Financial Conduct Authority

FINANCIAL CONDUCT AUTHORITY

FINAL NOTICE

To:	**Catalyst Investment Group Limited**
Address:	**68 Lombard Street** **London** **EC3V 9LJ**
FRN:	**197230**
Date:	**30 September 2013**

1. ACTION

1.1. For the reasons given in this Notice, were it not for Catalyst's financial position, the Authority would have imposed on Catalyst a financial penalty of £450,000 and pursuant to section 205 of the Financial Services and Markets Act 2000, the Authority has decided to publish a statement to the effect that Catalyst has contravened regulatory requirements. This action is in respect of breaches of Principles 1 and 7 of the Authority's Principles for Businesses which occurred between 19 November 2007 and 26 May 2010. This public censure will be issued on 30 September 2013 and will take the form of this Final Notice, which will be published on the Authority's website.

2. SUMMARY OF REASONS

2.1. During the relevant period, Catalyst was the primary distributor of ARM bonds in the UK. ARM bonds were structured products issued by a Luxembourg entity, ARM, the underlying assets of which are senior life settlements purchased in the United States. ARM bonds were issued to the public in quarterly tranches from about October 2007 to October 2009.

2.2. Catalyst promoted and distributed ARM bonds to investment intermediaries and independent financial advisers in the UK, who in turn promoted and sold them to retail investors. Between May 2007 and May 2010, Catalyst issued around 16

financial promotions relating to the ARM bonds to IFAs, consisting of brochures promoting the ARM bonds.

2.3. By 19 November 2007, ARM had formed the view that, under Luxembourg law, it needed a licence from the Luxembourg financial regulator, the CSSF, to continue to issue the ARM bonds, as inter alia it fell within the CSSF's interpretation of issuing on a "continuous basis". Catalyst became aware by 19 November 2007 of this and that ARM did not have such a licence. ARM applied to the CSSF for a licence in July 2009.

2.4. Between July 2009 and June 2010, the CSSF made a series of requests to ARM for further information relating to its application for a licence. On 20 November 2009, the CSSF requested that ARM cease issuing bonds pending a decision on the licence application. On 29 August 2011 (after the relevant period), the CSSF, having indicated to ARM previously that it was minded to reject ARM's application, formally did so. One consequence of the refusal of a licence under Luxembourg law is that the issuer of the bonds must be liquidated.

Principle 1

2.5. Catalyst did not conduct its business with integrity, in breach of Principle 1, in the following respects. Between 20 November 2009 and 26 May 2010 (when the Authority issued a First Supervisory Notice requiring Catalyst to cease promoting and arranging investments in the ARM bonds), Catalyst continued to promote bonds purportedly to be issued by ARM, and to arrange for the acceptance of funds from investors, without ARM's regulatory position being clearly disclosed to investors, after it became aware on about 20 November 2009 that the CSSF had requested that ARM not issue any further bonds, pending a decision on its application for a licence. Catalyst's conduct demonstrated a reckless disregard for the interests of investors.

2.6. Catalyst also sent letters to IFAs in December 2009 and investors in March 2010, which presented an unfair and misleading picture of ARM's regulatory position. The letters suggested that ARM's application for a licence was voluntary and omitted to disclose the risk of liquidation of ARM if the licence was not obtained. In addition the March 2010 letter suggested that either obtaining the ARM licence or relocating to Ireland would be quick to achieve.

2.7. These letters were sent after Catalyst became aware in November 2009 that ARM would not be issuing bonds unless and until its licence application was approved. In sending these letters, Catalyst showed a reckless disregard for the interests of investors.

Principle 7

2.8. Catalyst failed to pay due regard to the information needs of its customers and to communicate information to them in a way which was clear, fair and not misleading, in breach of Principle 7, in the following respects:

(1) Catalyst distributed misleading financial promotions to IFAs which failed to state (from 19 November 2007) Catalyst's view that ARM required a licence from the CSSF to issue bonds.

(2) Catalyst did not reassess or amend its financial promotions at any time from 19 November 2007 to reflect ARM's true regulatory position or the regulatory risk associated with ARM and the ARM bonds. From 20 November 2009, Catalyst knew that ARM would not issue any new bonds

unless and until the CSSF granted it a licence. Further, from 24 December 2009, Catalyst knew that one potential consequence for ARM of not obtaining a licence was liquidation. Catalyst should have reviewed all of its financial promotions to make sure that they stated these issues. Catalyst failed to do this and did not amend its financial promotions to ensure that they were clear, fair and not misleading, and gave an accurate picture of ARM's regulatory position.

2.9. As a result of Catalyst's breaches outlined above, investors in ARM bonds were exposed to risks of which they were not made aware, and may have suffered loss.

2.10. UK retail investors have invested £17.1 million in tranches 9 to 11 of the intended ARM bonds to be distributed by Catalyst. As no further bonds were issued by ARM after October 2009, and the legal ownership of the funds held by third party receiving agents is unclear, these investors are at risk of losing a significant part of their investment. The extent of any loss is currently unknown.

2.11. The Authority considers that the nature and seriousness of Catalyst's breaches would have warranted a financial penalty of £450,000, were it not for Catalyst's financial position. In the circumstances the Authority has decided to publish a statement to the effect that Catalyst has contravened regulatory requirements.

3. DEFINITIONS

3.1. The definitions below are used in this Final Notice:

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

"ARM" means ARM Asset Backed Securities SA;

"ARM bonds" means the ARM Capital Growth Bond and the ARM Assured Income Plan;

"ARM plc" means Assured Risk Mitigation plc;

the "Authority" means the body corporate formerly known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

"Catalyst" means Catalyst Investment Group Limited, company number 04031316;

"CSSF" means the Commission de Surveillance du Secteur Financier, the Luxembourg financial regulator;

the "December 2009 letter" means the letter from Catalyst to IFAs of around 30 December 2009;

"DEPP" means the Authority's Decision Procedures and Penalties manual;

"EG" means the Authority's Enforcement Guide;

"Handbook" means the Authority's Handbook of Rules and Guidance;

"IFA" means independent financial adviser;

the "March 2010 letter" means the letter from Catalyst to investors of around 26 March 2010;

"Principle" means one of the Principles set out in PRIN 2.1.1 R (Principles for Businesses);

"relevant period" means the period from 19 November 2007 to 26 May 2010;

"TLPI" means traded life policy investments.

4. FACTS AND MATTERS

Background to Catalyst

4.1. Catalyst was incorporated in England and Wales on 11 July 2000. It has been authorised by the Authority since 1 December 2001 to undertake regulated activities.

4.2. Over the relevant period, Catalyst engaged in a wide range of investment business activities, including distributing the ARM bonds into the UK market. The ARM bonds are bonds backed by TLPI; the underlying investment is in US life insurance policies.

4.3. ARM is a Luxembourg incorporated securitisation vehicle which at all material times has not been authorised or regulated by the Authority or any other national regulator. The ARM bonds were listed on the Irish Stock Exchange.

4.4. Catalyst was the primary distributor of ARM bonds in the UK, marketing them to retail investors via investment intermediaries and IFAs, who might give advice and/or facilitate sales to retail clients. Catalyst did not give advice or sell the ARM bonds directly to retail customers and was not authorised to do so.

4.5. Catalyst designed, approved and distributed to IFAs marketing materials and information about the ARM bonds, in the form of financial promotions. Many of these financial promotions were designed to be passed to prospective retail investors and used to inform the IFAs in order to provide advice to their customers.

4.6. Timothy Roberts has been a director and the principal shareholder of Catalyst from 30 September 2005. Mr Roberts has also been a director of ARM from 12 March 2007 onwards.

Traded life policy investments and the ARM bonds

4.7. TLPI are products whose underlying investment is in life insurance policies, of which the insureds are typically US citizens. The investor purchases a life insurance policy from the insured person for a lump sum. The investor pays the premiums on the policy for the remainder of the insured's lifetime, and benefits from the insurance payout on the death of the insured.

4.8. TLPI are complex and high risk investments that the Authority considers as being unsuitable for the mass retail market. Certain of the risks were noted in the materials produced by Catalyst. For example, the ARM brochures state "*Participation in the [ARM bond] may involve substantial risks and is suitable only for investors who have the knowledge and experience in financial and business matters necessary to enable them to evaluate the risks, tax implications and merits of such an investment*". The brochures listed, among the potential risks of

the product: the limited resources of the issuer; limited liquidity and an illiquid market for life insurance policies; the fact that ARM is not regulated; the fact that there had been no independent investigation into the assets backing the ARM bonds; and foreign exchange risk.

4.9. Between 2007 and 2010, ARM offered two types of TLPI bonds, the ARM Capital Growth Bond and the ARM Assured Income Plan, the latter paying regular interest to investors. Funds raised by the bonds were used to purchase TLPI policies. ARM transferred funds raised by the bond issue to a US trust based in Delaware to purchase life insurance policies of insured persons over 65 years old with a life expectancy of between three and 15 years. The policies are held and owned by the US trust.

4.10. The policy issuers (insurers) were required by contract to pay all maturity or sales proceeds of the policies held by the US trust to a "cash entitlement account" controlled by ARM on behalf of the bondholders.

4.11. ARM issued the bonds in tranches. A tranche would open for investment three months before bonds were issued. The tranche would close at the end of the three month period, and the bonds for that tranche would be issued to all those who had invested. The next tranche would then open for investment.

4.12. ARM bonds were issued to the public in quarterly tranches (tranches 1 to 8) from about October 2007 to October 2009.

4.13. Catalyst promoted tranches 9 to 11 to IFAs, and arranged for or effected the transfer of funds to the receiving agents pending the issue of tranches 9 to 11 from 1 October 2009 onwards, but the bonds for those tranches were never issued by ARM for the reasons set out below.

4.14. A total of £17.1 million was invested by UK retail consumers, and a further £1.2 million, US$1.3 million and €1.9 million was invested outside the UK, in tranches 9 to 11, even though no ARM bonds were issued for these tranches. The majority of these funds is still held in the accounts of the receiving agents, though some of the tranche 9 funds were sent to ARM and subsequently dispersed (including by making interest payments to investors in tranches 9 to 11 of £2 million).

Interaction with the Luxembourg financial regulator

4.15. Luxembourg law provides that securitisation undertakings which issue securities to the public on a continuous basis must be licensed by the Luxembourg financial regulator, the CSSF. One consequence of the CSSF refusing a securitisation undertaking's application for a licence is the liquidation of that firm.

4.16. ARM had formed the view by 19 November 2007 that it needed a licence from the CSSF to continue to issue bonds as it fell within the CSSF's interpretation of the definition of securitisation undertaking, inter alia because it issued bonds more than three times per year. Catalyst had this knowledge through Mr Roberts, Catalyst's controlling mind.

4.17. On that date, ARM engaged lawyers to apply to the CSSF for a licence, but no progress appears to have been made. On 9 July 2009, the CSSF wrote to ARM requesting it provide information to enable the CSSF to assess whether ARM's activities required a licence. ARM responded on 16 July 2009 that it believed its activities did need a licence from the CSSF, as it issued bonds to the public on a

continuous basis. On 23 July 2009, ARM belatedly submitted an application for a licence to the CSSF.

4.18. From this date, the CSSF made several requests for information to ARM about its business model and particularly the risks to investors posed by the bonds and the asset class.

4.19. On 1 October 2009 ARM issued the bonds which underlay tranche 8. It then opened tranche 9 for investment. On 20 November 2009, ARM was requested by the CSSF not to issue any more bonds, pending a decision from the CSSF on ARM's application for a licence.

4.20. Between 1 October 2009 (the date of issue of the last tranche of ARM bonds) and 26 May 2010 (when the Authority issued a First Supervisory Notice requiring Catalyst to cease promoting and arranging investments into ARM bonds), Catalyst arranged or effected the remittance of £17.1 million of UK investors' funds for intended tranches 9 to 11 of the ARM bonds.

4.21. By 24 December 2009, Catalyst became aware that one potential consequence of ARM failing to obtain a licence was ARM's liquidation.

4.22. On 9 June 2010, Catalyst notified the Authority that ARM had learned that the CSSF was minded to refuse its application for a licence but to allow ARM to transfer its operations to another jurisdiction, rather than issue a formal refusal.

Potential transfer of ARM's operations to Ireland

4.23. In early 2010, ARM decided to explore transferring its operations to Ireland, in parallel with continuing to seek a licence in Luxembourg. In January 2010, lawyers were instructed in Ireland to set up a "section 110 company" (that is, a company falling within the definition of section 110 of the Irish Taxes and Consolidation Act 1997) for this purpose. A section 110 company would normally be exempt from any requirement to be authorised by the Irish financial regulator in order to issue bonds. However, the section 110 company would still require approval from the Irish financial regulator for its prospectus and other aspects of its operation.

4.24. ARM plc was incorporated in Ireland and was intended to take over ARM's contracts with its various counterparties. The plan was for ARM's existing bondholders to exchange their ARM bonds for identical bonds to be issued by ARM.

4.25. By the end of the relevant period, ARM's operations had not been transferred to Ireland and this has not since been achieved. Trading in ARM securities was suspended and, on 29 August 2011, the CSSF issued its decision refusing ARM a licence. ARM has appealed that decision.

4.26. The position of investors is unclear: the pending investors in tranches 9 to 11 risk losing some or all of their investment, pending a decision on legal ownership of the funds. The position of the investors in tranches 1 to 8 is also unclear. They may lose some or all of their investment. None of the investors is currently receiving interest.

Financial promotions

4.27. At all material times since November 2007, the marketing brochures for ARM bonds issued by ARM and approved by Catalyst included the following statement:

> *"ARM is not regulated by the Financial Services Authority or any other regulator. This means that compensation will not be available from the Financial Services Compensation Scheme ("FSCS") if ARM is unable to meet its liabilities on the [bond] and you will not be able to refer a complaint against ARM to the Financial Ombudsman Service."*

4.28. This statement was correct but it was incomplete. At all times the brochures omitted to mention the full regulatory position: that ARM did not have a licence from the CSSF, but considered that it required one. The financial promotions issued after 20 November 2009 also did not state that ARM would not issue further bonds until its licence application had been successfully determined. Further, the financial promotions issued after 24 December 2009 did not disclose that one potential consequence for ARM (and investors) of not obtaining a licence was that ARM would be liquidated. In the circumstances the financial promotions were not clear, fair and not misleading, and gave an inaccurate picture of ARM's regulatory position.

Letters from Catalyst to IFAs and investors

4.29. On or about 30 December 2009, Catalyst wrote a letter to all IFAs who had sold the ARM bonds to customers. The December 2009 letter stated that:

> "*We are pleased to advise you that in order to offer investors further reassurance in this current climate, ARM… has made the decision to apply for authorisation from the…CSSF... Luxembourg's equivalent to the FSA in the UK …*
>
> *This process is in its final stages…The next issue date will be sometime before the 31st March 2010 although it is expected to be 1st February 2010*."

4.30. The December 2009 letter did not state that ARM was required to have a licence from the CSSF, nor the potential consequences should it fail to obtain one, which included the liquidation of ARM. It gave a latest date for the next issue of ARM bonds although ARM and Catalyst could not be certain whether or when further bonds could be issued.

4.31. On 26 March 2010, Catalyst wrote to investors in tranches 9 to 11 of the ARM bonds. The March 2010 letter informed investors of the interest which would be paid into their account for the preceding quarter. It went on to state:

> "*ARM is in the process of making some changes to its corporate structure which ARM believes will be in the best interests of the bondholders. As you are aware, the ARM Programme is listed on the Irish Stock Exchange and we are instructed that the ARM Board believes that it is advantageous for ARM to be either regulated in Luxembourg or have the issuer domiciled in Ireland, under the same organisation. ARM will initiate its next issue once these changes have been completed. We have been advised by ARM that it anticipates that this will take place shortly.*"

4.32. The March 2010 letter suggested that obtaining authorisation in Luxembourg was voluntary and did not state Catalyst's view that ARM required a licence from the CSSF in order to issue bonds in Luxembourg, nor the potential consequences for ARM should it fail to obtain one. It also suggested that the possible alternative of domicile in Ireland would be merely "advantageous", when in fact it was considered essential in order to avoid the potential risk of ARM being liquidated in the event that the CSSF was not prepared to grant a licence in Luxembourg.

5. FAILINGS

5.1. The statutory and regulatory provisions and policy relevant to this Final Notice are referred to in Annex A.

Principle 1

5.2. Catalyst did not conduct its business with integrity, in breach of Principle 1, in the following respects. Between 20 November 2009 and 26 May 2010, Catalyst continued to promote bonds purportedly to be issued by ARM, and to arrange for ARM to receive funds from investors for tranches 9 to 11, without ARM's regulatory position being clearly disclosed to investors, when it knew that ARM would not be issuing further bonds, pending the outcome of its application to the CSSF for a licence. This behaviour showed a reckless disregard for the interests of investors.

5.3. Catalyst also sent letters to IFAs in December 2009 and investors in March 2010 which presented an unfair and misleading picture of ARM's regulatory position. The December 2009 letter sent to IFAs explained that ARM had applied to the CSSF for a licence, and that the next ARM bond issue would be delayed until this had been approved, but that any investors' applications for a planned ARM bond issue on 1 January 2010 would still be valid for the delayed issue date. The December 2009 letter was misleading as it implied that ARM's application for a licence was voluntary rather than mandatory and by omitting to disclose the risk of liquidation of ARM if the licence was not obtained.

5.4. The December 2009 letter was sent after Catalyst became aware on 20 November 2009 that ARM would not be issuing bonds unless and until its licence application was approved. It did not mention that the CSSF had requested ARM to cease issuing bonds, and stated that the next issue had merely been delayed by agreement between ARM and the CSSF. As such, it did not give a clear, fair and not misleading picture of ARM's regulatory position and the risks of investing.

5.5. The March 2010 letter stated that it was "advantageous" for ARM to be regulated. Like the December 2009 letter, the March 2010 letter was misleading in that it did not set out Catalyst's view of the true regulatory position, namely that ARM was required under Luxembourg law to be authorised in order to issue the ARM bonds, nor did it refer to the potential consequences of its application for authorisation being unsuccessful. It also gave the impression that obtaining a licence or the alternative of a transfer to Ireland would be quick to accomplish and would inevitably succeed, which was not the case. As such, the March 2010 letter did not give a clear, fair and not misleading picture of ARM's regulatory position and the risks of investing.

5.6. In sending these letters, Catalyst showed a reckless disregard for the interests of investors.

Principle 7

5.7. Catalyst failed to pay due regard to the information needs of its customers and to communicate information to them in a way which was clear, fair and not misleading, in breach of Principle 7.

Financial promotions

5.8. Catalyst distributed misleading financial promotions, in that it failed accurately to state ARM's regulatory position and the regulatory risk associated with ARM and

the ARM bonds, in any of the financial promotions it issued from 19 November 2007 onwards.

5.9. The Authority considers that Catalyst should have amended its financial promotions to disclose this fact on learning that ARM took the view that it required a licence from the CSSF but did not have one. It did not do so.

5.10. From 20 November 2009, Catalyst knew that ARM would not issue any new bonds unless and until the CSSF granted it a licence. Further, from 24 December 2009, Catalyst knew that one potential consequence for ARM of failing to obtain a licence was liquidation. Catalyst should have reviewed all of its financial promotions to make sure that they stated these issues. Catalyst failed to do this and did not amend its financial promotions to ensure that they were clear, fair and not misleading, and gave an accurate picture of ARM's regulatory position.

6. SANCTION

6.1. The Authority's policy in relation to the imposition of a financial penalty or public censure is set out in Chapter 6 of DEPP which forms part of the Authority's Handbook. The regulatory provisions governing the determination of financial penalties changed on 6 March 2010, and the Authority has had regard to the fact that part of Catalyst's misconduct occurred after the new provisions came into force. However, as the majority of Catalyst's misconduct occurred before that change, the Authority has applied the penalty regime as set out in DEPP that was in place up to 5 March 2010. All references to DEPP in this section are references to the version that was in force up to and including 5 March 2010. The relevant provisions are set out in detail in Annex A.

6.2. The Authority has also had regard to the provisions of Chapter 7 of EG.

6.3. In determining whether a financial penalty is appropriate, the Authority is required to consider all the relevant circumstances of the case. DEPP 6.5.2G sets out a non-exhaustive list of factors which may be relevant to determining the appropriate level of financial penalty. The Authority considers that the following factors are particularly relevant in this case.

Deterrence: DEPP 6.5.2G(1)

6.4. When determining the level of penalty, the Authority has regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and 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)

6.5. The Authority has had regard to the seriousness of the breaches, the duration of the breaches and the risk of loss to consumers. The Authority considers Catalyst's breaches to be serious particularly in light of the risk of consumer loss occasioned by the breaches and the length of time over which the breaches occurred.

6.6. The Authority notes that Catalyst had adequate systems and controls in place for approving financial promotions but that these did not work in this case as they were not implemented appropriately.

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

6.7. The Authority considers that Catalyst's decision to continue promoting the ARM bonds and arranging the acceptance of investors' funds, even after ARM had been requested by the CSSF to cease issuing bonds, without ARM's regulatory position being clearly disclosed to investors, was reckless in that it disregarded the interests of investors. This put investors' money at risk. Catalyst was also reckless in sending misleading letters to IFAs in December 2009 and to investors in March 2010.

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

6.8. Catalyst made a gross profit of £4,679,295 in 2009 and £3,749,133 in 2010 as a result of promoting ARM investments.

6.9. In relation to its current circumstances, Catalyst has provided verifiable evidence it would suffer serious financial hardship if a financial penalty were imposed.

The amount of benefit gained or loss avoided: DEPP 6.5.2G(6)

6.10. Catalyst received significant benefits as a result of its breaches. Catalyst earned approximately £4.68 million gross profit in the year ending 31 December 2009, and £3.75 million gross profit in the year ending 31 December 2010, through commission on the ARM bonds and a monthly service charge received from ARM.

Conduct following the breach: DEPP: 6.5.2G(8)

6.11. Catalyst did not take steps of its own initiative to mitigate the risks posed to customers, once it became aware of the Authority's concerns about its conduct. Specifically, on 9 April 2010 the Authority requested Catalyst to voluntarily vary its Part IV permission to cease promoting ARM bonds to customers, pending the CSSF's decision on whether to grant ARM a licence. Catalyst refused to do so and continued to promote the ARM bonds until the Authority used its own initiative powers to prevent this.

Disciplinary record and compliance history: DEPP 6.5.2G(9)

6.12. The Authority has taken account of Catalyst's previous disciplinary record and general compliance history. In particular, in May 2010 the Authority used its own initiative powers to vary Catalyst's Part IV permission to prevent it from continuing to market ARM bonds and require it to contact investors giving full disclosure of ARM's regulatory position.

6.13. In addition, in May 2006 Catalyst received a private warning from the Authority relating to concerns that Catalyst had breached financial promotions rules.

Other action taken by the Authority: DEPP 6.5.2G(10)

6.14. In determining the appropriate level of financial penalty, the Authority has taken into account penalties imposed on other authorised firms for similar behaviour.

6.15. Having considered all the circumstances set out above, the Authority considers that £450,000 would be the appropriate financial penalty to impose on Catalyst.

However, taking into account Catalyst's financial position, the Authority has decided to publish a statement that Catalyst has contravened regulatory requirements.

7. REPRESENTATIONS

7.1. Annex B contains a brief summary of the key representations made by:

(1) Catalyst; and

(2) ARM, a third party identified in the reasons set out in this Notice, and to whom in the opinion of the Authority the matter is prejudicial;

and how they have been dealt with. In making the decision which gave rise to the obligation to give this Notice, the Authority has taken into account all of the representations made by Catalyst and ARM, whether or not set out in Annex B.

8. PROCEDURAL MATTERS

Decision maker

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

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

Publicity

8.3. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such a manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

Contacts

8.5. For more information concerning this matter generally, contact Anne Pike at the Financial Conduct Authority (direct line: 020 7066 8856 or by e-mail anne.pike@fca.org.uk).

Bill Sillett
Head of Department, Enforcement and Financial Crime Division

Annex A

Relevant regulatory provisions

1. The Act

1.1. The Authority's operational objectives are set out in section 1B of the Act and include securing an appropriate degree of protection for consumers.

1.2. If the Authority considers that an authorised person has contravened a requirement imposed on him by or under the Act, the Authority has the power, pursuant to sections 205 and 206 of the Act, to publish a statement to that effect or to impose a financial penalty of such amount as it considers appropriate.

2. The Principles

2.1. The Authority has published Principles which apply either in whole, or in part, to all authorised firms. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the Authority's regulatory objectives. A firm may be liable to disciplinary sanction where it is in breach of the Principles.

2.2. The Principles relevant to this matter (as at the relevant time) are:

(1) Principle 1 – a firm must conduct its business with integrity; and

(2) Principle 7 - a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

3. Relevant Handbook provisions

3.1. Guidance on the Authority's approach to penalties and public censures is set out in DEPP. DEPP came into effect on 28 August 2007.

3.2. The Authority's policy on the imposition and amount of penalties that applied for misconduct is set out in Chapter 6 of DEPP. DEPP is being applied as it stood prior to 6 March 2010 for the reasons set out in the body of this Notice. All references to DEPP in this section are references to the version that was in force up to and including 5 March 2010.

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

Financial penalty

3.4. DEPP 6.5.1G(1) provides that the Authority 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.

3.5. DEPP 6.5.2G 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)

3.6. When determining the appropriate level of financial penalty, the Authority 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)

3.7. The Authority 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 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)

3.8. The Authority 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 Authority 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.

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

3.9. The degree of seriousness of a breach may be linked to the size of the firm. For example, a systemic failure in a large firm could damage or threaten to damage a much larger number of consumers or investors than would be the case with a small firm: breaches in firms with a high volume of business over a protracted period may be more serious than breaches over similar periods in firms with a smaller volume of business.

3.10. In addition, the size and resources of a person may be relevant in relation to mitigation, in particular what steps the person took after the breach had been identified; the Authority will take into account what it is reasonable to expect from a person in relation to its size and resources, and factors such as what proportion of a person's resources were used to resolve a problem.

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

The amount of benefit gained or loss avoided: DEPP 6.5.2G(6)

3.12. The Authority may have regard to the amount of benefit gained or loss avoided as a result of the breach, for example:

(1) The Authority will propose a penalty which is consistent with the principle that a person should not benefit from the breach; and

(2) The penalty should also act as an incentive to the person (and others) to comply with regulatory standards and required standards of market conduct.

Conduct following the breach: DEPP 6.5.2G(8)

3.13. The Authority may take into account the conduct of the person in bringing (or failing to bring) quickly, effectively and completely the breach to the Authority's attention, the degree of cooperation the person showed during the investigation and any remedial steps taken since the breach was identified.

Disciplinary record and compliance history: DEPP 6.5.2G(9)

3.14. The Authority may take account of the previous disciplinary record and general compliance history of the person. This will include:

(1) whether the Authority has taken any previous disciplinary action against the person;

(2) whether the person has previously undertaken not to do a particular act or engage in particular behaviour;

(3) whether the Authority has previously taken protective action in respect of the firm, using its own initiative powers by means of a variation of the firm's Part IV permission, or has previously requested the firm to take remedial action and the extent to which that action has been taken; and

(4) the general compliance history of the firm.

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

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

Enforcement Guide

3.16. The Authority's policy on exercising its enforcement power for financial penalties and public censures is set out in Chapter 7 of EG, which came into effect on 28 August 2007.

Annex B

Representations

1. Catalyst's representations

General points

1.1. Catalyst made the following representations:

a. The businesses of Catalyst and ARM collapsed as a result of unforeseeable regulatory decisions – the regulatory community placed obstacles in the way of ARM and Catalyst that were neither foreseen nor reasonably foreseeable. Catalyst tried, but ultimately failed, to avoid this regulator-driven collapse. In entirely properly trying to do so, Catalyst sought a way to protect the interests of pending and new investors. That meant that Catalyst had to try to avoid a run on the ARM bonds whilst putting in place appropriate protection for monies placed by would-be investors. Catalyst is now criticised for the steps it took to avoid the regulator-driven collapse. Catalyst had to balance the interests of existing investors, pending investors and potential future investors. It did so appropriately throughout.

b. It is impossible properly to contextualise or assess the actions of Catalyst without knowing what passed between the regulators, and wholly unfair to take action against Catalyst without taking that material into account, and without being prepared to disclose to Catalyst the true background of what was going on between the regulators.

c. ARM applied for a licence on 23 July 2009 and had no reason to believe that it would not obtain one. Catalyst reasonably believed at all times that either the CSSF licence would be granted or the redomicile to Ireland would succeed, but believed that knowledge of those difficulties could cause a run on the bonds by consumers.

d. The position under Luxembourg law is unresolved as to whether ARM actually required a licence – if so this was only because the CSSF had changed the way it chose to interpret the 2004 Securitisation Law.

e. Mr Roberts is seriously ill and has not been able to assist Catalyst in the preparation of its submissions. This has seriously hampered Catalyst.

1.2. The Authority has reached the following conclusions:

a. The misconduct in issue is, in summary, Catalyst's failure to disclose the risks associated with investing in ARM bonds while ARM did not have a licence, and Catalyst's decision to continue to promote the ARM bonds and collect investors' funds after ARM was requested by the CSSF to stop issuing bonds, with the result that investors were exposed to risks of which Catalyst did not make them aware. It is not accepted that the failures of ARM and Catalyst's businesses were caused by 'regulator-driven collapse', however, in any event that would not be relevant to Catalyst's misconduct as set out in this Notice. Further, irrespective of whether Catalyst was

motivated by trying to avoid a 'run on the bonds', in any event this would not be a legitimate reason to send communications to investors which were not clear, fair and not misleading.

b. The relevant issue in determining whether Catalyst complied with the Principles for Businesses is Catalyst's state of knowledge as to the regulatory position of ARM and the attendant risks, and not the state of knowledge of any of the financial regulators. The communications between the regulators do not constitute material which falls to be disclosed under section 394 of the Act.

c. While Catalyst may have believed that ARM's regulatory position would be resolved, this was not guaranteed. The risk if it was not resolved was a serious one which required to be disclosed, even if it was not highly probable.

d. Irrespective of whether Luxembourg law required ARM to have a licence, the CSSF had stated that this was its view, and the contemporaneous evidence indicates that this was also Catalyst's view. ARM was aware of the CSSF's interpretation of the 2004 Securitisation Law and applied for a licence in that knowledge. There is no evidence that Catalyst considered, during the relevant period, that the CSSF had incorrectly interpreted the law or was advised that this was the case. The evidence shows that Catalyst did consider at the time that a licence was necessary and that potentially there would be adverse consequences were one not obtained.

e. The Authority accepts that Mr Roberts has a number of serious health issues. However, the Authority considers that Catalyst's legal representatives have had the opportunity fairly to represent its position.

<u>Continuing to promote ARM bonds and arrange for ARM to receive investor funds</u>

1.3. Catalyst made the following representations:

a. In continuing to promote the bonds and arrange the acceptance of funds after 20 November 2009 Catalyst did not breach the Authority's Principles for Businesses. Catalyst at all times believed that ARM's regulatory position would be resolved within a short period of time (either by obtaining a licence or by redomiciling). Catalyst knew that new funds received into tranches 10 and 11 would be held by receiving agents without being passed to ARM unless and until ARM was permitted to issue bonds. Catalyst believed that this adequately protected pending investors. With respect to the tranche 9 funds Catalyst believed the relevant funds would be held by ARM and that payments equivalent to bond interest payments would be made to investors. Further, tranche 9 to 11 investors were offered a return of their investment funds in September 2010 by ARM. Those who accepted obtained a return of their funds. Currently no investor losses have crystallised.

b. The Authority knew that ARM was not CSSF authorised but did not require Catalyst to stop promoting ARM bonds.

1.4. The Authority has reached the following conclusions:

a. Whether or not investors' funds were protected prior to being invested in the bonds, Catalyst acted recklessly in continuing to promote and arrange the acceptance of funds in respect of the bonds, in circumstances in which it knew that ARM not only did not have a licence but had been requested by the CSSF not to issue bonds without one. Although the CSSF's letter did not request that ARM stop marketing bonds or accepting funds, in the circumstances it was not reasonable for Catalyst to continue to promote the ARM bonds and arrange for the acceptance of funds from investors.

b. Irrespective of the Authority's knowledge, the fact that requirements were not imposed on Catalyst by the Authority (prior to those imposed by the First Supervisory Notice) is irrelevant to Catalyst's responsibility as an authorised firm to comply with the Principles for Businesses. It is an authorised firm's responsibility to make the appropriate regulatory decisions and to ensure its compliance with the relevant rules.

<u>The December 2009 and March 2010 letters</u>

1.5. Catalyst made the following representations:

a. As at the date of the December 2009 letter Catalyst reasonably believed that the prospects of ARM obtaining authorisation from the CSSF were good. It was not in the interests of investors to cause undue alarm to IFAs who marketed the ARM bonds distributed by Catalyst, or to do anything that might precipitate a high level of redemption requests. Catalyst accepted that in hindsight it could be said that the letter was over-optimistic but it reflected the genuine belief of Catalyst at the time that the application was likely to succeed and the letter was couched as it was because Catalyst believed that it was important not to cause undue alarm to existing or pending investors.

b. Catalyst accepted that the letter did not say that ARM was required to have a licence but Catalyst did not accept that it was clear that ARM was in fact required to have one. It further accepted that the letter did not deal with the potential consequences should ARM's application be unsuccessful, but those consequences were at least unclear and in any event the possibility of redomiciling provided an alternative option. The letter was clear, fair and not misleading and accordingly there was no breach of the Principles.

c. With respect to the March 2010 letter the desirability of not precipitating a rash of redemption requests was by that time increasingly acute. Even though the letter did not say that it was necessary that either the licence be granted or a redomicile take place, the letter was couched as it was because the function of the letter was not a generalised update (nor to persuade investors to invest any funds) and Catalyst believed it was

important not to cause undue alarm to pending investors. Catalyst attempted to produce a letter which met the need to inform pending investors of the credit they were about to receive, balanced with the desirability of not causing a rash of redemption requests with a consequent serious risk of losses to investors. Further, this was in circumstances in which the Authority had not taken any steps to require Catalyst to write to investors. The letter was clear, fair and not misleading and accordingly there was no breach of the Principles, and certainly no recklessness.

d. The Authority's First Supervisory Notice to Catalyst of 17 August 2010 (after the relevant period) was not published by the Authority in order to avoid a run on the bonds. This showed that the Authority took the same view as Catalyst regarding the protection of investors.

1.6. The Authority has reached the following conclusions:

a. While Catalyst may have believed when sending the December 2009 letter that the prospects of ARM being authorised were good, in all the circumstances the letter was not clear, fair and not misleading. There was a realistic possibility that ARM's regulatory position would not be resolved, with potentially serious consequences if that occurred. Irrespective of whether Catalyst was concerned that a run might be caused by the letter, in any event this would not provide a legitimate reason to send investors a communication which was not clear, fair and not misleading.

b. Irrespective of whether Luxembourg law required ARM to have a licence, the CSSF had stated that this was its view, and the contemporaneous evidence indicates that this was also Catalyst's view - Catalyst considered at the time that a licence was necessary and that there were potential adverse consequences were one not obtained. Equally redomiciling was not certain to provide a solution. In all the circumstances the letter was not clear, fair and not misleading and Catalyst acted recklessly in closing its mind to the risks to investors when sending the letter.

c. Irrespective of the primary purpose of the March 2010 letter, the Authority considers that it was not clear, fair and not misleading. There was a realistic possibility that ARM's regulatory position would not be resolved, with potentially serious consequences if that occurred. Catalyst should have disclosed this, in accordance with its regulatory responsibilities, and acted recklessly in not doing so. It is an authorised firm's responsibility to ensure its compliance with the relevant rules without needing to be prompted to do so by the Authority.

d. The First Supervisory Notice was issued outside the relevant period in respect of regulatory action in a specific set of circumstances and based on specific reasons, which in the circumstances (including that, as a direct result of that Notice, there were no longer any potential future investors at risk) it was not considered appropriate to publicise. The approach taken by the Authority to publication of that Notice is not analogous or relevant to the question of whether Catalyst was reckless in sending misleading

communications, which for the reasons set out in this Notice the Authority has concluded that it was.

Recklessness

1.7. Catalyst made the following representations:

a. Catalyst had not acted recklessly. It had, as was appropriate, attempted to balance the interests of existing and pending investors. It queried what Catalyst ought to have done differently. Any alternative strategy would have increased the risks of a run on the bonds and therefore reduced the prospects of the recovery plan succeeding. Catalyst might have been oversensitive to a run on the bonds, but could not be said to have acted recklessly, particularly in circumstances where it knew that financial regulators were aware of the issues and had said nothing.

b. In terms of what the term recklessness meant, Catalyst noted that it was something less than a deliberate act – something less than intending the consequences. DEPP 6.5.2G(3) expressly recognised the distinction between reckless and deliberate behaviour.

c. In relation to integrity and (by analogy to Principle 1) Statement of Principle 1, APER 4.1 repeatedly and exclusively referred to deliberate acts. There was no example of behaviour short of a deliberate act giving rise to or constituting a breach of Statement of Principle 1. By contrast Statement of Principle 2 (which is analogous to Principle 2) was intended to cover recklessness – see for instance APER 4.2.3 which sets out a classic case of recklessness.

d. As a result, on the basis of the Authority's own guidance, given the facts in this case, it would be inappropriate for the Authority to conclude that Catalyst had acted with a lack of integrity and in breach of Principle 1.

1.8. The Authority has reached the following conclusions:

a. As set out above, Catalyst was aware of the risks to investors and closed its mind to this risk. Relying on regulators to step in, even if they were aware of the issues, was not reasonable. Catalyst should not have misled investors in the way that it did, nor continued to promote bonds and effect the collection of funds for them without giving full disclosure of ARM's regulatory position to investors.

b. It accepts that recklessness is not the same as deliberately acting improperly. On the facts of this case recklessness refers to Catalyst closing its mind to the risks to investors. Catalyst should have had those risks in mind but chose to ignore them.

c. The guidance in APER is expressly inexhaustive. In this case Catalyst's behaviour went further than that set out in APER 4.2.4E, of 'failing to explain the risks of an investment to a customer'. Catalyst was closing its mind to risks of which it was aware rather than simply failing to exercise

due skill and care. The Authority notes that the Tribunal in, for instance, the case of Rayner & Townsend v FSA, took the view that, inter alia, closing one's eyes to a risk can constitute recklessness and a lack of integrity.

d. In all the circumstances the Authority considers that Catalyst acted recklessly.

Financial promotions

1.9. Catalyst made the following representations:

a. It accepted that its financial promotions materials did not refer to ARM's regulatory position in respect of CSSF authorisation. When CSSF changed its interpretation of the law ARM instructed lawyers to apply for a licence for it. When it later became clear that there was a real risk that ARM might not get CSSF authorisation, ARM pursued the alternative strategy (in parallel) of a redomicile. Before (and even upon) the formal licence application being made the CSSF did not require or even suggest that ARM stop issuing bonds and did not threaten any form of liquidation.

b. Catalyst was never required by the Authority (and ARM was never required by the CSSF) to write to investors regarding CSSF authorisation of ARM. This was clearly because nothing positive would have been achieved by doing so and there was a serious risk of precipitating a run on the bonds if that explicit message had been given. The same reasoning accounted for the Authority's decision to keep confidential the Supervisory Notice given to Catalyst in May 2010.

c. In the circumstances Catalyst denied that it had breached Principle 7 in relation to its financial promotions.

1.10. The Authority has reached the following conclusions:

a. While Catalyst may have believed that ARM's regulatory position would be resolved, this was not guaranteed. The risk if it was not was a serious one which required to be disclosed, even if it was not highly probable.

b. As set out above, irrespective of the fact that the Authority did not impose requirements on Catalyst, Catalyst was required to ensure its own compliance with the relevant rules, and the Supervisory Notice is not relevant to the case against Catalyst. Further, the prospect of a run on the bonds would not have been a legitimate reason to issue misleading promotions.

c. In the circumstances the Authority considers that Catalyst's financial promotions were not clear, fair and not misleading.

Sanction

1.11. Catalyst made the following representations:

a. The level of penalty proposed was excessive. There was no allegation made against Catalyst of dishonesty, there had been no crystallised investor losses, and Catalyst had fully co-operated with the Authority throughout.

b. It queried the Authority's allegation that it had received significant benefits as a result of its alleged breaches.

c. The proposed penalty was not consistent with those imposed in similar previous Authority cases, in that it was too high.

d. Catalyst was not able to pay any penalty.

1.12. The Authority has reached the following conclusions:

a. It accepts that Catalyst did not act dishonestly and that it co-operated with the Authority's investigation (though in respect of Catalyst's co-operation more generally it notes the matters set out at paragraph 6.11 of the body of this Notice). However, Catalyst's actions constituted a serious breach of the Principles, including acting recklessly, and though investor losses have not yet crystallised investors have been put at risk by Catalyst's actions. In all the circumstances the penalty level is appropriate.

b. The Authority considers that Catalyst received significant benefit from its breaches in that it received commission in relation to the bonds it promoted in a manner which was in breach of the Principles.

c. On the basis of the facts as set out in this Notice, the penalty level would be appropriate in comparison with those imposed in other cases.

d. Catalyst has provided verifiable evidence that it is not able to pay any financial penalty. In the circumstances the Authority has decided to publish a statement to the effect that Catalyst has contravened regulatory requirements. But for Catalyst's financial position, the Authority would have imposed on it a financial penalty of £450,000.

2. Third party representations

2.1. ARM made representations that CSSF authorisation was not compulsory for ARM on the proper interpretation of the relevant Luxembourg law because it was not, in fact, issuing securities to the public on a continuous basis.

2.2. The Authority has concluded that whether the proper interpretation of the relevant Luxembourg law is that a company in ARM's position would be considered to be issuing securities to the public on a continuous basis is not relevant to a consideration of Catalyst's conduct during the relevant period.