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**FINAL NOTICE**

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To: Mr David Andrew Jones

Date: 27 July 2010

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

**1. THE PENALTY**

- 1.1. The FSA gave David Jones (Mr Jones) a Decision Notice dated 23 July 2010 which notified him that pursuant to sections 56 and 66 of the Financial Services and Markets Act 2000 (the Act) the FSA had decided to impose a financial penalty on him in the amount of £320,000 and a full prohibition, prohibiting him from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm (the Prohibition Order);
- 1.2. The level of the penalty reflects Mr Jones's agreement to settle at an early stage of the FSA's investigation. He therefore qualified for a 20% (stage 2) reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount the FSA would have imposed a financial penalty in the amount of £400,000.
- 1.3. Under the terms of the Settlement Agreement dated 21 July 2010, Mr Jones agreed to waive and not to exercise his rights to refer the matter to the Financial Services and Markets Tribunal once a Decision Notice had been issued.
- 1.4. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on Mr Jones in the amount of £320,000.

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

- 2.1. The FSA decided to take this action as a result of Mr Jones's misconduct as an approved person at the entity now known as Northern Rock Asset Management Plc, formerly Northern Rock Plc (NR or the Firm).
- 2.2. The relevant period for the purposes of this Notice is the period commencing 10 January 2007 to the end of February 2008 (the Relevant Period). At all times during the Relevant Period, Mr Jones was an approved person. From 10 January 2007 to 1 February 2007, he was Finance Director (designate) with responsibilities as an approved person who was approved to perform the significant management (other business operations) controlled function (CF17) and the significant management (financial resources) controlled function (CF19). From 1 February 2007 to 22 February 2008, following Mr Jones's appointment as Finance Director, he had responsibilities as an approved person who was approved to perform the director controlled function (CF1).
- 2.3. From 1 February 2007, Mr Jones's reporting lines and therefore areas in relation to which he had responsibility as an approved person included the Debt Management Unit (the DMU) and the Credit Management Information Unit (the CMIU). Among other matters, the functions of the DMU included the management and recovery of the secured loan book. The CMIU was responsible for the collation and delivery of management information on a range of matters, including arrears and possessions in the secured loan book.
- 2.4. During the Relevant Period, Mr Jones's conduct fell short of the FSA's regulatory standards for approved persons in respect of the matters referred to below. His conduct demonstrated a lack of integrity in this regard and he is therefore considered not fit and proper to perform any controlled functions in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm.
- 2.5. Mr Jones breached Statement of Principle 1. In particular, despite becoming aware in January 2007 that there were 1,917 loans omitted from the impaired loan figures (i.e. loans reported as being either 3 months or more in arrears or in possession) which formed part of management information and subsequent communications made to the market (although not the Firm's financial statements):

- (1) he agreed on a deliberate course of action to deal with the position which was not transparent and did not have immediate effect;
- (2) he failed to correct either at the time or subsequently, misleading statements made in his presence regarding the impaired loans, which had been made to external stakeholders, including market analysts;
- (3) in the Relevant Period, he knew that data on impaired loans which did not include the pending possession loans was being provided to internal and external stakeholders. Mr Jones acted recklessly by not ensuring the data was correct; and
- (4) he acted recklessly as he caused or permitted the Firm's Operating and Business Review, information provided to the Assets and Liabilities Committee (ALCO) and to the Council of Mortgage Lenders (CML), to show figures which were, to his knowledge, false. Mr Jones could have, and should have, corrected this but did not do so.

2.6. Mr Jones's failures in this regard are serious because:

- (1) he was Finance Director (designate) and subsequently Finance Director of a large retail bank with responsibility for accurate internal and external reporting;
- (2) during the Relevant Period, he was an approved person and, from February 2007, had responsibility as an approved person for the DMU and CMIU; and
- (3) had the 1,917 loans remained in the Firm's reported arrears, the figure reported in the Operating and Business Review of the 2006 annual accounts would have been 0.68% of the loan book instead of 0.42% (at a time when the reported CML average was 0.89%). Alternatively, if the 1,917 loans had been included in the reported possessions, the stated possessions figures would have increased from 662 cases to approximately 2,579 cases.

### **3. RELEVANT STATUTORY PROVISIONS**

- 3.1. The FSA's regulatory objectives, set out in section 2(2) of the Act, include the maintenance of market confidence.
- 3.2. Section 56 of the Act enables the FSA to make an order prohibiting an individual performing a specified function or any function falling within a specified description, if it

appears to the FSA that the individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person, exempt person or exempt professional firm. The order may relate to a specified regulated activity, any regulated activity falling within a specified description or all regulated activities.

- 3.3. Under section 66(1) of the Act, the FSA may impose a financial penalty on an approved person if he is guilty of misconduct and if the FSA is satisfied that it is appropriate in the circumstances. Section 66(2) (a) provides that a person is guilty of misconduct if, whilst an approved person, he has failed to comply with a Statement of Principle issued under section 64 of the Act.

#### **Statements of Principle and Code of Practice for Approved Persons**

- 3.4. The FSA's Statements of Principle and Code of Practice for Approved Persons are issued by the FSA pursuant to section 64 of the Act. Statement of Principle 1 states that:

*"An approved person must act with integrity in carrying out his controlled function."*

- 3.5. APER 4.1 sets out descriptions of conduct which, in the opinion of the FSA, do not comply with Statement of Principle 1. This includes (but is not limited to) deliberately failing to inform (without reasonable cause) a firm of the fact that their understanding of a material issue is incorrect (APER 4.1.6E).

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

- 4.1. NR is a retail bank currently in public ownership. It de-mutualised in 1997 and entered the FTSE 100 in 2000. NR experienced sustained growth over the subsequent period and by the end of 2006 was the fifth largest UK mortgage lender with 8.3% of the residential mortgage market. Important to the Firm's rapid growth was the maintenance of its asset quality. The value of NR's securities was in part derived from a market perception of how its loan book was performing.
- 4.2. During 2005, staff within the DMU perceived that they were under pressure to maintain the Firm's reported arrears and possessions figures at half of the CML average. In order to maintain lower reported arrears and possessions figures, the DMU took a series of actions outside of Firm policies which improperly reduced the number of reported impaired loans. As it became more difficult to maintain the arrears figures, additional action was

taken to achieve a target of half the CML average. Further processes gave rise to a class of loans which were in default being recorded neither in the arrears nor in the possessions figures (the "pending possessions" issue, described more fully below). The FSA acknowledges that Mr Jones had no knowledge of these matters at that time and he first became aware of the pending possession loans issue on or about 10 January 2007 when those who were responsible for the DMU and CMIU informed him.

### **Pending possessions**

- 4.3. In 2005, loans where a possession order had been made but where physical possession of the mortgaged property had not yet been obtained, were removed from the arrears figures. The DMU also regarded these loans as not being in "actual possession". As a consequence from 2005 onwards, loans "pending possession" were not reported in either the arrears or possessions figures and were thus excluded from all reported data for impaired loans.
- 4.4. At the time the decision was taken in 2005 to remove the pending possession cases from the reported arrears, the number of such cases was minimal. However, the number of pending possessions increased in the first half of 2006.
- 4.5. Mr Jones was informed for the first time in January 2007, by the Deputy CEO of NR, David Baker, of the existence of the pending possession loans and that they were neither reported in the arrears nor possessions figures. Mr Baker sought Mr Jones's advice on whether the unreported loans impacted the Firm's stated provisions for bad debts. Mr Jones took steps to satisfy himself that the provisions, which were calculated using automated processes, were correct and that therefore the financial statements were accurate.
- 4.6. M Jones subsequently agreed with Mr Baker that because the provisioning was correct, there was no obligation to amend the annual 2006 accounts which were about to be published. However, he was aware that the reported data in respect of impaired loans stated in the Operating and Business Review for the 2006 annual accounts would be incomplete and therefore inaccurate since it did not include the details of the pending possession cases.
- 4.7. Further, Mr Jones agreed with Mr Baker's proposal to resolve the backlog of pending possession cases by bringing the cases into possessions over a six month period.

- 4.8. Whilst Mr Jones was not responsible for the DMU or CMIU in January 2007, he should have taken steps to have an informed discussion of the matter at a more senior level. When he did become responsible for the DMU and CMIU he allowed the Firm's Chief Executive and ALCO to receive information which did not fully and openly represent the true position.
- 4.9. In taking this course of action, Mr Jones failed to ensure timely internal reporting of pending possession cases, and was reckless as to the potential consequences.
- 4.10. From February 2007, Mr Jones had specific responsibility as an approved person for the DMU and the CMIU. The implementation of the plan to resolve the backlog of pending possessions cases was, therefore, his direct responsibility. He was also a member of ALCO. The monthly reports produced by the CMIU (and prepared with input from the DMU) to ALCO did not refer to the pending possession loans. Mr Jones knew that management information was being produced to ALCO which was incorrect. The Executive Directors, who made up some of the ALCO membership, received information in April 2007 which showed that pending possessions were not included in the reported arrears figures. Although Mr Jones maintains that it was clear, the FSA concludes that he should have ensured the accuracy of management information provided to ALCO and should have brought to all ALCO members' attention that the pending possessions were excluded from both the arrears and the possessions numbers.
- 4.11. Notwithstanding the agreement reached with Mr Baker to resolve the backlog of pending possession cases within 6 months, the reported figures were still incorrect in the interim results for 2007 published in July 2007, although the financial statements remained accurate. At that time there remained 828 undisclosed pending possessions. Despite knowing the issue had not been resolved in the timescale agreed, Mr Jones took no further action to correct the information in the 2007 interim accounts. No clear explanation was given to certain internal and external stakeholders that the pending possessions cases had been unreported in the first place and of the decision made as to how to resolve the backlog of cases.

#### **Comments to the market and external parties**

- 4.12. On 24 January 2007, Mr Jones participated in a presentation to the market discussing the Firm's 2006 accounts. In this presentation Mr Baker made misstatements about the impaired loans. Although the FSA acknowledges that there would have been limited

opportunity for Mr Jones to have contradicted Mr Baker at the time, he did fail to correct the misstatements made by Mr Baker (at the time and subsequently) that NR's arrears levels were less than half the CML average. Mr Baker attributed this to improved collections and improved front end risk underwriting processes. Mr Jones knew that the reported data in respect of impaired loans stated in the Operating and Business Review for the 2006 annual accounts appeared low because 1,917 pending possession cases had not been reported.

## **5. BREACHES**

5.1. In performing his controlled functions, Mr Jones's conduct fell short of the FSA's regulatory standards for approved persons. In particular, Mr Jones breached Statement of Principle 1 in that he failed to act with integrity in carrying out his controlled functions because:

- (1) when he was informed that 1,917 cases had been omitted from the impaired loan figures, he failed to ensure that all senior management of the Firm were fully aware of the position, or to make any formal record that this issue had arisen;
- (2) he agreed on a course of action which was not transparent and did not have immediate effect;
- (3) he knew that the reported impaired loans figures in the Operating and Business Review for the 2006 annual accounts and the 2007 interim accounts were inaccurate as they did not include the pending possessions figures. Had the true number of impaired loans been disclosed in January 2007, either the Firm's arrears figure would have increased by more than 50% or alternatively, if the 1,917 loans had been reported as in possession, the possessions figures would have increased by 300%. In addition Mr Jones was aware that ALCO was considering inaccurate information regarding the impaired loans figures and that misleading statements were being made by the Firm to external parties including market analysts; and
- (4) he continued to attend monthly ALCO meetings during the Relevant Period where the omission of the pending possession cases, and the subsequent decision to feed these cases into the possessions or arrears data, was not known to all ALCO members. Despite this, Mr Jones did not specifically bring the issue to the

attention of all ALCO members nor ensure that the decision that had been made, was formally explained or recorded anywhere.

- 5.2. By reason of his misconduct as described above, the FSA considers that Mr Jones has acted without integrity and is not a fit and proper person to perform any functions in relation to any regulated activities carried on by any authorised person, exempt person or professional firm.

## **6. ANALYSIS OF THE PROPOSED SANCTION**

- 6.1. The FSA has taken into account the totality of Mr Jones's conduct and considers that during the Relevant Period, he acted without integrity in the exercise of his controlled function responsibilities and that his conduct fell below the standards expected of an approved person exercising a significant influence function. Mr Jones's conduct is accordingly considered to constitute a breach of Statement of Principle 1.
- 6.2. The FSA accepts that Mr Jones's conduct must be viewed in the context of his overall behaviour during the Relevant Period. In particular, the FSA has taken into account his strong professional record, including Mr Jones's career of 13 years in the regulated sector and that he has previously not been the subject of any regulatory action. The FSA has also taken into account the impact of the financial crisis on the Firm, which began in August 2007, and became Mr Jones's priority from that point onwards.
- 6.3. Nonetheless, having regard to the guidance referred to at Chapter 9.9 of the Enforcement Guide (EG) and in particular to the fact that:
- (1) Mr Jones demonstrated a serious lack of integrity for a period of approximately 12 months during which time internal and external stakeholders were provided with incorrect information (which he knew was incorrect) on numerous occasions;
  - (2) he held a very senior role in a high impact firm, with responsibilities as an approved person to perform the director controlled function; and
  - (3) the integrity of senior managers is a key factor in the FSA's work to maintain confidence in the financial system;



it is appropriate and proportionate for Mr Jones to be prohibited from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm.

### **Prohibition**

- 6.4. The FSA has had regard to the guidance in Chapter 9 of the Enforcement Guide (EG) in proposing that a Prohibition Order is appropriate in this case. The relevant provisions of EG are set out in Annex A of this notice.

### **Financial penalty**

- 6.5. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. The relevant provisions of EG and DEPP are set out in Annex A of this notice.
- 6.6. In determining the appropriate level of financial penalty the FSA has also had regard to Chapter 13 of the Enforcement Manual (ENF), the part of the FSA's Handbook setting out the FSA's policy on the imposition of financial penalties in force until 27 August 2007 and therefore applying for part of the Relevant Period.
- 6.7. The FSA considers it appropriate to impose a financial penalty against Mr Jones, in addition to making the Prohibition Order in accordance with EG 9.23. The FSA has taken all of the circumstances of the case into account in deciding that the imposition of a financial penalty is appropriate and the level of the penalty imposed is proportionate.
- 6.8. DEPP sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

### **Deterrence**

- 6.9. The FSA considers that the imposition of a financial penalty will promote high standards of regulatory conduct by deterring approved persons from acting in this way.
- 6.10. In determining the appropriate level of penalty, the FSA has had regard to Mr Jones's conduct in the performance of his controlled functions. It has taken into account the need to ensure those who are approved persons act with integrity. The FSA considers that a

significant penalty should be imposed to demonstrate to Mr Jones, and to others, the seriousness with which the FSA regards this behaviour.

**The nature, seriousness and impact of the breach: DEPP 6.5.2G(2)**

- 6.11. The FSA considers that Mr Jones's breach of Statement of Principle 1 is of a serious nature. The impact of the failure to report the 1,917 impaired loan accounts is set out at paragraph 2.6(3) above.

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

- 6.12. The FSA considers that Mr Jones's failure to escalate the issues he discovered to all internal and external parties from at least January 2007, his implementation of an agreement to deal with the pending possessions loans in the manner described and his failure to correct the misleading statements made in the reported accounts by others was reckless.

**Whether the person on whom the penalty is to be imposed is an individual: DEPP 6.5.2G(4)**

- 6.13. The FSA has taken into account the fact that as an individual, the imposition of a financial penalty is likely to have a significant impact on Mr Jones. The FSA considers the imposition of a financial penalty to be proportionate and appropriate in relation to the seriousness of the misconduct, especially in view of the seniority of his position at the Firm. Mr Jones's role included ensuring that business was conducted in full compliance with all applicable laws, regulations and codes of practice.

**The financial resources and other circumstances of the person: DEPP 6.5.2G(5)**

- 6.14. There is no evidence to suggest that Mr Jones would be unable to pay the proposed financial penalty.

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

- 6.15. The FSA accepts that Mr Jones has not financially benefited from his conduct.

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

- 6.16. Mr Jones has complied with the requirements imposed upon him by the FSA. The FSA accepts that he has co-operated with the FSA's investigation.

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

- 6.17. The FSA has not previously taken any disciplinary action against Mr Jones.

**Previous action taken by the FSA: DEPP 6.5.52G(10)**

- 6.18. The FSA seeks to ensure consistency when it determines the appropriate level of penalty and has taken into account previous decisions made in relation to similar misconduct by approved persons.

**Other points in mitigation**

- 6.19. The FSA has noted that Mr Jones was not directly responsible for the DMU and CMIU in January 2007.
- 6.20. Mr Jones placed undue weight on the accuracy of the financial statements whilst failing to consider the importance of ensuring the accuracy of the Operating and Business Review.
- 6.21. Mr Jones has stated that he believed that the non-disclosure of the pending possessions would not be misleading to investors or other stakeholders because the financial statements were correct and he believed that loan loss impairment charges on residential loans were not material to NR's financial position or forecasts at the time.
- 6.22. Mr Jones has stated that it was his understanding that the executive director members of ALCO were aware from April 2007 that there were a number of loans in default which were not reported in either the arrears or possessions figures.

**7. CONCLUSION**

- 7.1. Having regard to Mr Jones's demonstration of a lack of integrity and accordingly his breach of Statement of Principle 1, he has also acted in contravention of the FIT test for approved persons as set out at Annex A. In accordance with section 56 of FSMA and for the reasons set out in this notice, it is proportionate and appropriate for the FSA to make an order prohibiting Mr Jones from performing any functions in a regulated firm if it

appears that he is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person.

- 7.2. Having regard to the seriousness of the breaches and the risks they posed to the FSA's statutory objective of maintaining confidence in the financial system, the FSA proposes to impose on Mr Jones a financial penalty of £320,000.
- 7.3. It is necessary and proportionate to impose a financial penalty and a prohibition on Mr Jones in order to promote high standards of regulatory conduct and to deter other approved persons from acting in this way.

## **8. DECISION MAKERS**

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

## **9. IMPORTANT**

- 9.1. This Final Notice is given to Mr Jones in accordance with sections 390 of the Act.

### **Manner and time for payment**

- 9.2. The financial penalty of £320,000 must be paid in full by Mr Jones no later than 28 days from the date of the issue of this Final Notice ("the due date for payment").

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

- 9.3. If all or any of the financial penalty is outstanding after the due date for payment the FSA may recover the outstanding amount as a debt due and owing by Mr Jones to the FSA.

### **Publicity**

- 9.4. 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 Mr Jones or prejudicial to the interests of consumers.

**FSA contacts**

- 9.5. For more information concerning this matter generally, contact Bill Sillett (direct line: 020 7066 5880) of the Enforcement and Financial Crime Division of the FSA.

**Will Amos****FSA Enforcement and Financial Crime Division**

## ANNEX A

### Relevant Rules, Guidance and other Regulatory Provisions

#### 1 Fit and Proper Test for Approved Persons

1.1 The purpose of the part of the FSA Handbook entitled the Fit and Proper Test for Approved Persons (HT) is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.

1.2 FIT 1.3.1G provides:

"The *FSA* will have regard to a number of factors when assessing the fitness and propriety of a *person* to perform a particular *controlled function*. The most important considerations will be the *person's*:

- (i) honesty, integrity and reputation;
- (ii) competence and capability; and
- (iii) financial soundness".

1.3 FIT 2.1 .1G provides that in determining a person's honesty, integrity and reputation, the FSA will have regard to all relevant matters including, but not limited to those set out in FIT 2.1.3G.

1.4 The matters referred to in FIT 2.1.1G to which the FSA will have regard include, but are not limited to:

- (1) whether the person has been the subject of disciplinary proceedings, by the FSA;
- (2) whether the person has contravened any of the requirements and standards of the regulatory system;
- (3) whether the person has been dismissed, or asked to resign and resigned, from employment or from a position of trust, fiduciary appointment or similar; or
- (4) whether, in the past, the person has been candid and truthful in all his dealings with any regulatory body and whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards.

#### 2 Enforcement Guide

2.1 The FSA's policy in relation to the decision to make a prohibition order is to set out on Chapter 9 of the Enforcement Guide (EG).

2.2 EG 9.1 explains the purpose of prohibition orders made under section 56 in relation to the FSA's regulatory objectives.

- 2.3 EG 9.4 sets out the general scope of the FSA's power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual's lack of fitness and propriety is relevant.
- 2.4 EG 9.5 states that the scope of a prohibition order will depend on the reasons why the person is not fit and proper and the severity of risk which he poses to consumers or the market generally.
- 2.5 EG 9.8 to 9.14 set out guidance on the FSA's approach to making prohibition orders against approved persons.
- 2.6 EG 9.8 provides that, in deciding whether to make a prohibition order, the FSA will consider whether its regulatory objectives can be achieved adequately by imposing disciplinary sanctions.
- 2.7 EG 9.9 provides that when the FSA decides whether to make a prohibition order against an approved person, it will consider all the relevant circumstances of the case. EG 9.9 refers to a non exhaustive list of factors include:
- ...
- (2) Whether the individual is fit and proper to perform functions in relation to regulated activities. The criteria for assessing the fitness and propriety of approved persons are set out in FIT 2.1 (Honesty, integrity and reputation); FIT 2.2 (Competence and capability) and FIT 2.3 (Financial soundness).
- (3) Whether, and to what extent, the approved person has failed to comply with the Statements of Principle issued by the FSA with respect to the conduct of approved persons;
- ...
- (5) The relevance and materiality of any matters indicating unfitness.
- (6) The length of time since the occurrence of any matters indicating unfitness.
- (7) The particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates.
- (8) the severity of the risk which the individual poses to consumers and to confidence in the financial system.
- 2.8 EG 9.12 provides examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order to withdraw the approval of an approved person. The examples include serious breaches of the Statements of Principle for approved persons.
- 2.9 EG 9.23 states that in appropriate cases the FSA may take other action against an individual in addition to making a prohibition order, including the use of its powers to impose a financial penalty.

### **3 DEPP (pre March 2010)**

3.1 DEPP 6.2 provides guidance on deciding whether to take action. The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty or public censure. Set out below is a list of factors taken from DEPP 6.2.1G that may be relevant for this purpose. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

The nature, seriousness and impact of the suspected breach, including:

- (a) the duration and frequency of the breach;
- (b) the amount of any benefit gained or loss avoided as a result of the breach;
- (c) whether the breach reveals serious or systemic weaknesses of the management systems or internal controls relating to all or part of a person's business;
- (d) the impact or potential impact of the breach on the orderliness of markets including whether confidence in those markets has been damaged or put at risk; and
- (e) the loss or risk of loss caused to consumers or other market users.

3.2 The conduct of the person after the breach will be taken into account, including but not limited to the degree of co-operation the person showed during the investigation of the breach and the likelihood that the same type of breach (whether on the part of the person under investigation or others) will recur if no action is taken.

3.3 The FSA will have regard to the previous disciplinary record and compliance history of the person including, whether the FSA (or any previous regulator) has taken any previous disciplinary action resulting in adverse findings against the person and the general compliance history of the person and whether the FSA (or any previous regulator) has previously issued the person with a private warning.

3.4 Action taken by the FSA in previous similar cases will also be considered.

3.5 DEPP 6.5 provides guidance on determining the appropriate level of financial penalty. The FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned. The list of factors in DEPP 6.5.2G is not exhaustive: not all of these factors may be relevant in a particular case, and there may be other factors, not included below, that are relevant.

3.6 The FSA does not apply a tariff of penalties for different kinds of breach. This is because there will be very few cases in which all the circumstances of the case are essentially the same and because of the wide range of different breaches in respect of which the FSA may take action. The FSA considers that, in general, the use of a tariff for particular kinds of breach would inhibit the flexible and proportionate policy which it adopts in this area.

3.7 The following factors may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act:



## **Deterrence**

- 3.8 When determining the appropriate level of penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

### **The nature, seriousness and impact of the breach in question**

- 3.9 The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached. The following considerations are among those that may be relevant:
- (1) the duration and frequency of the breach;
  - (2) 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
  - (3) the loss or risk of loss caused to consumers, investors or other market users.

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

- 3.10 The FSA will regard as more serious a breach which is deliberately or recklessly committed. The matters to which the FSA may have regard in determining whether a breach was deliberate or reckless include, but are not limited to, the following:
- (1) whether the breach was intentional, in that the person intended or foresaw the potential or actual consequences of its actions;
  - (2) where the person has not followed a firm's internal procedures and/or FSA guidance, the reasons for not doing so;
  - (3) where the person has taken decisions beyond its or his field of competence, the reasons for the decisions and for them being taken by that person; and
  - (4) whether the person has given no apparent consideration to the consequences of the behaviour that constitutes the breach.
- 3.11 If the FSA decides that the breach was deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case.

### **Whether the person on whom the penalty is to be imposed is an individual**

- 3.12 When determining the amount of a penalty to be imposed on an individual, the FSA will take into account that individuals will not always have the resources of a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than on a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individual are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level.

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

- 3.13 The FSA may take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the person were to pay the level of penalty appropriate for the particular breach. The FSA regards these factors as matters to be taken into account in determining the level of a penalty, but not to the extent that there is a direct correlation between those factors and the level of penalty.
- 3.14 The purpose of a penalty is not to render a person insolvent or to threaten the person's solvency. Where this would be a material consideration, the FSA will consider, having regard to all other factors, whether a lower penalty would be appropriate. This is most likely to be relevant to a person with lower financial resources; but if a person reduces its solvency with the purpose of reducing its ability to pay a financial penalty, for example by transferring assets to third parties, the FSA will take account of those assets when determining the amount of a penalty.
- 3.15 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.
- 3.16 The size and resources of a person may also be relevant in relation to mitigation, in particular what steps the person took after the breach had been identified; the FSA 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.
- 3.17 A person's incentive to commit a breach may be greater where the breach is, by its nature, harder to detect. The FSA may, therefore, impose a higher penalty where it considers that a person committed a breach in such a way as to avoid or reduce the risk that the breach would be discovered, or that the difficulty of detection (whether actual or perceived) may have affected the behaviour in question.