Financial Services Authority

FINAL NOTICE

To: Credit Suisse International and Credit Suisse Securities (Europe) Limited (the "UK operations of Credit Suisse")

Of: One Cabot Square, London E14 4QL

Dated 13 August 2008

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 the UK operations of Credit Suisse a Decision Notice dated 1 August 2008 which notified them 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 £5.6 million on the UK operations of Credit Suisse in respect of a breach of Principles 2 and 3 of the FSA's Principles for Business which occurred between 30 September 2007 and 19 February 2008 ("the Relevant Period").

1.2. The UK operations of Credit Suisse have confirmed that they will not be referring the matter to the Financial Services and Markets Tribunal.

1.3. Accordingly, for the reasons set out below and having agreed with the UK operations of Credit Suisse the facts and matters relied on, the FSA imposes a financial penalty on the UK operations of Credit Suisse in the amount of £5.6 million.

1.4. The UK operations of Credit Suisse agreed to settle at an early stage of the FSA's investigation. They therefore qualified for a Stage 1 discount under the FSA's executive settlement procedures.

2. REASONS FOR THE ACTION

Summary

2.1. In the Relevant Period, the UK operations of Credit Suisse breached Principle 2 by failing to conduct their business with due skill, care and diligence and breached Principle 3 by failing to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.

2.2. These breaches relate to the pricing of certain asset-backed securities held by the Structured Credit Group ("the SCG") within the Investment Banking Division of Credit Suisse. Credit Suisse announced on 19 February 2008 that it had identified evidence of mismarkings and pricing errors by a small number of traders in the SCG, and that it was therefore repricing certain asset-backed positions. A significant proportion of the repricing was attributable to positions held by the UK operations of Credit Suisse.

2.3. In breach of Principle 3, the UK operations of Credit Suisse failed to put adequate systems and controls in place to detect in a timely manner the mismarks and pricing errors that led to the repricing. They failed to recognise until mid-February 2008 that certain of the SCG's asset-backed positions were substantially over-valued.

2.4. In breach of Principle 2, the UK operations of Credit Suisse failed to use their controls over a highly complex business effectively. They failed adequately to supervise the complex business of the SCG which required close supervision and did not translate identified concerns about the pricing of certain asset-backed positions within the SCG into tangible or timely actions.

Statutory and Regulatory Provisions

2.5. 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.

2.6. Pursuant to section 2(2) and section 3 of the Act, one of the FSA's statutory objectives is market confidence: maintaining confidence in the financial system.

2.7. Principle 2 of the FSA's Principles for Business states that:

"A firm must conduct its business with due skill, care and diligence."

2.8. Principle 3 of the FSA's Principles for Business states that:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

2.9. The FSA's approach to exercising its main enforcement powers is set out in the Enforcement Guide.

Relevant Context

2.10. The FSA considers that firms should take particular care to price complex products accurately and ensure that those with a potential incentive to misprice are properly monitored and controlled, particularly in more difficult financial conditions. For example, the FSA's

Financial Risk Outlook dated January 2007 warned about the risks associated with more challenging market conditions and identified as a Priority Risk that *"Illiquid financial instruments are difficult to value, which raises, for example, conflict-of-interest risks"*.

2.11. The Financial Risk Outlook stated as follows under the heading of 'Valuation of illiquid and complex assets': *"Capital invested in alternative asset classes is increasing, alongside growth in the amount of money exposed to structured products. Some of these products are illiquid and their complexity may make them difficult to value… The integrity of the valuation process can be strengthened by appropriate use of independent pricing…*

…There is a continuing requirement for many parties involved in trading and pricing complex and illiquid assets to consider their inherent conflicts of interest. These arise when the same party makes investment decisions and also plays a key role in the pricing of the same investments. In particular, this is important for those professionals whose remuneration is directly linked via an incentive arrangement to the declared investment performance of a portfolio containing investments for which the professional has assigned prices."

Facts And Matters Relied On

2.12. The UK operations of Credit Suisse are FSA-authorised subsidiaries of Credit Suisse, a major global financial group whose headquarters are in Zurich. Credit Suisse has three business divisions, Private Banking, Investment Banking and Asset Management. Its market capitalisation for 2007 was CHF 76,024 million (USD 67,093 million); for 2006, CHF 86,576 million (USD 74,290 million).

2.13. In its Investment Banking division, Credit Suisse has approximately 20,600 employees operating in 57 locations across 26 countries. The SCG within Credit Suisse's Investment Banking Division specialises in structured products including commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), collateralised debt obligations (CDO) and other asset-backed securities (ABS).

2.14. The principal activities of the SCG are structuring and issuing securities based on underlying pools of assets, including CDOs and credit correlation trades. These are often highly complex, high risk, leveraged products. In addition, the SCG warehouses and trades underlying ABS cash bonds and deals in credit default swaps for trading and hedging purposes.

2.15. The business of the SCG is conducted through several legal entities within the Credit Suisse group, including the UK operations of Credit Suisse. The UK operations of Credit Suisse were responsible for ensuring the adequacy and effective operation of their systems and controls, including those provided in part by other companies within the group. In the Relevant Period, price testing responsibilities for the CDO trading books held by the SCG were split between three groups based in different locations.

2.16. On 12 February 2008, Credit Suisse announced its financial results for 2007. The Credit Suisse group reported income from continuing operations of CHF 8,549 million for the full year 2007, an increase of 3% compared to 2006.

2.17. On 19 February 2008, Credit Suisse announced that it had re-priced certain asset-backed positions in its Structured Credit Trading business within Investment Banking, involving a write down of revenues of approximately USD 2.85 billion. The announcement referred to an internal review being carried out into mismarkings and pricing errors by a small number of traders.

2.18. Before the announced write down, Credit Suisse had announced on 13 February 2008 a USD 2 billion 10 year bond issue which was due to close on 19 February 2008. Following the announcement of 19 February, the coupon and the spread of the bond issue were adjusted by 25 basis points and settlement was postponed to 20 February 2008.

2.19. On 20 March 2008, Credit Suisse announced that it had revised its final valuation reduction to USD 2.65 billion (CHF 2.86 billion), of which USD 1.03 billion (CHF 1.18 billion) related to Quarter 4, 2007. USD 1.67 billion of this was attributable to the UK operations of Credit Suisse, of which USD 684 million related to Quarter 4, 2007. The positions which were the subject of the write down, mismarkings and pricing errors were proprietary positions. Credit Suisse announced that, following its internal review, it had concluded that the write down had been caused by pricing errors that were, in part, the result of intentional misconduct by a small number of traders and that the controls put in place to prevent or detect this activity were not effective. Credit Suisse also identified a series of remedial actions.

2.20. In relation to the write down, Credit Suisse disclosed in its 2007 Annual report in March 2008 that a SOX (Sarbanes Oxley) 404 material weakness had existed in its internal controls over financial reporting as at 31 December 2007.

Key Review Findings

2.21. Credit Suisse's senior management commissioned a detailed review of the causes of the write down which identified serious failings in the design, implementation, operation and management of controls over the SCG. The principal failings identified in that review and/or in Credit Suisse's announcements on 19 February 2008 and 20 March 2008 were as follows:

2.21.1. The systems and controls of the UK operations of Credit Suisse for the management and supervision of traders in the SCG and for the pricing of highly complex products within the SCG were not effective and were not applied consistently. The systems and controls in place, such as a complex matrix structure for the supervision of traders in the SCG, were too complicated and fragmented. Some individuals within control functions lacked a clear understanding of the responsibilities that had been assigned to them;

2.21.2. There were failures to respond adequately to a number of warning signals or "red flags" and to translate identified concerns about price testing variances in CDO positions within the SCG into tangible or timely actions;

2.21.3. Certain personnel within control functions with responsibility for recording or checking prices were overly deferential in challenging certain SCG traders and do not appear to have had sufficient seniority or management support to challenge effectively;

2.21.4. Undue reliance was placed on the technical ability and revenue contribution of certain Front Office staff, who were highly influential in down-playing price testing variances and in influencing the price testing methodology used, and did not take appropriate action to control and manage such staff effectively; and

2.21.5. Certain control functions failed to escalate in a timely manner price testing variances that were identified, owing to issues such as the complex booking structure used for the CDO trading business, a lack of effective supervision over price verification processes and an over-reliance on assertions made by certain Front Office staff.

Chronology of Events

2.22. By September 2007, Credit Suisse had identified CMBS, RMBS, Leveraged Finance and CDOs as priority risk areas which warranted concern and organised detailed review meetings by product type, including for CDO and ABS products.

2.23. In August/September 2007, some significant price testing variances in the SCG's books were identified but, although questions were asked, the explanations given by certain traders were not adequately challenged.

2.24. In October 2007, inconsistencies in the valuation of ABS bonds were identified between different books held by the SCG. The differences were attributed to timing differences (i.e. London versus New York closing prices), but were not investigated further.

2.25. Price testing variances continued to be identified in November and December 2007 but concerns were not effectively escalated or resolved. Certain traders were able to continue pricing certain positions higher than market indices despite requests to the contrary.

2.26. In December 2007 and January 2008, Credit Suisse discussed with certain traders variances identified in a benchmarking exercise between Front Office marks and the ABX index (an index referencing asset-backed securities). Explanations provided by the relevant traders do not appear to have been challenged sufficiently. Credit Suisse agreed to perform a further detailed analysis of specific marks relative to the ABX index.

2.27. At the end of January 2008, a Front Office supervisor of the SCG undertook a "CDO drill down" of the SCG's books. Concerns were raised in February 2008 that some positions were over-valued.

2.28. On 12 February 2008, Credit Suisse announced its financial results for 2007.

2.29. On 15 February 2008, Credit Suisse notified the FSA that, based on some preliminary work, there was a potentially material mismarking issue and that additional analysis was ongoing.

2.30. On 17 February 2008, Credit Suisse suspended a number of traders.

2.31. On 19 February 2008, Credit Suisse announced the repricing of asset-backed positions, estimated at USD 2.85 billion. The write down was revised on 20 March 2008 to USD 2.65 billion (CHF 2.86 billion).

Conclusion

2.32. By reason of the facts and matters set out above, the UK operations of Credit Suisse breached Principle 2 and Principle 3 by failing to conduct their business with due skill, care and diligence and by failing to take reasonable care to organise and control their affairs responsibly and effectively and to implement adequate risk management systems.

<u>Principle 3 (management and control)</u>

2.33. The FSA concurs with Credit Suisse's own findings that the systems and controls of the UK operations of Credit Suisse for the management and supervision of the SCG and for the pricing of highly complex products within the SCG were inadequate. In particular:

2.33.1. The processes relied upon by the UK operations of Credit Suisse included a complex matrix structure for the SCG with multiple reporting lines which at times led to uncertainty as to supervisory responsibilities. The SCG and its supervisors were widely distributed across different locations which added further fragmentation and complexity to the control infrastructure;

2.33.2. The valuation governance processes which were in place for the SCG did not effectively identify the valuation issues that contributed to the write down. The pricing of a significant portion of the SCG's positions was not subject to sufficient scrutiny and challenge in extremely illiquid markets. Pricing methodologies were not consistently applied across different trading books. This inconsistency in approach impeded the ability of certain control functions to quantify, escalate and appropriately resolve price testing variances;

2.33.3. The booking structure relied upon by the UK operations of Credit Suisse for the CDO trading business was complex and overly reliant on large spreadsheets with multiple entries. This resulted in a lack of transparency and inhibited the effective supervision, risk management and control of the SCG; and

2.33.4. There was a failure to recognise until mid-February 2008 that certain positions held by the SCG were substantially over-valued.

Principle 2 (skill, care and diligence)

2.34. The FSA concurs with Credit Suisse's own findings that the controls that the UK operations of Credit Suisse had in place were not used effectively. In particular:

2.34.1. The business of the SCG was highly complex and required close supervision. However, its supervisors did not consistently apply the supervisory standards that were in place, and they did not ensure that they had the necessary capabilities to supervise the SCG properly;

2.34.2. Many errors were made in price testing procedures for ABS cash and ABS CDO positions held in different locations;

2.34.3. Certain traders in the SCG were able to circumvent controls by exploiting their technical knowledge and their expertise relative to certain control personnel. Such traders were treated with too much deference;

2.34.4. Too much reliance was placed on inexperienced and/or junior staff to resolve pricing issues with the Front Office and to challenge Front Office staff. Insufficient senior level oversight was committed to supervising and supporting day-to-day control processes;

2.34.5. Reassignments and reorganisations within certain control functions, together with remote supervision and demanding workloads, exacerbated the situation. As a result, such control staff tolerated delays in the provision of explanations for price testing differences and did not sufficiently escalate any concerns about the explanations provided;

2.34.6. Concerns about the pricing of CDO positions within the SCG were not translated into tangible actions until mid-February 2008; and

2.34.7. As a result of these failures, the UK operations of Credit Suisse failed to price certain positions held by the SCG accurately and failed to prevent or detect in a timely manner certain mis-marks and pricing errors by a small number of traders.

3. SANCTION

3.1. The FSA's policy on the imposition of financial penalties and public censures is set out in the FSA's Decision Procedure & Penalties manual (DEPP) and Enforcement Guide. 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 benefit of compliant behaviour.

3.2. The FSA considers that the seriousness of this matter merits the imposition of a significant financial penalty. The factors which have been taken into account in determining the financial penalty to be imposed on the UK operations of Credit Suisse include:

3.2.1. There is a high risk that market confidence will be damaged by the sudden and unexpected write down and revaluation of securities. It is therefore appropriate to impose significant fines on firms whose skill, care and diligence in carrying out proper supervision and oversight and whose management and control of businesses fall below expected standards, particularly where highly complex products are involved, in order to ensure that firms develop and maintain robust internal policies and procedures;

3.2.2. Credit Suisse's management have accepted that the matters highlighted by its review were of a serious nature. The combination in the SCG's holdings of exotic products, opaque valuations and high leverage should have led to especially tight controls over this area. Mismarking and pricing errors in relation to certain securities existed for approximately five months from the start of Quarter 4, 2007 until the announcement on 19 February 2008;

3.2.3. There were serious weaknesses in systems and controls and the sudden and unexpected announcement of the write down on 19 February 2008 risked undermining market confidence;

3.2.4. There was a failure adequately to manage the risks of potential mispricing arising from the conflict of interest inherent in many areas of the financial services sector, whereby (as in this case) traders typically play a key role in pricing securities although these prices have a direct effect on the calculation of their personal remuneration; and

3.2.5. In deciding on the level of penalty, the FSA has had regard to the size and financial resources of the UK operations of Credit Suisse. They are part of a major financial institution and should have high levels of systems and controls commensurate with the requirement adequately to supervise a complex, highly profitable global business with a high level of risk.

3.3. In determining the level of financial penalty the FSA has taken into account the following mitigating factors:

3.3.1. Credit Suisse ultimately detected the mispricing and identified the need to revalue positions. It ensured prompt public disclosure of the mis-marking and pricing errors as soon as it appreciated their full extent;

3.3.2. Credit Suisse's senior management commissioned, on an expedited basis, a detailed review of the causes of the write down and have accepted its findings. Disciplinary action has been taken in respect of certain individuals;

3.3.3. Extensive resources have been committed to a comprehensive remedial programme with the support of Credit Suisse's senior management;

3.3.4. The positions which were the subject of the write down, mismarkings and pricing errors were proprietary positions; and

3.3.5. Credit Suisse informed the FSA promptly of these issues, has kept the FSA informed of developments and has been co-operative.

Conclusions

3.4. The FSA considers in all the circumstances that the seriousness of the breach of Principles 2 and 3 by the UK operations of Credit Suisse merits a substantial financial penalty. In determining the financial penalty the FSA has considered the need to deter market participants from engaging in this type of activity. The FSA has also had regard to penalties in other similar cases.

3.5. The FSA has decided to impose a financial penalty of £5.6 million. This takes into account the applicable Stage 1 discount for early settlement.

4. DECISION MAKERS

4.1. 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.

5. IMPORTANT

5.1. This Final Notice is given to the UK operations of Credit Suisse in accordance with section 390 of the Act.

Manner of and time for Payment

5.2. The financial penalty must be paid in full by the UK operations of Credit Suisse to the FSA by no later than 27 August 2008, 14 days from the date of the Final Notice.

If the financial penalty is not paid

5.3. If all or any of the financial penalty is outstanding on 28 August 2008, the FSA may recover the outstanding amount as a debt owed by the UK operations of Credit Suisse and due to the FSA.

Publicity

5.4. 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 you or prejudicial to the interests of consumers.

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

FSA contacts

5.6. For more information concerning this matter generally, you should contact Helena Varney (Tel: 020 7066 1294) of the Enforcement Division of the FSA.

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Tracey McDermott
Head of Department
FSA Enforcement Division