farrell's overall responsibility for the systems and controls of AFP as CEO, conflicts of interest management responsibility was specifically allocated to him from 28 February 2008. Mr Farrell was responsible for AFP's conflicts management processes and did not maintain or operate organisational and administrative arrangements to prevent conflicts of interest arising and giving rise to material risks of damage. This was particularly serious as several of the conflicts directly involved Mr Farrell.
- 4.21. 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 at Guernsey cell level 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 in which AFP or associated entities had an interest.

4.22. Principle 8 of the FSA's Principles for Businesses 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. AFP did not consistently record the conflicts arising nor did AFP record the steps taken to manage these conflicts.

4.23. AFP had high-level conflict of interest policies in place which set out some principles of general conflict management, but AFP did not follow these policies. Further, AFP and Mr Farrell received advice from external consultants as to the procedures it should follow to comply with the FSA's rules, but AFP and Mr Farrell did not follow this advice. AFP was also required by SYSC 10.1.10 to have an appropriate written conflicts of interest policy in place by 1 November 2007. A written policy was not implemented until August 2008, by which time the UK Funds' money had been invested in the Guernsey cells.

4.24. 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 had taken reasonable steps to ensure that the customer did not object to AFP's

interest or conflict, before the transaction was undertaken. AFP could only demonstrate that it had taken such steps through maintaining conflicts records.

- 4.25. 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.
- 4.26. AFP only rarely recorded conflicts management analysis it carried out 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 committee (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. There was no clear or consistent procedure for conflict recording and no centralised single record of conflicts and their mitigation until after the Relevant Period.
- 4.27. In certain cases, material details of the conflicts arising from transactions were omitted from the conflicts notes or other documents AFP did create (whether 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 from Mr Addison on 15 September 2007 to most of AFP's staff, including Mr Farrell, 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.
- 4.28. For AFP to comply with both COB 7.1 and SYSC 10 (and its 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 in respect 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.

- 4.29. 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.
- 4.30. Before the creation of a centralised conflicts log in 2009 AFP drafted 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 were created after the relevant transactions. These nine conflict file notes were created in February 2009, following a request on 30 January 2009 from the ACD of the UK Funds for the provision of AFP’s conflicts of interest policy and register.
- 4.31. 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 explanation of their identification and mitigation, had no such notes.
- 4.32. One of the potential mechanisms open to AFP for managing its conflicts was through disclosure to the relevant clients. 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 relating to transactions undertaken by the Guernsey cells. In certain cases where disclosure was recorded as being made, the disclosure was not sufficiently detailed to enable the directors to reach an informed view of the conflict. In other cases 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.

- 4.33. As the CEO of AFP, Mr Farrell should have ensured that conflicts were recorded and disclosed properly. In particular, material details of the conflicts arising from certain transactions were often omitted from the conflicts notes Mr Farrell created (whether created contemporaneously or after the event) which obscured the full extent of the conflict. Concerns were raised internally to Mr Farrell about the deficiencies in conflict management and recording in the Relevant Period, but the deficiencies were not addressed in a timely fashion.
- 4.34. During the Relevant Period, throughout which Mr Farrell was responsible for ensuring that conflicts were managed properly, AFP and Mr Farrell caused the Guernsey cells to enter into a number of significant transactions in which AFP or associated entities made gains at the expense of the Guernsey cells and where these conflicts arising were recklessly not recorded, managed and/or disclosed as set out below. The FSA considers that, in relation to these transactions, Mr Farrell failed to act with integrity in carrying out his controlled functions of CF3 (Chief Executive) and CF4 (Partner).

AGL Shares

- 4.35. AFP and Mr Farrell caused the Guernsey cells to make 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 AGL; (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, (who was the CEO of AFP and the majority shareholder in 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

- 4.36. 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.
- 4.37. On 15 February 2007, a business plan was co-presented to the non-AFP directors of the Guernsey cells by Mr Farrell. 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.
- 4.38. 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, Mr Farrell sold 5,166 shares to the Guernsey cells at a cost of £500,121. It was not stated in the business plan presented to the non-AFP Guernsey directors by Mr Farrell and Mr Addison that Mr Farrell would be making 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.
- 4.39. 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 Mr Farrell and 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. Further when the Guernsey cells purchased new shares from AGL, the funds went into AGL which may have benefited the Guernsey cells as

shareholders in AGL, but when the Guernsey cells purchased Mr Farrell's shares, the funds went to Mr Farrell which did not benefit the Guernsey cells. There is only documentary evidence of the Guernsey cells' directors approving the issuing of loan notes but not the equity transactions.

4.40. 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.

4.41. 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, Mr Farrell and AFP did not manage the conflict by obtaining an independent valuation of AGL.

Management of the conflict of interest: Documentation and disclosure

4.42. In this transaction, there was a clear and obvious risk that Mr Farrell and AFP could put their own interests ahead of the Guernsey cells. However, Mr Farrell recklessly failed to manage the conflict. Mr Farrell omitted to inform the non-AFP Guernsey cell directors that he would be selling his shares to the Guernsey cells. Further, Mr Farrell did not seek an independent valuation, allowing reliance to be placed on his own valuation when this was clearly inappropriate, and did not record the relevant conflicts of interest in relation to the transaction.

4.43. 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*". However, 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.

4.44. Another document prepared by Mr Farrell, 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. Mr Farrell's note recorded that he 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 gives the impression that the conflict of interest was managed by stating 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, the note Mr Farrell created is misleading as it does not make it clear that the business plan presented to the directors of the Guernsey cells on 15 February 2007 did not include 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.

4.45. 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.

4.46. 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 Farrell's involvement

- 4.47. Mr Farrell personally benefited from these transactions, both through his ultimate majority ownership of AGL, which the Guernsey cells financed, and through the sale of his own shares to the Guernsey cells. Despite his personal material interest, he was heavily involved in this transaction for the Guernsey cells. He presented an incomplete picture of the transaction to the Guernsey cells' non-AFP directors and failed to explain the complete picture before the transaction went ahead; he produced a note for AFP's investment committee setting out AFP's view of the management of conflicts (although this was produced after the transaction). He provided the recommendation for the valuation of the AGL shares and did not obtain an independent valuation. He did not include these investments in a centralised assessment of issues, including conflicts of interest, for Guernsey cell investments where AFP also had an interest until September 2008. This was 18 months after they occurred. Further, Mr Farrell signed the revolving discounted note facility on behalf of the Guernsey cells.
- 4.48. Recognising the considerable conflict problems arising out of this transaction, Mr Farrell recklessly failed to manage effectively his personal conflicts of interest and recklessly failed to disclose the conflict of interest arising from the sale of his own shares to the Guernsey cells' directors.

Investments in Company A

- 4.49. 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.

- 4.50. 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.
- 4.51. 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

- 4.52. AFP’s £3 million fee was not contemporaneously disclosed to the non-AFP directors of the Guernsey cells.
- 4.53. There is no evidence of the rationale for the Company A Acquisition being recorded or discussed in any Investment Committee meetings, ICPs or conflicts notes, nor any justification for the size of the fee. There is also no documentation recording how the conflict arising from Mr Farrell’s position as a director of Company A from August 2007 was monitored and managed.
- 4.54. 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 (which was used in this transaction) so that there was a clear paper trail of dealing with the conflict in a fair manner. Funding was provided for the Company A Acquisition from the Guernsey cells through the unlisted cell company in August and October 2007. In spite of the clear specific advice, there was no paper trail in respect of conflict management in the Company A transaction.
- 4.55. 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 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 File Note down-plays Mr Farrell's role in the transaction; it 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 but 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.

- 4.56. 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 Farrell's involvement

- 4.57. Mr Farrell knew that AFP would receive the £3 million fee financed by the Guernsey cells' investment in Company A, and in his capacity as a director of Company A approved Company A paying out this fee to AFP. He also signed loan documentation on behalf of Company A. He therefore was aware of the transaction and the obvious conflict of interest arising out of the transaction, given his market experience. However, recognising the conflict problems posed by this transaction, he recklessly failed to manage the conflict of interest, in particular in failing to disclose this conflict of interest to the non-AFP Guernsey cell directors and failing to produce accurate, contemporaneous and complete conflicts records demonstrating how AFP managed the conflict.

Investments in Cru Investment Management Limited

- 4.58. 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 also 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.

- 4.59. 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. In addition agreeing to invest the Guernsey cells' money in Cru improved AFP's ability to negotiate favourable distribution terms with Cru.
- 4.60. 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 provided finance to Cru by subscribing for £480,000 worth of A shares in Cru at £1 per share (equating to a 6.78% stake of the voting shares). On this basis, Cru would have been effectively valued at around £7 million at this time. As at 30 April 2007 the £480,000 invested by the Guernsey cells represented 99.8% of the share capital and share premium of Cru, yet the Guernsey cells held just 6.78% of the voting shares (and the associated rights to dividends). On 14 February 2007, the Guernsey cells also provided the first tranche of debt funding of £780,000.
- 4.61. The transactions meant that although the Guernsey cells had contributed the substantial majority of the actual share capital of Cru, they only had a small minority of the voting, ownership and dividend rights.
- 4.62. 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

- 4.63. There was a significant conflict resulting from AFP causing the Guernsey cells to invest in Cru, which transaction benefited AFP's business partner. This also had the effect of improving AFP's ability to negotiate favourable terms with Cru in the distribution agreement.
- 4.64. Mr Farrell 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 non-AFP Guernsey cell directors, but omitted to inform the 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.
- 4.65. 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.
- 4.66. 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 to AFP's Investment Committee in respect of the Cru transaction, which indicates that Mr Farrell was one of the analysts proposing the transaction, was not prepared until July 2008.
- 4.67. 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*".

Mr Farrell's involvement

- 4.68. Mr Farrell was recorded in proposal documents as the analyst who proposed the original Cru investments to AFP's investment committee; he also produced a note for AFP's senior management setting out how he believed any potential conflicts of interest were managed. Both notes were produced after the transaction occurred.
- 4.69. Mr Farrell was also responsible for presenting the original Cru transaction to the non-AFP directors of the Guernsey cells.
- 4.70. Mr Farrell did not include these investments in a centralised assessment of issues, including conflicts of interest, for Guernsey cell investments where AFP also had an interest, until September 2008. This was 18 months after they occurred. Mr Farrell was instrumental in directing the Guernsey cells to invest in Cru and was aware of the conflicts arising out of the investments, but recklessly failed to take effective steps to manage these conflicts.

Investments in Company B

- 4.71. 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. Mr Farrell was the non-executive chairman of the board of Company B.

Equity Investments

- 4.72. 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.

4.73. 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 ICP 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 ICP 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 various 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

- 4.74. 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.
- 4.75. 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 documented or considered by AFP.

Management of the conflict of interest: Documentation and disclosure

- 4.76. Steps were not taken by Mr Farrell to prevent the conflict of interest between AGL's interests and those of the Guernsey cells (for example, in earning the management fees under the Property Advisory Agreement) giving rise to a risk of damage to the interests of the Guernsey cells. Although a conflict of interest was acknowledged in one of the later ICPs there is no evidence that the conflicts were properly managed at the time.
- 4.77. 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.

- 4.78. 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.
- 4.79. 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 Farrell's involvement

- 4.80. Mr Farrell signed the Property Agreement with Company B and therefore was aware of the transactions giving rise to the conflicts between AFP's parent and the Guernsey cells. He was also a Board member of Company B and received warnings about its performance, yet continued to cause the Guernsey cells to provide finance to Company B.
- 4.81. Mr Farrell recommended the price at which the share warrants should be sold to the Guernsey cells and, through his majority shareholding in AGL, was the substantial beneficiary of the £49,999 profit raised from the sale of the share warrants. Despite this obvious personal conflict of interest, Mr Farrell failed to obtain an independent valuation of the price of the warrants being sold to the Guernsey cells.

- 4.82. Mr Farrell was aware of the many obvious conflicts in the Company B investments, but recklessly failed to manage the conflicts effectively. Conflict notes in relation to this transaction were not produced contemporaneously, and it was not until September 2008, one year after the initial transaction, that it was included in AFP's centralised assessment of Guernsey cell investments where AFP had an interest.

Summary

- 4.83. In summary therefore, Mr Farrell was responsible for ensuring that AFP properly managed conflicts but, in situations where there was a clear and obvious risk that he or his associates profited from transactions at the expense of the Guernsey cells, he recklessly failed to manage such conflicts effectively or at all and recklessly failed to ensure that AFP followed conflict management and recording procedures.

Separation of decision making between the UK Funds and Guernsey cells

- 4.84. In his role as CEO of AFP, Mr Farrell was responsible for the overall operation of AFP's business, including its compliance with regulatory requirements. This included responsibility for ensuring, through appropriate conflicts management procedures, that non-public information in relation to certain of AFP's clients (the Guernsey cells) was appropriately separated from investment decision makers responsible for the UK Funds (other clients of AFP).
- 4.85. 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 information and knowledge between those involved in making investment decisions at UK Funds level and those involved in making investment decisions 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.

- 4.86. While external investors would only have known the 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.
- 4.87. 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. Mr Farrell 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.
- 4.88. Mr Farrell was aware of these risks through his membership of AFP's investment and risk committees. In his capacity as CEO, 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. This inadequate lack of separation was a key risk which Mr Farrell ought to have properly mitigated from January 2007, when AFP took on the role of investment manager to the Guernsey cells.

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 Farrell's conduct fell short of the FSA's regulatory standards for approved persons. Mr Farrell's conduct demonstrated a lack of integrity contrary to Statement of Principle 1 because he recklessly failed to manage conflicts of interest in respect of the four transactions referred to in this Decision Notice in

respect of which, as he knew, there was a risk that he, his business associates or AFP would benefit to the detriment of the Guernsey cells. At the very least, Mr Farrell should have ensured that he and AFP fully disclosed the extent and nature of the conflicts, for example by disclosing to the non AFP Guernsey cell directors sufficient information, prior to transactions taking place, to enable them to give informed consent to the transaction taking place. Mr Farrell recklessly ignored specific advice that was provided to AFP in August 2007, that transactions should be properly documented, with transparency as to the nature of the risks being run and a record of how the Firm reached a decision on the transaction.

5.3. During the Relevant Period, Mr Farrell's conduct fell short of the FSA's regulatory standards for approved persons. Mr Farrell's conduct demonstrated a lack of due care, skill and diligence and Mr Farrell therefore breached Statement of Principle 6. In particular Mr Farrell was instrumental in AFP setting up a structure which contained significant and in-built liquidity risks. Mr Farrell failed to aim to ensure that AFP provided a prudent spread of risk by adopting an investment strategy of allocating a majority of the UK Funds' assets into the Guernsey cells for which there was a limited secondary market. Mr Farrell did not properly manage the inherent liquidity risks arising from this strategy, for example by investing in easily realisable cash or cash equivalent investments. Investors were therefore exposed to the risk that the UK Funds would not be able to liquidate their holdings in the secondary market to meet redemption requests, a risk which crystallised in March 2009 resulting in the suspension of the UK Funds.

5.4. Further, during the Relevant Period, Mr Farrell failed to take reasonable steps to ensure that the business of AFP for which he was responsible in his controlled function complied with the relevant requirements and standards of the regulatory system, with regard to conflicts management. Mr Farrell therefore breached Statement of Principle 7. Mr Farrell failed effectively to manage conflicts of interests by not putting in place adequate systems and controls in respect of recording and, where necessary, disclosing the conflicts in order to ensure and demonstrate that the risks had been properly considered and mitigated by AFP. In order to manage these conflicts fairly, it was not sufficient for Mr Farrell to rely on the inadequate conflict

management process AFP did have in place. There should have been a formal conflict procedure which provided for adequate review of documented conflicts within the Firm.

- 5.5. With regard to the lack of segregation of non-public information, separate and distinct investment committees should have been set up from the outset, and controls placed over the provision of indicative prices to market makers, given that the Guernsey cells were intended by AFP to be marketed to outside investors. Mr Farrell's failure to take steps, prior to December 2008, to do this constituted a breach of Statement of Principle 7.

6. SANCTION

- 6.1. The FSA's policy on the imposition of financial penalties and public censures is set out in Chapter 6 of DEPP, which forms part of the FSA Handbook and came into force on 28 August 2007. It was previously set out in Chapter 13 of 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 a public censure 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.
- 6.3. Mr Farrell earned £211,000 during the Relevant Period from his role at AFP. Furthermore, Mr Farrell made a capital gain/profit of £2,044,514 on the sale of some of his AGL shares during the Relevant Period. The Investigation Team notes that £492,364 of this gain/profit resulted from sales of AGL shares to the Guernsey cells, a transaction in which Mr Farrell was personally conflicted and had considerable

involvement, including involvement in valuations which ultimately determined his own personal gain.

The nature, seriousness and impact of the breach

- 6.4. 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.
- 6.5. 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

- 6.6. In relation to Mr Farrell's behaviour in breach of Statement of Principle 1, the FSA considers that Mr Farrell recklessly contravened regulatory requirements and acted without integrity.

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

- 6.7. Having reviewed the material provided by Mr Farrell regarding his financial position, the FSA considers that payment of the financial penalty may cause him serious financial hardship or financial difficulties. However, the FSA considers that reducing the financial penalty would reduce its deterrent effect. The need for the seriousness of Mr Farrell's breaches to be publicly recognised outweighs the potential consequences for Mr Farrell.
- 6.8. Therefore, the seriousness of Mr Farrell's misconduct is such that, in all the circumstances, it is necessary for a financial penalty of £650,000 to be imposed.

Disciplinary record and compliance history

- 6.9. Mr Farrell has not previously been the subject of disciplinary action by the FSA.

Other action taken by the FSA

- 6.10. 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

- 6.11. For the reasons set out above, the FSA considers that Mr Farrell 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 £650,000.
- 6.12. Further, the FSA considers that Mr Farrell 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 Farrell'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 Farrell 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 Farrell's representations, whether or not set out below.

General points

- 7.2. Mr Farrell made representations that:

- (1) he had not breached any of the FSA's Statements of Principle. In particular, Mr Farrell 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 Farrell. 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) he had never held the position of ‘Chief Investment Officer’ or ‘Head of Investments’ at AFP.

7.3. The FSA has found that:

- (1) Mr Farrell 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 Farrell 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 Farrell; and
- (3) the material relied on by the FSA includes references indicating that Mr Farrell was held out (internally) as ‘Chief Investment Officer’ and (externally) as ‘Head of Investments’.

Liquidity and spread of risk

7.4. Mr Farrell made representations that:

- (1) the investment strategy of allocating the majority of the UK Funds’ investment to the Guernsey cells did not have ‘inbuilt liquidity risks’. Any strategy would have liquidity considerations, but AFP recognised

the need to provide adequate liquidity, and did so. AFP reasonably considered that it was in the best interests of the UK Funds to allocate significant scheme property into the transferrable securities of the Guernsey cells which were set up for that purpose and provided diversified and differentiated exposure to a broad spectrum of assets. The UK Funds and Guernsey cells also had investment limits which ensured that risk was spread. The setting up of the structure did not display a lack of due skill, care and diligence. It was adopted and implemented following careful planning and consideration, including professional advice given to AFP. The structure was made known to the ACD and the FSA, who raised no objections. It fully complied with the requirements of COLL and all other relevant rules;

- (2) the secondary market trading of the Guernsey cells was not limited. The CISX is a recognised market, there was material trading of the Guernsey cells by third parties, and it was growing over time. Besides the secondary market, the Guernsey cells also increased liquidity by issuing new shares from time to time. Only the inappropriate use of hindsight in the wake of the global financial crisis supports an allegation of failing to aim to provide a prudent spread of risk. The severity of the crisis was not a known risk in advance, even if the crisis itself was. Any issues were exaggerated by the advent and impact of the global financial crisis and by a massive reduction in the availability of generally available external investment and a connected contraction in liquidity;
- (3) the risk that the UK Funds may not be able to liquidate their holdings in the Guernsey cells in the secondary market to meet potential redemption requests had been considered, and was prudently managed, by AFP. The risk never crystallised and was still capable of proper and effective management at the time immediately prior to suspension. That would have remained the case had the UK Funds not been suspended. There was sufficient liquidity to allow the funds to continue trading and plans to manage liquidity proactively were being formulated and reviewed on a

constant basis from late August 2008, following the extreme currency movements at that time. The suspension was not supported by AFP and was not warranted as other avenues were available to generate sufficient cash within the UK Funds to meet any potential redemption requests. These included the sale of assets at the UK Fund or Guernsey cell level as well as injections of new capital at both levels; and

- (4) at all times AFP aimed to provide a prudent spread of risk and, as far as it was able to, it achieved this aim.

7.5. The FSA has found that:

- (1) Although the broad nature of the investment objectives and prospectuses of the UK Funds allowed direct investment in transferable securities such as those of the Guernsey cells, the investment strategy adopted by AFP plainly did have inbuilt liquidity risks, as it involved concentration of funds in the Guernsey cells. The fact that the structure was known to the ACD and the FSA did not absolve AFP of its responsibility to aim to provide a prudent spread of risk. The substantial and continuing investment of the UK Funds in the Guernsey cells indicates that AFP did not seek to ensure that the UK Funds held diversified assets with varying exposures to liquidity risk;
- (2) the Guernsey cells' shares had few other investors and a limited and, for some Guernsey cells, completely untested secondary market and a primary market that did not demonstrate sufficient additional demand related to the liquidity needs of the UK Funds. Although the severity of the financial crisis may not have been anticipated, this did not affect the fact that the strategy adopted by AFP did not aim to provide a prudent spread of risk;
- (3) AFP did not take reasonable steps to manage liquidity and cash levels in the UK Funds, and its response to falling cash balances and market instability did not display due skill, care and diligence. There was an insufficient cash buffer and the potential sources of additional liquidity

were insufficiently certain and/or sizeable to generate sufficient liquidity as and when required. The liquidity risk did crystallise – the FSA has seen no evidence that the suspension of the UK Funds was unwarranted; and

- (4) in all the circumstances AFP failed to aim to provide a prudent spread of risk.

Management of conflicts of interest

7.6. Mr Farrell 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 Farrell's alleged failings and the losses suffered by investors. Therefore the risk alleged had to be regarded as effectively managed;
- (3) AFP, and Mr Farrell, never put their interests above the interests of investors. AFP 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, Mr Farrell or their 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.

7.7. The FSA has found that:

- (1) as set out in this Decision Notice, Mr Farrell and AFP did not manage conflicts of interest fairly. AFP's 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 Farrell'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

7.8. In relation to all four transactions, Mr Farrell 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 Mr Farrell, nor 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 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.

7.9. 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 Farrell'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 Mr Farrell and AFP's failure to manage conflicts fairly, there was a clear risk that Mr Farrell, 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 Farrell 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

7.10. Mr Farrell 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.

7.11. 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

7.12. Mr Farrell 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.

7.13. 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

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

- (1) AFP was not required to inform the Guernsey cell directors each time the loan facility was increased. AFP exercised its discretion appropriately; and
- (2) investments in Cru did not increase the funds under management on the basis of which AFP's fees were calculated.

7.15. The FSA has found that:

- (1) 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
- (2) 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

7.16. Mr Farrell 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 Farrell 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.

7.17. 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) Mr Farrell and 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

7.18. Mr Farrell made representations that:

- (1) AFP's investment decision making structure was not flawed. Mr Farrell 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.

7.19. 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.

Sanction

7.20. Mr Farrell made representations that:

- (1) AFP consistently acted in accordance with its contractual and regulatory obligations, as did Mr Farrell. 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 Farrell, 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 Farrell 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 Farrell 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 Farrell'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 Farrell's failings is a relevant factor – the large number of investors who were subject to that risk increased the seriousness of Mr Farrell's failings;
- (2) all of the relevant circumstances have been taken into account in determining the appropriate penalty. The FSA accepts that Mr Farrell 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 Farrell is consistent with the penalties imposed in previous cases, taking into account the seriousness of Mr Farrell's misconduct; and
- (4) although payment of the financial penalty may cause Mr Farrell serious financial hardship, the seriousness of his misconduct is such that, in all

the circumstances, it is necessary for a financial penalty of £650,000 to be imposed.

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 Farrell 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 Farrell 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 provision, 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 an 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 main provisions relevant to the action specified above are set out below.

Statements of Principle and the Code of Practice for Approved Persons

- 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 6 states that: *“An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function”*.
- 15.5. 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 this controlled function complies with the relevant standards of the regulatory system.”*
- 15.6. 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.
- 15.7. 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.
- 15.8. 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.
- 15.9. 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.
- 15.10. 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”*.

15.11. 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”

15.12. 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...”*

15.13. 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.

15.14. 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

- 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

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 was 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 4.49 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 2.11(1)(b) of this Decision Notice
- (12) The “Company A Acquisition” is defined in paragraph 4.50 of this Decision Notice
- (13) “Company B” is defined in paragraph 4.71 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 4.55 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