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**FINAL NOTICE**

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To: Barclays Capital Securities Limited (Barclays Capital or the Firm)

Of: 5 The North Colonnade  
London  
E14 4BB

FSA Reference No: 124431

Date: 24 January 2011

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) gives you final notice about a requirement to pay a financial penalty:**

**1. THE PENALTY**

- 1.1. The FSA gave Barclays Capital Securities Limited (“Barclays Capital” or “the Firm”) a Decision Notice on 17 January 2011 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA had decided to impose a financial penalty of £1,127,559 on Barclays Capital in respect of a breach of Principle 10 (Clients’ assets) of the FSA’s Principles for Businesses (“the Principles”) and breaches of the related FSA rules contained in the Client Assets sourcebook (“CASS”) (set out in Appendix 1 and referred to collectively in this Final Notice as the “Client Money Rules”). The breaches occurred between 1 December 2001 and 29 December 2009 (the “Relevant Period”).
- 1.2. Barclays Capital confirmed on 17 January 2011 that it will not be referring the matter to the Upper Tribunal (Tax and Chancery Chamber).
- 1.3. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on Barclays Capital in the amount of £1,127,559.

- 1.4. Barclays Capital agreed to settle this matter at an early stage of the FSA's investigation and received a 30% (Stage 1) reduction in financial penalty under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £1,610,799.
- 1.5. In this type of case, the FSA considers an appropriate approach is to calculate the financial penalty by reference to a number of factors, including the amount of client money held. The penalty (before Stage 1 discount) is equivalent to 1% of the average daily amount of unsegregated client money held by Barclays Capital over the Relevant Period.

## **2. REASONS FOR THE ACTION**

- 2.1. The principal objective of the Client Money Rules is to ensure that client money is adequately protected. A fundamental requirement is that firms must keep client money separate from firm money in segregated client accounts or money market deposits with the firm's trustee obligations acknowledged. This ensures that client money is safeguarded and ring-fenced, to the extent possible, in the event of insolvency of a firm.
- 2.2. The FSA has imposed a financial penalty on Barclays Capital for failing to arrange adequate protection for clients' assets when it was responsible for them intra-day in breach of Principle 10. Specifically, Barclays Capital failed to segregate client money placed on GBP money market deposits intra-day in a segregated trust account, instead co-mingling the client money with its own funds throughout the Relevant Period. The funds were segregated overnight throughout the Relevant Period.
- 2.3. Barclays Capital also breached CASS Rules 7.4.11R and 7.3.2R and the previous applicable versions of these rules as set out in Appendix 1.
- 2.4. The FSA views these failings as particularly serious because:
  - a) Barclays Capital has a leading market presence both in the United Kingdom and globally;
  - b) the failure to segregate and, therefore, adequately protect client money intra-day in accordance with the Client Money Rules remained undetected for over eight years; and
  - c) during the Relevant Period:
    - i. the average daily amount of client money which was not segregated on an intra-day basis held on an annual basis increased from approximately £6 million in 2002 to approximately £387 million in 2009; and
    - ii. the highest amount held in the account and at risk at any one time was £752 million.

- 2.5. Barclays Capital's failure to segregate client money intra-day for over eight years posed a significant risk of loss to its clients in the event that Barclays Capital became insolvent intra-day during the Relevant Period. If Barclays Capital had become insolvent intra-day there was the risk that its clients would have been classed as general unsecured creditors in the insolvency process rather than having the right to claim their money from a pool of protected client money. Further, in the event of Barclays Capital's insolvency, the co-mingling of client money and Barclays Capital's own funds would have hindered the ability to accurately trace client money. Consequently, the likelihood of such clients recovering their money in the event of the insolvency of Barclays Capital would have been reduced.
- 2.6. Barclays Capital's failures therefore merit the imposition of a significant financial penalty. In determining the level of financial penalty, the FSA has taken into account a number of factors, including:
- a) only one of the client money market accounts used by Barclays Capital was affected;
  - b) upon discovery of the issue by Barclays Capital, the Firm corrected the situation promptly;
  - c) Barclays Capital instigated a review of its compliance with Client Money Rules at its own initiative (the "CASS Review");
  - d) the failure to segregate client money did not result in any incorrect financial reporting by Barclays Capital during the Relevant Period or in any loss to clients of Barclays Capital;
  - e) the FSA does not consider that Barclays Capital committed the breach deliberately or recklessly; and
  - f) Barclays Capital co-operated fully with the FSA during its investigation.

### **3. RELEVANT STATUTORY AND REGULATORY PROVISIONS**

- 3.1 The FSA's statutory objectives set out in section 2(2) and section 3 of the Act include maintaining market confidence in the financial system.
- 3.2. Section 206 of the Act provides:
- "If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such an amount as it considers appropriate."*
- 3.3. The FSA's Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rules making power as set out in the Act and reflect the FSA's regulatory objectives.
- 3.4. Principle 10 states:
- "A firm must arrange adequate protection for clients' assets when it is responsible for them."*
- 3.5. The related Client Money rules referred to in paragraph 1.1 are set out in Appendix 1.
- 3.6. The FSA's approach to exercising its enforcement powers is set out in the Decision

Procedure and Penalties manual (“DEPP”) and Enforcement Guide (“EG”). As this matter relates to events prior to the introduction of EG and DEPP, the FSA has also had regard to the previous relevant policies set out in the Enforcement Manual (“ENF”).

#### **4. FACTS AND MATTERS RELIED ON**

##### **Background**

- 4.1. Barclays Capital is a wholly owned subsidiary of Barclays Bank PLC (“BBPLC”) and is part of the investment banking division of BBPLC.
- 4.2. Since 1 December 2001, Barclays Capital has been regulated and authorised by the FSA to hold and control client money. It is required to do so in accordance with the provisions of the FSA’s Client Assets Sourcebook (“CASS”) and before that the Conduct of Business Sourcebook (“COB”) (see Appendix 1). In particular, Barclays Capital is required, under CASS 7.4.11R, to hold client money in segregated client accounts with authorised credit institutions and banks. Barclays Capital’s client money is held in segregated accounts at BBPLC. Barclays Capital is also required, under CASS 7.3.2R, to put in place arrangements to minimise the risk of loss of client money, or of rights associated with client money.

##### **The nature of the segregation issue**

- 4.3. On a daily basis, following completion of the client money calculation, Barclays Capital segregates client money with its parent, BBPLC, overnight.
- 4.4. From the initial set up of the GBP client money market deposit account on 3 February 1999 until 29 December 2009, the GBP client money market deposit account within Barclays Capital (“GBP client money market account”) was segregated overnight. However, the deposits were set up to auto-mature the following morning (before 9:00 am), whereby the funds flowed back into Barclays Capital’s corporate account with BBPLC (“the Corporate Account”). The GBP client money then remained in the Corporate Account for between five and seven hours each day until the GBP denominated client money was calculated and segregated again at the end of the day and placed overnight.
- 4.5. The Corporate Account did not have trust status in place and co-mingled Barclays Capital’s own funds and client money. The Corporate Account was also used by Barclays Capital during the day to make and receive payments. As a result, GBP denominated client money auto-maturing into the Corporate Account was mixed on a daily basis with Barclays Capital’s own funds, typically for between five and seven hours, on an intra-day basis. In the event of the intra-day insolvency of Barclays Capital, the daily co-mingling of client money in the Corporate Account would have potentially inhibited the tracing of client money.
- 4.6. Since March 2008, Barclays Capital had a combination of GBP and USD denominated client money markets deposits. The failings identified by the FSA relate solely to the GBP denominated client money market deposits. The USD denominated client money market deposits were segregated both inter-day and intra-day throughout the Relevant Period.

### **Identification of the segregation issue**

- 4.7. In late 2009 Barclays Capital initiated the CASS Review, which was its own review of compliance with the FSA's CASS requirements.
- 4.8. The initial stage of the CASS Review included an exercise to map CASS related processes and controls from both the Barclays Capital and BBPLC perspectives. During the course of reviewing the front to back processes for the GBP and USD segregation processes, Barclays Capital identified an inconsistency in the booking conventions used for the GBP and USD denominated overnight client money market deposits. It was noted that the GBP money market deposit within Barclays Capital was set up to auto-mature the following morning into the corporate account whereas the USD money market deposit was not.

### **Escalation of the segregation issue**

- 4.9. Following discovery of the segregation issue, Barclays Capital CASS Review project team decided to change the GBP client money market account process by bringing it into line with the process used for the USD money market deposit. The process change was approved on 23 December 2009 and implemented on 29 December 2009, immediately following the Christmas break. The inconsistency in the GBP and USD money market deposit process and subsequent process changes were not escalated to senior management within Barclays Capital at this time. The FSA was therefore not notified of the issue at this time.
- 4.10. In response to the FSA's Dear CEO letter dated 19 January 2010 and accompanying Client Money & Asset report, Barclays Capital appointed external consultants in February 2010 to undertake a quality assurance review of the work completed by Barclays Capital and to provide technical advice.
- 4.11. On 4 March 2010 the external consultants advised senior management within Barclays Capital that the historic auto-maturing process for the GBP client money market account deposit resulted in a lack of intra-day segregation and constituted a breach of the FSA's CASS rules. Senior management immediately instigated an investigation into the structure and operation of the historic and current client money bank accounts and notified the FSA about the segregation issue on 17 March 2010.

### **Impact of the segregation issue**

- 4.12. From the point of set up of the GBP client money market account overnight deposit account, the timing of the GBP money market deposit placement and maturing processes were such that client money was co-mingled with Barclays Capital funds each day for approximately five to seven hours and not segregated in accordance with the FSA's CASS rules. In March 2008 the USD client money market overnight deposit account was introduced by Barclays Capital. Since the USD client money market deposit account was not set up to auto-mature it was not affected by the same issue as the GBP client money market account.

- 4.13. The amount of client money that was not segregated intra-day ranged from £1.6 million to £752 million during the Relevant Period. The average daily amount of unsegregated client money held on an annual basis increased throughout the Relevant Period from approximately £6 million in 2002 to approximately £387 million in 2009.

## **5. SANCTION**

- 5.1 The FSA's policy on the imposition of financial penalties and public censures is set out in DEPP and EG. In determining the financial penalty, the FSA has had regard to this and to the provisions of ENF that were in force during the Relevant Period.
- 5.2. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms that have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.
- 5.3. For the reasons set out above, the FSA considers that Barclays Capital breached Principle 10 and the CASS Rules. In determining that the financial penalty is appropriate and proportionate in this case, the FSA has considered all the relevant circumstances. The FSA considers the following factors to be particularly important.

### **Deterrence**

- 5.4. The FSA has always viewed compliance with its client money requirements as of significant importance. The FSA considers there is a need to send a strong and robust message to the industry that firms must handle client money in a way that is compliant with CASS Rules and the FSA's Principles. In particular, firms must ensure that client money is segregated at all times, both intra- and inter-day, thereby affording some protection to clients in the event of a firm's insolvency.
- 5.5. Barclays Capital is a wholly-owned subsidiary of BBPLC, and has a leading market presence both in the United Kingdom and globally. Barclays Capital was fully aware of the obligations placed on it by the CASS Rules and understood the importance of segregating client money.

### **Seriousness and impact of the breach**

- 5.6. The FSA has had regard to the seriousness of the breach including the nature of the requirements breached and the duration of the breach. The FSA considers Barclays Capital's breach of Principle 10 and breaches of the CASS Rules to be particularly serious for the following reasons:
- a) in the event of the insolvency of Barclays Capital, the risk to unsegregated client money held by it intra-day was significant. The average amount of unsegregated client money held on an annual basis increased throughout the Relevant Period, from approximately £6 million in 2001 to approximately £387 million in 2009. At its peak, the highest amount that was unsegregated at any one time was £752 million;
  - b) the segregation error remained undetected by Barclays Capital for in excess of eight years and client money was, therefore, at risk intra-day throughout the Relevant Period; and
  - c) Barclays Capital did not notify the FSA of the intra-day segregation failure

until two and a half months after it was initially identified and remedied.

- 5.7. Although no client of Barclays Capital suffered any loss as a consequence of the segregation error, significant amounts of client money were put at risk of financial loss for five to seven hours each day during the Relevant Period. The principal purpose of the segregation requirement under the Client Money rules is to protect client money in the hands of a third party in the event of the insolvency of the third party. Where client money is not segregated, such protection is lost and the purpose of Principle 10 and the CASS Rules is defeated. Crystallisation of risk is therefore irrelevant in assessing the seriousness of a CASS breach, since the CASS Rules are intended to prevent such risk crystallising in the first place.

**The extent to which the breach was deliberate or reckless**

- 5.8. The FSA does not consider that Barclays Capital committed the breach deliberately or recklessly.

**The size, financial resources and other circumstances of the firm**

- 5.9. In deciding the level of penalty, the FSA has had regard to the size of the financial resources of Barclays Capital and the wider BBPLC group. The FSA has no evidence to suggest that Barclays Capital is unable to pay the financial penalty.

**The amount of profits accrued or loss avoided**

- 5.10. Barclays Capital did not profit from, or avoid losses as a result of, the breach.

**Conduct following the breach**

- 5.11. Following discovery of the segregation issue in December 2009, Barclays Capital corrected the situation promptly. However, Barclays Capital did not inform the FSA of the issue until 17 March 2010, some two and a half months later.
- 5.12. Barclays Capital has cooperated fully, working with the FSA to facilitate an early settlement of this matter.

**Disciplinary record and compliance history**

- 5.13. In August 2009, the FSA took enforcement action against Barclays Capital for failures concerning transaction reporting, imposing a financial penalty of £2.45 million. Whilst the subject matter of the previous case is not directly related to the current action, the FSA has had regard to this when considering the sanction in the current case.

**Other action taken by the FSA**

- 5.14. In determining the level of financial penalty, the FSA has taken into account the penalties imposed by the FSA on other authorised persons for similar behaviour.

**Conclusion**

- 5.15. The FSA considers that the seriousness of Barclays Capital's breach of Principle 10 and the CASS Rules merits a significant financial penalty. In determining the financial penalty the FSA has considered the need to send a clear message to the industry of the need to ensure that client money is properly segregated at all times, both intra- and inter-day, in accordance with the relevant rules and that failure to do so will result in severe consequences.

- 5.16. The FSA considers, taking into account the applicable Stage 1 discount for early settlement, that a financial penalty of £1,127,559 million is appropriate. This figure has been arrived at by reference to all of the factors above, in particular, the amount of client money held in respect of the GBP client money market account, and the failure of Barclays Capital to segregate client money held by it intra-day for over eight years.
- 5.17. The penalty also takes account of the mitigating factors set out above, in particular Barclays Capital's co-operation with the FSA following discovery of the breach. Before the Stage 1 discount, the penalty is equivalent to 1% of the daily average amount of unsegregated client money held by Barclays Capital in respect of the GBP client money market account over the Relevant Period.

## **6. DECISION MAKER**

- 5.1 The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers on behalf of the FSA.

## **7. IMPORTANT**

- 7.1. This Final Notice is given to Barclays Capital in accordance with section 390 of the Act.

### **Manner of and time for Payment**

- 7.2. The financial penalty must be paid in full by Barclays Capital to the FSA by no later than 9 February 2011.

### **If the financial penalty is not paid**

- 7.3. If all or any of the financial penalty is outstanding on 9 February 2011, the FSA may recover the outstanding amount as a debt owed by Barclays Capital and due to the FSA.

### **Publicity**

- 7.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to Barclays Capital or prejudicial to the interests of consumers.

### **FSA contacts**

- 7.5. For more information concerning this matter generally, you should contact Samantha Carruthers (Tel: 020 7066 0174) of the Enforcement and Financial Crime Division of the FSA.

**William Amos**

**Head of Department**

**FSA Enforcement and Financial Crime Division**

**APPENDIX 1: RELEVANT CLIENT MONEY RULES**



- 1.1. Conduct of Business Rule 9.3.37R, in force from 1 December 2001 to 31 March 2004, states:

*“A firm must, except to the extent permitted by the client money rules, hold client money separate from the firm’s money.”*

- 1.2. Client Assets Rule 4.3.3R, in force from 1 April 2004 to 31 October 2007, states:

*“A firm must, except to the extent permitted by the client money rules, hold client money separate from the firm’s money.”*

- 1.3. Client Money Rule (“CASS”) 7.4.11R, in force from 1 November 2007 onwards, states:

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

- 1.4. CASS 7.3.2R, in force from 1 November 2007 onwards, states:

*“A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence.”*