
FINAL NOTICE

To: City Index Limited

Of: Park House, 16 Finsbury Circus, London EC2M 7EB

Dated 20 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 City Index Limited (“City Index” or the “Firm”) a Decision Notice on 13 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 £490,000 on City Index in respect of breaches of rules set out in chapter SUP 17 of the FSA Handbook and breaches of Principles 2 and 3 of the FSA’s Principles for Businesses which occurred between 5 November 2007 and 21 September 2009 (“the Relevant Period”).
- 1.2 City Index has confirmed 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 City Index in the amount of £490,000.
- 1.4 This penalty is discounted by 30% pursuant to the Stage 1 early settlement discount scheme. Were it not for this discount, the FSA would have imposed a financial penalty of £700,000 on City Index.

2 REASONS FOR THE ACTION

Summary

- 2.1 Accurate and complete transaction reporting is essential to enable the FSA to meet its statutory objectives of maintaining market confidence and reducing financial crime. The primary function for which the FSA uses transaction reports is to detect and investigate suspected market abuse: insider trading and market manipulation.
- 2.2 A transaction report is a data set submitted to the FSA and relates to an individual financial market transaction which includes (but is not limited to) details of the product traded, the firm that undertook the trade, the trade counterparty and the trade characteristics such as buy/sell identifier, price and quantity.
- 2.3 In the Relevant Period, City Index breached the following:
- (1) Chapter 17 of the Supervision Manual, which is part of the FSA Handbook (SUP 17), by failing to submit accurate transaction reports in respect of nearly 60% of its reportable transactions, in that:
 - (a) it failed to report approximately 55,000 transactions; and
 - (b) it reported approximately 1,970,000 transactions with one or more data fields completed improperly;
 - (2) Principle 2 by failing to conduct its business with due skill, care and diligence through failing to identify fundamental errors in its transaction reporting process upon the implementation of a new trading platform; and
 - (3) Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively in relation to transaction reporting, in that throughout the Relevant Period, it failed to have in place adequate transaction reporting processes and procedures to ensure that it was fully compliant with requirements under SUP 17.
- 2.4 The FSA considers these failings to be serious, particularly because of:
- (1) the high proportion of transactions which City Index reported with one or more data fields completed improperly;
 - (2) the sustained period over which these failings endured (and consequently their impact on the FSA's ability to detect potential market abuse and reduce financial crime); and

- (3) the fact that City Index's failures occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of MiFID and public statements by the FSA.

2.5 Since these issues came to light, the Firm has taken a number of steps which mitigate the seriousness of its failings. These include:

- (1) commissioning a formal review of the City Index transaction reporting processes and controls by external consultants;
- (2) conducting an internal review of the accuracy and completeness of historical transaction reporting; and
- (3) implementing a comprehensive remediation project to address the IT and controls issues identified by the review.

Relevant regulatory provisions

2.6 The FSA is authorised pursuant to section 206 of the Act, if it considers that an authorised person has contravened a requirement imposed on him by or under the Act, to impose on him a penalty in respect of the contravention, of such amount as it considers appropriate.

2.7 Maintaining market confidence and the reduction of financial crime are statutory objectives for the FSA under section 2(2) of the Act.

2.8 The transactions which are required to be reported to the FSA are defined in SUP 17.1.4R as follows:

“A firm which executes a transaction:

- (1) in any financial instrument admitted to trading on a regulated market or a prescribed market (whether or not the transaction was carried out on such a market); or*
- (2) in any OTC derivative the value of which is derived from, or which is otherwise dependent upon, an equity or debt-related financial instrument which is admitted to trading on a regulated market or on a prescribed market,*

must report the details of the transaction to the FSA.”

2.9 The time period for making reports is stipulated in SUP 17.2.7R:

“A firm must report the required details of the transaction to the FSA as quickly as possible and by not later than the close of the working day following the day upon which that transaction took place.”

2.10 SUP 17.4.1EU provides:

“Reports of transactions ...shall contain the information .specified in SUP 17 Annex 1 EU which is relevant to the type of financial instrument in question and which the FSA declares is not already in its possession or is not available to it by other means.”

2.11 SUP 17.4.2R provides:

“The reports referred to in SUP 17.4.1 ...shall, in particular include details of the names and the numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the firms concerned.”

2.12 Annex 1 to SUP 17 provides lists of fields and mandatory information to be provided as the minimum content of a transaction report.

2.13 Paragraph 4 EU of SUP 17 Annex 1 requires firms to identify whether a transaction was a buy or sell from the reporting firm’s perspective.

2.14 Principle 2 of the FSA’s Principles for Businesses requires firms to conduct their business with due skill, care and diligence.

2.15 Principle 3 of the FSA’s Principles for Businesses requires firms to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.

2.16 The FSA’s approach to exercising its enforcement powers is set out in the Decision Procedure & Penalties Manual (“DEPP”) and Enforcement Guide (“EG”).

Facts and matters relied upon

Background

2.17 SUP 17 requires transaction reports containing mandatory details to be submitted to the FSA by the end of the next business day following the day on which the firm entered into the transaction. At the end of each working day, transaction reports received by firms are loaded onto the FSA’s transaction monitoring system.

- 2.18 Firms are able to report transactions to the FSA using one or more Approved Reporting Mechanisms (“ARMs”), which are specialised systems approved by the FSA for the purpose of transaction reporting.
- 2.19 The implementation of MiFID across all European Economic Area (“EEA”) Member states on 1 November 2007 (effective on 5 November for transaction reporting) introduced changes to the list of products in which transactions had to be reported and standardisation of the list of fields which were required to be included in the reports. SUP 17 was amended from 1 November 2007 to reflect these changes. Whilst the changes required to be implemented by firms were significant in respect of their MiFID transaction reporting obligations the mandatory content of the transaction reports for many products remained largely unaffected by the MiFID changes.
- 2.20 The FSA has provided regular and detailed information to firms in its “Market Watch” publication on transaction reporting issues prior to and during the Relevant Period. In order to assist firms with transaction reporting generally and with respect to changes introduced by MiFID, the FSA issued a Transaction Reporting User Pack (TRUP) in July 2007.
- 2.21 Reminders were given by the FSA in Market Watch in March 2007 and June 2008 (Issues 19 and 28 respectively) and TRUP, that firms should regularly review the integrity of transaction report data.
- 2.22 Issue 28 of the Market Watch in June 2008 stated:

“Firms must report transactions to us accurately to help us monitor for market abuse and maintain market confidence. Accuracy in transaction reports also reduces the number of requests for clarification that we need to make to firms.

Therefore, we encourage all firms to review the integrity of their transaction report data regularly. Our Transaction Monitoring Unit is happy to provide firms a sample of reports we have received so that firms can check those transaction reports against their own records...

We will be undertaking regular reviews of the quality and completeness of firms’ submissions. We expect firms now to be fully compliant with the transaction reporting requirements set out in SUP 17. Where we identify problems with transaction reporting we will consider the use of our enforcement tools. In doing so, we will take into account the appropriateness of the firm’s systems and controls, including its monitoring programme around transaction reporting.”

City Index transaction reporting processes

- 2.23 City Index is a broker (authorised by the FSA since 2001) which enters into spread bets, contracts for differences and other transactions with its (primarily retail) clients. These transactions derive their value from financial instruments admitted to trading on regulated or prescribed markets and must be reported to the FSA in accordance with SUP 17.1.4(2)R.
- 2.24 At MiFID implementation, the Firm operated two different trading platforms, specifically “G1” and “FIBS”. Each system reported its respective transactions, with the Firm relying upon an external ARM, as permitted by SUP 17.2.3R, to facilitate onward transmission to the FSA.
- 2.25 In March 2008, a new trading platform, “G2” was introduced, replacing FIBS. It was intended to operate eventually as a universal trading platform. In the following months, G2 gradually subsumed the activities of G1, and by October 2008 had taken over all trading and transaction reporting responsibilities for the Firm.

Emergence of transaction reporting issues

- 2.26 On or around 12 June 2008, as a result of examining a Suspicious Transaction Report made by City Index to the FSA, the FSA alerted the Firm to a discrepancy between a transaction reporting submission and information held by the FSA. Internally, the Firm identified that it had failed to report spread betting transactions in the preceding five weeks, affecting 55,589 transactions.
- 2.27 Around this time, the Firm’s Operations department also identified a long-standing issue regarding a failure to re-submit to the ARM, transactions that had been rejected by the system as a result of ISIN numbers being input incorrectly or similar data entry errors. The Firm attributed this issue to a lack of staff training. The issue affected approximately 10 transactions per working day during the period from 5 November 2007 to 1 August 2008.
- 2.28 The Firm quickly took steps to ensure the resubmission of affected trades, and carried out training with IT staff concerning the resubmission of rejected trades in the future.
- 2.29 In July 2009, the FSA identified from sample data a number of issues around the Firm’s transaction reporting which gave rise to concern.

- 2.30 The FSA therefore required the Firm to undertake further analysis and address these issues by taking appropriate remedial action. In September 2009, City Index informed the FSA that there were fundamental errors in the set-up of the G2 process which were not identified, affecting all transaction reporting, and that there had been deficiencies in the internal governance of its transaction reporting processes and procedures.
- 2.31 Further analysis of the Firm's historic transaction reporting revealed that in all transactions reported on the G2 trading platform, the buy/sell indicator was input from the client's perspective rather than the firm's perspective. This reporting error related to 1.85 million transactions. The effect of the error was that reports to the FSA stated that City Index's clients had "bought" a spread bet when they had in fact "sold" a spread bet, and vice versa.
- 2.32 Approximately 10% of these transaction reports were also rendered non-compliant with SUP 17 by the Firm's population of one or more other fields. As these transaction reports were already affected by the erroneous population of the buy/sell indicator field, they are not considered to add to the total number of transaction reports in breach. The other fields affected are as follows:
- (a) derivative type;
 - (b) instrument type;
 - (c) market venue;
 - (d) price multiplier;
 - (e) quantity; and
 - (f) unit price.
- 2.33 As regards transaction reporting by the FIBS and G1 trading platforms, 122,380 transaction reports had included incorrect codes for derivative type and/or price and/or strike price fields. Specifically, the Firm applied the wrong code to identify the derivative type when populating that field; stated that the price had been expressed in pounds, when in fact it had been expressed in pence, thereby reporting erroneous prices; and rounded up unit prices to one decimal place, again thereby reporting erroneous prices.
- 2.34 As regards the re-submission of failed reports (see paragraph 2.27 above), the precise number of failed reports is not known and therefore the FSA has relied on an extrapolated figure of 1,850 in order to estimate the total number of reports in breach.

2.35 The transaction reporting errors detailed above had not previously been identified by the Firm due to the absence of an internal mechanism for ensuring the accuracy and validation of its transaction reports.

Analysis of breaches

2.36 During the Relevant Period, the sum of City Index’s transaction reports in breach of SUP 17 is therefore:

Description	Total reports in breach of SUP 17
Total number of reports not reported to the FSA	55,589
Total number of reports made to the FSA but containing one or more fields incorrectly populated	1,972,709
Total reports in breach	2,028,298
Reports in breach as a percentage of reportable transactions	60%

2.37 In addition, the Firm breached the FSA’s Principles for Businesses as follows:

- (1) the Firm failed to conduct its business with due skill, care and diligence in breach of Principle 2, in that on implementation of the G2 trading platform, the Firm failed to identify fundamental errors in the set-up of the G2 process relating to transaction reporting; and
- (2) the Firm failed to take reasonable care to organise and control its affairs responsibly and effectively in relation to transaction reporting, in breach of Principle 3, in that it failed to have in place, at the implementation of MiFID and throughout the Relevant Period, adequate transaction reporting processes and procedures to ensure that it was fully compliant with MiFID requirements. Specifically, the Firm failed to make arrangements to ensure adequate internal governance of its transaction reporting processes and procedures and failed to put in place an internal mechanism for ensuring the accuracy and validation of its transaction reports.

3 SANCTION

3.1 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 guidance. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who 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.

3.2 The FSA considers these failings to be serious, particularly because of:

- (1) the high proportion of transactions which City Index reported with one or more data fields completed improperly;
- (2) the sustained period over which these failings endured (and consequently their impact on the FSA's ability to detect potential market abuse and reduce financial crime); and
- (3) the fact that City Index's failures occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of MiFID and public statements by the FSA.

3.3 The Firm took a number of steps which mitigate the seriousness of its failings. These include:

- (1) commissioning a formal review of the City Index transaction reporting processes and controls by external consultants;
- (2) conducting an internal review of the accuracy and completeness of historic transaction reporting; and
- (3) implementing a comprehensive remediation project to address the IT and controls issues identified by the review.

4 CONCLUSIONS

4.1 The FSA considers in all the circumstances that the seriousness of the breaches merits a substantial financial penalty. In determining the financial penalty the FSA has considered the need to deter City Index and other firms from committing similar breaches. The FSA has also had regard to penalties in other similar cases.

4.2 The FSA considers that a financial penalty of £700,000 is appropriate, discounted to £490,000 after the applicable Stage 1 discount for early settlement.



5 DECISION MAKERS

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.

6 IMPORTANT

6.1 This Final Notice is given to City Index in accordance with section 390 of the Act.

Manner of and time for payment

6.2 The financial penalty must be paid in full by City Index to the FSA by no later than 3 February 2011, 14 days from the date of the Final Notice.

If the financial penalty is not paid

6.3 If all or any of the financial penalty is outstanding on 4 February 2011, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

Publicity

6.4 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 the Firm or prejudicial to the interests of consumers.

6.5 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

6.6 For more information concerning this matter generally, City Index should contact Celyn Armstrong (020 7066 2818) or Kenneth McArthur (020 7066 4120) at the FSA.

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Financial Services Authority



Jamie Symington

Head of Department

FSA Enforcement and Financial Crime Division