Financial Services Authority

FINAL NOTICE

To: **Deutsche Bank AG**

Of: **Winchester House**
1 Great Winchester Street
London EC2N 2DB

Date: **10 April 2006**

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.

ACTION

1. On 6 April 2006 the FSA gave Deutsche Bank AG[1] ("Deutsche") a Decision Notice which notified it 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 £6,363,643 on Deutsche in respect of breaches of the FSA's Principles for Business ("the Principles") referred to below. This consisted of the following elements:

   1.1 a penalty of £3.5 million in respect of the breaches of Principles 2 and 5 of the Principles in relation to the Scania transaction;

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[1] Deutsche is a limited liability company incorporated in Germany and passported into the UK under the Investment Services Directive. Its prudential regulator is the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). The FSA's decision in this instance relates to the conduct of Deutsche's London branch (an EEA Authorised firm).

1.2 a penalty of £500,000 in respect of the breaches of the Principle 2 of the Principles in relation to the Cytos transaction; and

1.3 an additional amount of £2,363,643 in respect of the loss avoided by Deutsche in relation to the Scania transaction (referred to in paragraph 19.8).

REASONS FOR THE ACTION

2. The FSA imposed the penalty on Deutsche in respect of breaches of the Principles referred to below. These breaches arose from two transactions conducted by the London branch of Deutsche during March 2004.

3. **The Scania transaction**

3.1 The first transaction relates to the offer and sale by Deutsche of 63.7 million B ordinary shares in Scania AB ("Scania B shares"), a Swedish truck manufacturer, on 4 March 2004 ("the Scania transaction"). Deutsche agreed to purchase the Scania B shares from AB Volvo ("Volvo") and to dispose of them by way of an accelerated book build ("the book build"). An accelerated book build is where an investment bank acquires a block of securities, intending to sell it on to clients by compiling a "book" of orders from these clients and then managing the distribution of the shares. In compiling a book, an investment bank will often give an indication of the likely allocation price of the book. This is known as a marketing range.

3.2 Scania B shares are listed on Sweden's Stockholmsbörsen ("Stockholmsbörsen"). This was not a prescribed market for the purposes of the FSA's Code of Market Conduct (MAR 1.1.3(1) G) in force at the time of the Scania transaction. The provisions of MAR did not, therefore, apply to the Scania transaction.

3.3 Deutsche acted in contravention of the Principles set out below, in respect of the following aspects of the Scania transaction:

<u>Trading in the market during the book build</u>

3.4 Deutsche acted in contravention of Principle 5 of the Principles by failing to observe proper standards of market conduct, in that:

i. a trader in its equities trading division ("the Deutsche trader") conducted proprietary trading in high volumes (relative to other market participants) of Scania B shares in the secondary market for a period during a sensitive time of the book build and in a manner that was not transparent as it was conducted through two external Swedish brokers. Therefore it was not apparent to the market that Deutsche was trading in Scania B shares while the book build was progressing. The trading was conducted at the request of Deutsche's then Head of European Cash Trading, David Maslen ("Mr Maslen");

ii. the size and manner of the trading had the potential to affect the price of Scania B shares in the market. It did, in fact, have a material effect on the market price of the shares for a period while the book build was in progress in that it contributed to the share price moving up by approximately 0.85% to within the marketing range and remaining within the marketing range for most of that period; and

iii. through Deutsche's failure to consider the manner of the trading and then to monitor the trading adequately, potential investors did not obtain a full understanding of the nature of the supply and demand for Scania B shares independent of Deutsche and the fact that it was Deutsche's activity that was affecting the share price during its period of trading. The price at which Scania B shares traded on the secondary market and the demand for Scania B shares, independent of Deutsche, could have been relevant for the decisions of potential investors whether to enter or remain in the book build.

3.5 Deutsche's failure to observe proper standards of market conduct is made more serious by the fact that the FSA considers that, whatever the purpose of its trading, Deutsche knew or ought reasonably to have known, that undertaking proprietary trading in Scania B shares in the size and manner in which it was conducted had the potential to affect the share price and the impressions of supply and demand for Scania B shares in the market, while the book build was in progress and this could be relevant to potential investors.

3.6 Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence in that:

i. Mr Maslen had an active role in the book build process and instructed the Deutsche trader to trade in Scania B shares during the book build. Despite his role and the potential effect of such proprietary trading, there was a failure to notify or seek clearance from compliance and/or more senior management before or during the course of the proprietary trading; and

ii. Mr Maslen and the Deutsche trader failed to check the restricted list prior to the commencement of or during the proprietary trading in Scania B shares and therefore the objective of the restricted list was not achieved. Despite their knowledge of the Scania B book build neither was aware that Scania B shares were on Deutsche's restricted list and they traded in contravention of the restricted list.

<u>Announcements made to the Equity sales force</u>

3.7 During the course of the book build on 4 March 2004 and 5 March 2004 Deutsche's Equity Capital Markets ("ECM") made a series of announcements to its Equity sales force in London ("Equity Sales") by means of Deutsche's internal electronic messaging system ("DB Chat"). The contents of these announcements were subsequently disseminated by Equity Sales to their institutional clients.

3.8 Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence in that:

i. three of the announcements were incomplete in respect of the basis of the demand for the book build as they did not disclose the basis of coverage calculations;

ii. one of the announcements was inaccurate in respect of the level of cover;

iii. one of the announcements failed to clearly disclose that an indication of interest entered into the book was only an estimate; and

iv. it failed to adequately consider whether it could comply with its internal requirements to hold a position in the medium to long term when assessing whether it could include a proprietary order in the calculation of its cover for an announcement.

3.9 Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence in that it made an announcement on DB Chat that Deutsche would be reporting its holding in Scania B shares to the Stockholmbörsen prior to it actually notifying the Stockholmbörsen of its holding. As a result, the contents of the announcement were disclosed by Equity Sales to some of Deutsche's clients who had participated in the book build prior to it being disclosed by the Stockholmbörsen.

4. The Cytos transaction

4.1 The second transaction relates to Deutsche's offering of Cytos Biotechnology AG ("Cytos") shares on 25 March 2004, which was managed by Deutsche's staff in London ("the Cytos transaction"). Cytos is a Swiss public company listed on the Swiss Exchange ("SWX")[2]. The Cytos share price was stabilised ("the stabilisation exercise") by a Zurich based trader ("the Zurich trader") under instruction from Deutsche's London staff. Mr Maslen had no relevant involvement in the stabilisation exercise.

4.2. The FSA's Price Stabilising Rules did not apply to the Cytos transaction. However, Deutsche decided that its internal procedures in relation to price stabilisation, based upon the FSA's stabilisation regime, should apply to the Cytos transaction.

4.3. Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence in that its relevant London staff did not:

i. ensure that the trader, who conducted the stabilisation trades in Zurich understood and followed the internal procedures regarding stabilisation that Deutsche had intended to apply to the Cytos transaction; and

ii. escalate issues arising from the stabilisation exercise to compliance in a timely manner.

RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

5. Section 206 of the Act provides:

"if the [FSA] considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate."

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2 This was not a prescribed market for purposes of the FSA's Code of Market Conduct (MAR 1.1.3(I)(G) and the Price Stabilising Rules contained in MAR did, therefore, not apply.

6. The Principles, as set out in the FSA's Handbook of Rules and Guidance represent high level standards of business. The Principles constitute requirements imposed on authorised persons under the Act.

7. Principle 2 of the Principles provides:

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

8. Principle 5 of the Principles provides:

"A firm must observe proper standards of market conduct."

FINDING OF FACTS

The Scania transaction

9. Background to book building

9.1 A "block trade" is a transaction involving the sale or purchase of a large quantity of shares and may involve the disposal of a significant shareholding by a shareholder.

9.2 When a sale has been underwritten by an investment bank on behalf of a shareholder it is typically described as a "placing". The investment bank may agree to fully underwrite such a transaction and guarantee the price at which it will buy the shares from the original holder. It may acquire the block of shares intending to distribute it to clients. One method of achieving this is by compiling a book of indications of interest from the clients. This is known as "book building".

9.3 When a deal is classified as a "bought" deal, it generally refers to an offering in which the investment bank buys all the shares in a particular company and sells them to investors. Once the investment bank owns the shares they are considered as being "on risk", which means that, if the investment bank is unable to generate sufficient buy orders for the shares to the value of the purchase amount of the shares, it would be left with an exposure to the shares and possibly make a loss on the deal. The investment bank may then seek to place the shares as quickly as possible to its clients. This is frequently termed an "accelerated book build".

9.4 Information about the deal and the marketing range is communicated by the investment bank to the market. The marketing range is fixed initially by the price at which the investment bank thinks it can sell the deal.

9.5 The sales desk at the investment bank will contact potential investors, typically institutions, to obtain indications of interest. These indications of interest will reflect the size and level of the investors' demand and their price sensitivity, if any. Price sensitivity arises because investors may express varying levels of demand at different prices, which means that the level of demand in the book can be "price sensitive". While the book is open investors will not have certainty in respect of the eventual price at which the shares will be allocated, however, the marketing range would offer an indication. The indications of interest from potential investors can be amended during the course of a book build and there may be communications between potential investors, the investment bank's sales desk and internally within the investment bank regarding the level of demand. Potential investors may exaggerate their demand in a potentially successful deal on the expectation that, given a high level of demand for the shares, individual indications of interest will be scaled back.

9.6 The indications of interest are collated by the syndicate desk of the investment bank who are responsible for creating or "building" a book. The book shows the investment bank the overall level of demand for the shares, the nature of the investors and any potential price sensitivity in the demand.

The secondary market

9.7 The secondary market is the market where share transactions take place after the initial distribution. Many book builds, such as the Scania transaction, occur whilst there is an open secondary market in the same shares. During a book build investors may change their decisions regarding their participation in the book build. The current price at which shares are trading in the secondary market and the level of supply and demand for those shares are considerations that may potentially be taken into account by investors when considering subscribing for the shares via a book build. Other considerations for investors may include the liquidity of the stock and their views on the long term performance of the shares.

9.8 If an investment bank responsible for a book build is active in a secondary market in significant volumes at the time the book build is progressing, market participants can reasonably expect that its activity is undertaken in a transparent way. Such transparency will enable any investors who are concerned by the current share price and the identity of any significant purchasers to make suitably informed decisions regarding any potential participation in the book build.

Coverage

9.9 An investment bank may refer to the level of "cover" which is the extent to which the level of demand in the book is meeting the amount of shares available.

9.10 Cover is often measured in percentage terms or as a numbered multiple. A fully covered deal would be 100% or one times covered when orders for the entire block of shares are generated. In such a case, the investment bank conducting the book build has no obligation or exposure, as all the shares held would have been sold on to the secondary market. A deal with twice as much demand as supply would be two times or 200% covered. As investors may have different levels of demand depending on the price at which the shares in the book build is eventually allocated, the level of "cover" may change depending on the book allocation price.

9.11 From an investor's perspective, cover is a measure of the demand for a transaction and is strongly indicative of market interest in the transaction. Where a transaction is covered by a multiple greater than one, it gives an indication to investors that demand from the market is greater than the supply made available by the book build and that the investors may not receive a full allocation. Cover provides an indication of the extent to which an investor's original indication of interest may be scaled back because of excess demand over supply. It may also provide an indication of how well the shares will subsequently perform in the secondary market.

Closing and allocation

9.12 The book is "closed" when the investment bank announces that it is not accepting any more indications of interest. Generally the sales desk will give potential investors notice that the book is due to close, in order to allow them time to place their last indications of interest or amend any previous indications of interest. A decision will then be made by the investment bank as to what level the book will be priced at, and how the available shares will be allocated amongst those investors who placed indications of interest in the book. This allocation is particularly important if the book has been oversubscribed, which means there are more indications of interest than available shares. The decision regarding pricing and allocation will reflect a number of factors including the size of the indications of interest, the price the potential investor is willing to pay and the nature of the investor.

9.13 Once the decisions regarding price and allocation have been made, the sales desk at the investment bank will communicate this to the potential investors and, on agreement, the shares will be allocated.

10. Background to approval of the Scania transaction

10.1 During the period leading up to 4 March 2004, Deutsche discussed terms with Volvo under which it might assist Volvo in disposing of its Scania B holding of 63.7 million B ordinary shares. Scania shares are listed on Sweden's Stockholmsbörsen. Prior to the Scania transaction, the stock was extremely illiquid.

10.2 On the morning of 4 March 2004, Deutsche concluded an agreement with Volvo to purchase its Scania B shares for approximately SEK 14.9 billion or £1.1 billion. The Scania transaction was important for Deutsche. As it was a "bought deal", if Deutsche was unable to sell any Scania B shares it would be left with an exposure to them on its books. It was recognised by Deutsche that in order to "break even" on the Scania transaction, an allocation price of SEK 234 would need to be obtained. At the time of the Scania transaction, Deutsche was close to its internal value at risk ("VAR") limits (a measure of the market risk Deutsche was exposed to). The VAR limit is self imposed by Deutsche and is a strategic measurement of its appetite for market risk considering such factors as perceived economic prospects.

10.3 The average daily volume of Scania B shares traded from the beginning of 2004 to 3 March 2004 was 308,225 shares. On 3 March 2004 (the day prior to the book build) Scania B shares closed at a mid price of SEK 239, with a volume for the day of 204,165 shares. At a Deutsche Equity Commitment Committee ("ECC") meeting on 2 March 2004 the view was expressed that trading in as little as 50,000 Scania B shares could move the price of the shares. However, it was anticipated at the ECC meeting that once the Scania transaction was announced liquidity levels would increase significantly as Volvo were disposing of approximately 29% of the share capital of Scania.

10.4 The book build was managed by the ECM Syndicate team, which was part of Deutsche's Global Corporate Finance Division and provides equity and equity linked products and services, including syndication.

11. Mr Maslen

11.1 Mr Maslen was responsible for monitoring any risk that Deutsche took in such trades, and was also responsible for managing any residual or proprietary risk which was incurred in terms of both Deutsche and his book. He worked at Managing Director level within Deutsche in London, and 86 people throughout Europe reported to him. At the time, he had approximately 16 years' experience in cash equity trading (which relates to sales and trading of equities). Mr Maslen is an FSA approved person, holding the controlled function of investment adviser.

11.2 Mr Maslen was significantly involved in the Scania transaction being run by the ECM Syndicate team, but he also had responsibilities with regard to equity trading (a separate team within Deutsche in London). He therefore was above the Chinese Wall[3] between ECM and the equities trading division, which is known as being "supra wall". In this capacity, he was a party to non-public information in relation to order flow information, he participated in discussions with senior management prior to the Scania transaction regarding its merits and was involved in setting the marketing range for the book build. He was also aware of the progress of the Scania transaction (including the size of indications of interest in the book and who placed the indications of interest). After the book closed, he was significantly involved in the allocation and pricing of the Scania transaction. One of the reasons for Mr Maslen's involvement was that the group that he managed within the equities trading division was to be responsible for managing any position (or back book) in Scania B which Deutsche could not distribute to clients.

12. Summary of the events of 4 March 2004

12.1 At 10.35am[4] on 4 March 2004, Deutsche announced on DB Chat that it was the sole book runner of the book build of Volvo's entire shareholding of 63.7 million B ordinary shares in Scania, at a price between SEK 234 and 236.5 ("the marketing range").

12.2 Deutsche's Equity Sales team then contacted potential investors to seek indications of interest. Any indications of interest received, including the size and any investor price limits, were entered into an electronic order book system called "book builder", which was controlled by ECM. To track the progress of the book build, Deutsche was able to access running totals of indications of interest received. This included a running total of indications of interest where demand was within the marketing range and a total of indications of interest at "maximum demand", which represented all indications of interest, received whether within the marketing range or below.

12.3 Initially, the book build progressed well and strong demand was obtained. By 11.40am indications of interest for 31 million Scania B shares at SEK 234 had been received. At that time there was no significant difference between indications of interest received at SEK 234 and those received at maximum demand. Between

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[3] Chinese Wall procedures are designed to control the flow of information between distinct sections of a firm's business, in order to prevent possible and/or apparent conflicts of interest.

[4] All times referred to in this Warning Notice are UK times.

10.40am and 11.40am, Scania B shares traded in the secondary market at prices between SEK 237 and SEK 234.

12.4 Between 11.40am and 11.55am, the market price of Scania B shares dropped to SEK 231.50 before moving back to SEK 233. At this time, as is discussed further at paragraph 13.1 below, Deutsche Bank commenced purchasing shares in the market.

12.5 At 12.30pm an announcement was made on DB Chat to the effect that the book was 80% covered. This is discussed in more detail in paragraph 14.2.

12.6 By 1.30pm the progress of the book build had stalled. In the intervening hour, indications of interest for 1.8 million shares at SEK 234 had been received (an extra 2.3% of the book).

12.7 At 2.00pm an order for approximately 10% of the book was entered into the book on behalf of Deutsche. Shortly afterwards, at 2.10pm, an existing indication of interest by Deutsche Private Bank was amended, which had the effect of covering the book at maximum demand (non-price sensitive). This indication of interest was an individual's estimate of potential demand at a lower price than the existing indication of interest.

12.8 At 2.10pm Deutsche announced on DB Chat that the book in Scania B shares was covered and would close at 2.30pm. At this time the book builder system showed that the book was covered at maximum demand. This included Deutsche's 10% order in the book, together with the estimated indication of interest on behalf of Deutsche Private Bank. At a possible allocation price of SEK 234, the cover achieved for the book was only 83%. This is discussed in more detail in paragraph 14.6

12.9 After 2.14pm the Scania B share price fell below the marketing range. Deutsche's purchasing volumes fell significantly after this time and Scania B shares were purchased below the marketing range. The last instructions given by the Deutsche trader to the external Swedish brokers' to purchase Scania B shares was at 2.34pm and these trades were executed at 3.03pm.

12.10 Following 2.30pm as the secondary market price of Scania B shares fell, there were a number of adjustments to the book in the size and prices of indications of interest that had been placed by investors. At 2.50pm an announcement was made on DB Chat that the book had closed. Meetings then took place to decide the price at which the Scania B shares should be allocated. Mr Maslen was involved in the discussions.

12.11 Deutsche decided to price the deal at SEK 234, even though this meant that it would have to remain with a risk position in the stock. Scania B shares were consequently allocated to investors at SEK 234. The market price of Scania B shares at 3.42pm, being the time the allocation was announced to Equity Sales, was SEK 230.50. By the time of the allocation meeting an erroneous indication of interest had been corrected (decreasing demand by 4.7 million shares at SEK 234), and some investors had withdrawn from the book as the secondary market share price continued to fall. Other investors' indications of interest were scaled back by the allocation team. In total, 75% of the Scania B shares in the book (47.8 million shares) were eventually distributed to clients, with the remainder (15.9 million shares) retained by Deutsche. Including the proprietary trading, Deutsche owned a maximum of 19.2 million Scania

B shares on 4 March 2004.

12.12 The Scania B share price fell and closed for the day at SEK 229.

13. Trading in the market while the book build was progressing

13.1 After the market price dropped to SEK 231.50 at 11.41am, Mr Maslen has stated that he decided to take a position in Scania B shares through the market as the market price was lower than the marketing range for the book and he believed he may not receive a full allocation of the shares if he placed an order in the book as he was of the view that at the time the book build was progressing well. He believed that the Scania shares were an attractive proposition. Mr Maslen therefore instructed a Deutsche trader who reported to him to purchase shares. The Deutsche trader was a senior trader with extensive experience in equities trading.

13.2 The Deutsche trader then made contact with one of the two external Swedish brokers he was to use during the day. The Deutsche trader used the two external Swedish brokers and did not deal directly in the Scania B shares. The external Swedish brokers were responsible for the actual execution of the orders. At times the Deutsche trader gave them specific instructions regarding the price and trading strategy. On other occasions they used their own discretion within parameters set by the Deutsche trader.

13.3 Mr Maslen did not consult Deutsche's Compliance department ("Compliance") in London nor Deutsche senior management in advance of the proprietary trading. Mr Maslen has stated that he believed he did not have to consult Compliance or Deutsche senior management in advance or, or during, the proprietary trading.

13.4 Mr Maslen initially gave the Deutsche trader instructions as to what quantity of shares he wanted. Thereafter, Mr Maslen and the Deutsche trader communicated on several occasions face-to-face and by mobile telephone. Mr Maslen gave some general instructions to purchase further shares. During the period of the trading, further orders were passed by the Deutsche trader to the external Swedish brokers and the external Swedish brokers reported back to the Deutsche trader with details of the total quantity of Scania B shares purchased and the average price paid. Mr Maslen has stated that he believed, during the course of the trading, that approximately 1.25 million Scania B shares had been purchased on his behalf. In fact, a total of 3.5 million Scania B shares were purchased by the Deutsche trader. Mr Maslen was unaware of this as he failed to monitor carefully either the nature or the extent of the trading.

13.5 Deutsche's trading in Scania B shares in the market on 4 March 2004 is discussed below.

<u>11.51am to l2.18pm</u>

13.6. At 11.51 am, when the Scania B share price fell below the marketing range, the Deutsche trader contacted the first external Swedish broker and subsequently placed the first order for Scania B shares. At 11.55am the first purchase was made at SEK233.

13.7 During this period Deutsche purchased a total of 734,500 Scania B shares representing 93% of the total Scania B shares traded in the market during this period. Most of this volume was purchased on the offer side of the market. The purchase of relatively large volumes on the offer will, in the absence of other significant trading, have the effect of contributing to a rise in the share price. The external Swedish brokers used by the Deutsche trader to execute the orders often tried to execute a series of orders, at different prices in the market at the same time.

13.8 The trading conducted on Deutsche's behalf during this period contributed to the bid/offer spread (the quoted prices at which, a buyer is prepared to buy and a seller is prepared to sell) for Scania B shares moving up by approximately 0.85% from SEK 232.50 - SEK 233 to SEK 234.50 - SEK 235, which was within the marketing range.

12.18pm to 2.14pm

13.9 During this period the Scania B share price largely remained at a level within the marketing range. The Deutsche trader purchased a further 2,217,300 Scania B shares representing some 88% of the total shares traded in the secondary market in this period. The trading was predominantly on the bid at SEK 234.50 and towards the end of this period at SEK 234. The purchase of relatively large volumes on the bid will in the absence of other significant trading, have the effect of the share price remaining relatively constant.

13.10 The two external Swedish brokers that the Deutsche trader used to execute the orders often tried to execute a series of orders, at different prices, for Deutsche in the market at the same time.

13.11 The trading conducted on Deutsche's behalf during this period contributed to the bid/offer spread generally remaining at a level within the marketing range. After 2.14pm, no further orders were placed by Deutsche within the marketing range.

2.14pm to 3.03pm

13.12 In this period, the bid/offer spread for Scania B shares moved down at 2.14pm from SEK 234.00 - 234.50 to SEK 232.50 - 233.00 at 3.03pm.

13.13 After 2.14pm, 16 minutes before the advertised closure of the book, Deutsche's trading slowed and shares were purchased, mainly on the bid, at prices below the marketing range. Of the total of 1,598,700 Scania B shares bought during this period, 549,300 (34%) were bought on behalf of Deutsche.

13.14 The final instructions to the external Swedish brokers to purchase shares were given at 2.34pm and were executed at 3.03pm.

Summary of the trading

13.15 At 11.55am the first order to purchase Scania B shares was placed by one of the external Swedish brokers. Between this time and 2.14pm which was shortly after the announcement was made that the book was covered and would be closing ("the relevant time") the Deutsche trader purchased 2,951,800 million shares on behalf of Deutsche through the two external Swedish brokers. This meant that Deutsche was responsible for approximately 90% of the volume of Scania B shares traded in the market in the relevant time. During the relevant time Deutsche's bids were accepted by sellers and replaced, under a steady selling pressure. Deutsche used the external Swedish brokers simultaneously and gave them similar volumes to trade in the market, which meant that during the relevant time there were large open orders in the market at different prices.

13.16 On 4 March 2004, the Deutsche trader purchased up to 3.5 million Scania B shares on behalf of Deutsche out of a total of 8.1 million shares traded in the market. The average price of these purchases was SEK 234.18.

13.17 The trading was conducted at a time when Deutsche was "on risk", and already owned the 63.7 million Scania B shares it had purchased from Volvo. At 2.00pm Deutsche placed an order on its own behalf into the book which amounted to 10% of the book. When later in the day the size of Deutsche's position in Scania B shares became clear (including the shares purchased in the market and the order placed in the book on behalf of Deutsche), instructions were given to those working on the Scania transaction ("the Scania deal team") for the prompt liquidation of a significant proportion so as to reduce Deutsche's risk in Scania B.

13.18 The graph at Appendix A shows the intraday share price movements for Scania B shares and the volumes of shares bought by Deutsche through the two Swedish brokers during 4 March 2004.

<u>Transparency of the trading</u>

13.19 The Deutsche trader decided to use the two external Swedish brokers to conduct the trading on Deutsche's behalf rather than executing the orders himself. By using two different brokers and not conducting the trading through Deutsche's own membership on the Stockholmbörsen the identity of the purchaser giving rise to the majority of the demand present in the market was not transparent. The trades executed by the external Swedish brokers on behalf of Deutsche were only visible in the Swedish market as the two brokers' trading.

<u>Trading in breach of the restricted list</u>

13.20 During March 2004, Deutsche's policy in London was to maintain a list of securities about which Deutsche had particular knowledge and/or interests, which might give rise to a conflict of interest ("the restricted list"). Deutsche sought to manage conflicts by imposing restrictions on the activities its staff could conduct in those securities. All restrictions were communicated by the restricted list. At the time of the Scania transaction, the restricted list was available to all of its employees on Deutsche's Compliance website (on Deutsche's intranet). Deutsche's policies in relation to the restricted list stated that employees were responsible for checking the list before they conducted transactions.

13.21 The book build met Deutsche's internal criteria for entry on to the restricted list. The restriction prohibited proprietary trading in Scania B shares. Restrictions on trading in Scania B shares were added to the restricted list at 10:50am on 4 March 2004. Details of the restriction appeared 15 minutes later on Deutsche's intranet.

13.22 On 4 March 2004 at 1.39pm the Deutsche trader (but not Mr Maslen) was sent an e-mail indicating that the Scania B shares were on the restricted list. However, the

Deutsche trader, did not read the email while conducting the trading in Scania B shares and did not check the restricted list prior to or while conducting the trading. Mr Maslen erroneously assumed that Scania B shares would not be on Deutsche's restricted list and, therefore, he did not check the restricted list when giving the instructions to purchase Scania B shares to the Deutsche trader.

13.23 Apart from Mr Maslen and the Deutsche trader, some other employees at Deutsche were aware of the trading in the market. However, none of them informed Compliance, and senior management at Deutsche were unaware of the trading until after the book build had closed.

Principle breaches in relation to the trading

13.24 The FSA considers that Deutsche failed to observe proper standards of market conduct in contravention of Principle 5 of the Principles.

13.25 In relation to such failures:

i. a Deutsche trader in its equities trading division conducted proprietary trading for a period in high volumes of Scania B shares in the secondary market. Deutsche's purchasing of Scania B shares in the market during most of the book build was significantly higher than that of other market participants;

ii. the trading was conducted at a sensitive time while Deutsche was running a book build in Scania B shares and in a manner that was not transparent;

iii. trading initially occurred below and then at or around the marketing range. Later it tailed off at a price below the marketing range subsequent to Deutsche's announcement on DB Chat that the book was covered and would be closing; and

iv. Deutsche's trading was not transparent to the market as a result of the use of the two external Swedish brokers. The high levels of orders and demand in the market for Scania B shares was largely Deutsche's demand and orders.

13.26 As a result of the trading:

i. the size and manner of the trading had a material effect on the market price of the Scania B shares for a period while the book build was in progress in that it contributed to the price of the shares moving up by approximately 0.85% to within the marketing range and thereafter remaining within the range until it slipped down to below the marketing range; and

ii. during that period of trading, investors and potential investors did not obtain a full understanding of the nature of the demand for Scania B shares independent of Deutsche and the fact that it was Deutsche's activity that was affecting the share price during the period of trading. This could have been relevant to decisions of potential investors as to whether to participate or to remain in the book build.

13.27 The FSA consider that Deutsche's failure to observe proper standards of market conduct is made more serious by the following matters. The FSA considers that:

i. both Mr Maslen and the Deutsche trader knew, or ought reasonably to have known, prior to conducting proprietary trading in Scania B shares, if high volumes of Scania B shares were purchased by Deutsche at a sensitive time during the book build then this could have the potential to affect the Scania B share price and investors understanding of the nature of the supply and demand for Scania B shares. They both had extensive experience in equities trading and Mr Maslen also had extensive experience in book building. Both also knew that Deutsche was operating a book in Scania B shares;

ii. Deutsche knew or ought to have known that the market price and the demand for Scania B shares could be relevant to the decisions of certain potential investors and participants in the book as to whether to enter into or remain in its book build; and

iii. Deutsche knew or ought to have known that market participants would reasonably expect that Deutsche would not trade in a non-transparent manner that influenced the supply and demand of Scania B shares in the market.

13.28 Deutsche acted in breach of Principle 2 of the Principles and failed to conduct its business with due skill, care and diligence in that:

i. Mr Maslen was actively involved in the book build process including having some involvement in setting the marketing range and in the ultimate pricing and allocation of the book. Mr Maslen was also responsible for equity trading. During the book build Mr Maslen instructed the Deutsche trader to conduct proprietary trading in Scania B shares in the market and failed to monitor his trading sufficiently closely. As set out in paragraph 13.3, despite Mr Maslen's role in the Scania transaction and the potential effect of such trading there was a failure to notify or seek clearance from compliance and/or senior management before or during the course of the proprietary trading; and

ii. Scania B was placed on Deutsche's restricted list on 4 March 2004. The restricted list was an important control, which prohibited proprietary trading in shares without prior clearance. The proprietary trading conducted by the Deutsche trader on Deutsche's behalf was in breach of its restricted list. The objective of the restricted list was not achieved as, despite the fact that both Mr Maslen and the Deutsche trader were aware of the book build being undertaken by Deutsche, as set out in paragraph 13.22 neither of them checked the restricted list prior to the commencement of or during the proprietary trading in Scania B shares and therefore was not aware that Scania B was on Deutsche's restricted list.

14. Announcements on DB Chat

14.1 On 4 and 5 March 2004, a series of announcements were made by the ECM Syndicate desk to Equity Sales in London about the book build by means of the DB Chat system. The contents of these statements were disseminated via Equity Sales to their institutional clients.

The 12.30pm announcement on 4 March 2004

14.2. This announcement was made as a result of investors asking for updates on the Scania transaction. It stated:

"Scania books are now over 80% covered. Long only institutions account for at least 75% of this demand. We're leaving books open to give US a chance to look at it. We will give at least 30 mins notice prior to closing books."

14.3 A total of 63.7 million shares were made available in the book build. At the time of this announcement, demand showing in the book builder order system totalled 41.7 million shares. This calculation included all indications of interest irrespective of any marketing range limits (at maximum demand) and 36.1 million shares at a price of SEK 234 (the bottom of the marketing range), which amounted to 65% and 57% of the Scania transaction size respectively.

14.4 However, a large indication of interest from a client amounting to 7 million shares had not been entered into the book at the time of this announcement, but was included in its calculation of coverage. This adjusted the level of cover to 76% and 68% at maximum demand and a price of SEK 234, respectively. Therefore, on the basis of maximum demand, Deutsche was still 2.3 million shares short of the figure of 51 million shares which equated to 80% coverage. On the basis of demand in the marketing range, Deutsche was 7.9 million shares short of the 51 million figure contained in the announcement.

14.5. The announcement referred to demand at a price at which Deutsche had previously considered it may have to sell the Scania B shares in the event that it was unable to place all the Scania B shares, which was SEK 230. The announcement did not make this clear and could have been understood to have reflected coverage within the marketing range. The announcement was therefore inaccurate in the calculation of the percentage of cover achieved and incomplete because it did not make clear the basis of this cover.

The 2.10pm announcement on 4 March 2004

14.6 A further announcement was made on DB Chat at 2.10pm, which reported that:

"Scania books are now covered. We will close books at 14.30. Please get your last orders in ASAP."

14.7 At the time of this announcement demand showing in book builder was for 64 million shares at maximum demand and 57.6 million shares at a price of SEK 234. This represented approximately 100.4% and 90.3% of the deal size respectively (and as explained at paragraph 14.11 errors in recording indications of interest meant that the actual coverage within the marketing range was only 83%). In terms of coverage in the marketing range, Deutsche was in fact 6.1 million shares short of 100% coverage. The result was that Deutsche was not "covered" within the marketing range. However, this was not stated in the announcement. The announcement also did not distinguish between demand at maximum demand and demand within the marketing range.

14.8 In making this announcement Deutsche was taking into account an order from its proprietary trading desk and an estimate of an indication of interest from Deutsche Private Bank. Without these the book would not have been covered at maximum demand. Sufficient care was not given to whether it was appropriate to include these and/or whether to make the basis of inclusion clear in the announcement.

Deutsche Bank proprietary order

14.9 Between 1pm and 2pm it was clear that interest in the book build had slowed. At this time Mr Maslen proposed to the Scania deal team that an order for 6.4 million shares, representing 10% of the book build be made. This was discussed with members of the Scania deal team and Deutsche's Legal and Compliance departments. It was confirmed that such an order could be made and included within any coverage announcement if the position was to be held on a medium to long term basis. The order was made and included within the 2.10pm announcement.

14.10 At the time of making the order, Deutsche was close to its internal VAR limits and had also purchased a large number of shares in the secondary market. Consequently, when the book closed Deutsche was left with a large position in Scania B shares which also included its proprietary trading order. When the size of Deutsche's exposure to Scania B shares became clear, instructions were given for the liquidation of most of the position to the Scania deal team. This possibility had not been appropriately considered when the 2.10pm announcement was made.

Deutsche Private Bank indication of interest

14.11 At 2.10pm an indication of interest was entered into the book on behalf of Deutsche Private Bank. Although, there had been a previous, smaller indication of interest, there had been no such specific indication of interest on this occasion from this client. The indication of interest was an estimate by an individual of the client's possible level of demand at SEK 230 (a price that individual thought the book may be allocated at) and was incorrectly entered into book builder as being in the SEK234-236.5 marketing range.

14.12 The estimated indication of interest increased Deutsche Private Bank's book builder entry by 4.7 million shares to 5.9 million shares (or 9.2% of the deal) within the marketing range. Deutsche Private Bank was not aware of the size of the indication of interest placed in the book on its behalf and subsequently was not allocated any Scania B shares. In its announcement at 2:10pm, Deutsche failed to disclose that this indication of interest was an estimate.

Announcement made at 8.34am on 5 March 2004

14.13 The announcement was entered onto DB Chat after allocations had been made the previous day and attempted to explain how Deutsche had obtained its holding in Scania B shares, detailing the extent of that holding. The announcement reported that:

"Scania. The book was covered when we closed it. When the stock price fell, we lost some of that cover and we scaled some people back on allocations, in order to not exacerbate the situation – hence we were left with position in the stock. Deutsche Bank AG and its subsidiaries will officially report a holding of 9.6% this morning."

14.14 The figure of 9.6% refers to Deutsche's total holding in Scania B shares and not just those acquired through the book build.

14.15 "*Scania the book was covered when we closed it*" was a dictation error and should have read "*Scania the book was covered when we announced it was closed"*. However, as demonstrated above, the block of Scania B shares was not "covered" in the manner which could be understood by all market participants, that is, being within the marketing range.

14.16 Deutsche explained why it was left with a position in the shares by stating: "*When the stock price fell, we lost some of that cover and we scaled some people back on allocations, in order to not exacerbate the situation*". However, this was an incomplete explanation as Deutsche was also left with a position in the shares because of its proprietary order and because it was not fully covered at the allocation price when the book closed.

<u>Principle breaches in relation to the Announcements on DB Chat</u>

14.17 Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence in that:

i. three of the announcements made on 4 and 5 March 2004 on DB Chat to Equity Sales were incomplete as they did not disclose the basis for the calculations contained within them. The failure to explain the basis of the coverage could have had a significant impact on market participants' understanding of the coverage figures;

ii. one of the announcements was inaccurate in respect of the level of cover;

iii. the announcement at 2.10pm on 4 March 2004 stating that the Scania books were covered failed to disclose that the Deutsche Private Bank indication of interest was an estimate; and

iv. adequate checks were not performed to ensure that it could comply with its internal requirements to hold a proprietary position in the medium to long term when assessing if it could include a proprietary order in calculation of cover.

14.18 As a result, there was a risk that any clients who might make decisions on their participation in the book build on the basis of the information disseminated to them by Equity Sales on 4 March 2004, would make their decisions on the basis of incomplete and, in one case, incorrect information.

15. Announcement to the Stockholmsbörsen

15.1 On 5 March 2004, Deutsche sent a fax to the Stockholmsbörsen at 11.15am disclosing that Deutsche had:

"*acquired 18,914,651 class B shares in Scania B. As a result Deutsche Bank and its subsidiary companies hold a total of 19,511,651 B shares, which together represent a 9.76% in the share capital of Scania AB and 1.77% of the voting rights in Scania AB.*"

15.2 The DB Chat announcement of 8.34am was circulated to Equity Sales prior to the official disclosure to the Stockholmsbörsen, without any confidentiality restrictions. A number of staff in Equity Sales then disseminated the information regarding the position to certain Deutsche clients who had participated in the previous day's book build. The staff failed to warn them of the possibility that the information might have an impact on the price and that this information should not be acted upon prior to the holding being announced officially by the Stockholmsbörsen. This announcement was of relevance to clients because it contained potentially price sensitive information regarding Deutsche's residual holding in Scania B shares after the book build, which should have been announced under the Stockholmsbörsen rules.

Principle breaches in relation to the announcement to the Stockholmsbörsen

15.3. Deutsche acted in contravention of Principle 2 of the Principles by failing to conduct its business with due skill, care and diligence that it made an announcement on DB Chat that Deutsche would be reporting its holding in Scania B shares to the Stockholmsborsen prior to it actually notifying the Stockholmsbörsen of its holding. As a result, the contents of the announcement were disclosed by Equity Sales to some of Deutsche's clients who had participated in the book build, prior to it being disclosed by the Stockholmsbörsen.

The Cytos transaction

16. Background

16.1 On 13 March 2004 Cytos and Deutsche entered into an agreement whereby Deutsche would act as lead manager and underwriter on an offering by Cytos. This was structured as a combined rights issue with a pre-emptive rights offering, followed by a global placement of any shares not taken up by existing shareholders in the rights offering. The offering was to be up to 945,770 new shares.

16.2 On 15 March 2004 Cytos announced that it was raising new capital by way of a rights issue. Deutsche placed the security on its restricted list, which prohibited trading in Cytos.

16.3 As part of the Cytos transaction, Cytos granted Deutsche an over-allotment option (called a "greenshoe" option)[5] to purchase 100,000 shares at the offer price, solely for the purpose of covering over-allotments made, or short positions incurred, in relation to the offering of shares.

[5] A greenshoe option is an option that a lead manager has with an issuer to enable him to acquire additional shares at the issue price.

17. The Cytos stabilisation trade on 25 March 2004

17.1 On 24 March 2004 Deutsche agreed with Cytos that the offering price would be set at CHF 40 per share (the share price had closed at CHF 42.40 the previous day). It was also agreed that the offering would be scaled back and that the over allocation of 100,000 shares would be covered by the greenshoe option to enable Deutsche to stabilise the price. However, this resulted in an over-allocation of 1,209 shares in addition to that covered by the greenshoe option, which meant that Deutsche had a "naked short" position of 1,209 shares.

17.2 The draft preliminary prospectus for the Cytos offering included a statement, which was approved by Compliance, that there was a possibility that Deutsche could effect transactions on the SWX exchange that stabilised or maintained the market price of the Cytos shares at levels which might not otherwise prevail in the market. This statement was also contained in the final prospectus issued on 25 March 2005.

17.3 The FSA's Price Stabilising Rules did not apply to the Cytos transaction. However, Deutsche decided that its procedures in relation to price stabilisation, based on the FSA's stabilisation regime, should apply to the Cytos transaction.

17.4 Deutsche's procedures in London also stated that Compliance should be informed prior to engaging in stabilisation and that Compliance should be consulted in the event of any questions arising.

17.5 Having made the decision to stabilise the price, the syndicate team within ECM in London with responsibility for conducting the Cytos transaction ("the Cytos team"), delegated the task of carrying out the stabilisation to the Zurich trader. The Zurich trader had not carried out transactions within the UK stabilisation regime previously and had no knowledge of Deutsche's stabilisation rules.

17.6 During an early telephone conversation on 25 March 2004, the stabilisation rules were explained to the Zurich trader by two members of the Cytos team.

17.7 During the telephone conversation the two members of the Cytos team explained that:

i. stabilisation trades could not be done above the issue price of CHF 40;

ii. the first stabilisation trade would represent a "marker" giving the upper price limit for future trades. This limit could only be exceeded if the market traded above the limit of its own accord. If the price dropped, the trader could only stabilise the price up to the market trade's value;

iii. the first stabilisation trade (the marker trade) should be conducted at CHF 40; and

iv. the naked short could be covered at any price and therefore could be covered above or below the issue price of CHF 40.

17.8 Once trading started on the SWX exchange, the Zurich trader:

i. bought 1,209 shares (covering the naked short) at CHF 43 in the opening auction, using the proprietary book. Subsequently, a further 5,000 Cytos shares were purchased for the proprietary book at CHF 43. These trades were all conducted at a price that was 7% higher than the price of the placement, and were above Cytos' previous day's close at CHF 42.40. The trades were conducted at CHF 43 in an attempt by the Zurich trader to ensure that the market price opened at CHF 43 or higher. The Zurich trader was prepared to take a loss in the proprietary book to facilitate this. The trades in the proprietary book were also conducted in contravention of the restrictions imposed by Deutsche's restricted list; and

ii. conducted the first "stabilising trade" for 1,000 Cytos shares at CHF 39.95 (the marker trade) by matching it with a sell in the proprietary book, but shortly thereafter, entered a further stabilisation trade at a price of CHF 40, despite there being no market trades at CHF 40 since the first stabilising trade. By transacting above the market trade, this trade was conducted at a higher level than the market price at that time. This was in breach of Deutsche's own procedures.

17.9 The Zurich trader updated two members of the team during the stabilisation exercise. Members of the Cytos team knew that the Zurich trader had bought Cytos shares in the proprietary book (in breach of the restricted list) and in an attempt to ensure that the shares opened at a higher price than that at which it had closed the previous day. Despite this knowledge they did not escalate this, or the other matters that they were aware of, to Compliance until the morning of 26 March 2004.

18. Principle breaches in relation to the Cytos transaction

18.1 Deutsche acted in contravention of Principle 2 of the Principles by failing to act with due skill, care and diligence in relation to its attempt to stabilise the Cytos share price, in that the relevant London staff did not:

i. ensure that the Zurich trader, who conducted the stabilisation trades understood and followed the internal procedures regarding stabilisation Deutsche had intended to apply to that transaction; and

ii. escalate issues arising from the stabilisation exercise to Compliance in a timely manner.

19. Penalty

19.1 In consequence of the above actions, Deutsche is in contravention of Principles 2 and 5 of the Principles. The FSA therefore proposed to impose a penalty pursuant to section 206 of the Act in respect of these contraventions.

19.2 The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 13 of the Enforcement manual ("ENF") which forms part of the FSA's Handbook. The primary purpose of imposing 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.

19.3 The severity of the penalty should reflect the degree of wrongdoing in each case and be proportionate to the breach in question. The level of financial penalty should also take into account all the relevant circumstances of the case (ENF 13.3.1). In setting the level of penalty in this case, the FSA has taken into account the following particular matters.

Seriousness of the misconduct

19.4 Deutsche is one of the largest financial institutions in the world. Deutsche's resources allow it to trade in large volumes and take significant risks, as occurred in the transactions referred to above. Deutsche has the financial resources at its disposal to ensure that its internal arrangements are compliant.

19.5 The FSA considers that Deutsche's conduct on these occasions constituted a serious breach of the Principles for the following reasons:

i. the significant size and profile of the Scania transaction meant that a large number of counterparties could have been affected by Deutsche's actions; and

ii. the Scania and Cytos transactions demonstrated a number of separate failings by Deutsche to appropriately conduct it business.

The extent to which the misconduct was deliberate or reckless

19.6 The FSA has had regard to the extent to which it considers Deutsche's conduct was deliberate or reckless.

19.7 The FSA considers the actions of Deutsche to have been deliberate in the purchasing of a significant proprietary position of Scania B shares in the secondary market at the same time as running the book build. However, the FSA does not allege that Deutsche Bank deliberately sought to manipulate the market and there is no evidence that Deutsche's conduct in respect of the other matters of concern to the FSA was deliberate.

The amount of profits accrued or loss avoided

19.8 The FSA notes that the Deutsche avoided a loss of £2,363,643 through its actions, and in determining what action to take, is guided by the principle that a person should not benefit from a contravention of the Principles.

Conduct following the contravention

19.9 The FSA acknowledges the significant cooperation and assistance it has received from Deutsche during its investigation. It also notes that Deutsche:

i. undertook its own significant internal investigation into the transactions with the assistance of external advisers;

ii. self-reported the matters to the FSA, and provided the FSA with the results of this investigation;

iii. has undertaken a review of its ECM and related sales and trading processes since March 2004;

iv. has undertaken internal disciplinary action against some of the individuals involved in the matters of concern; and

v. enhanced its compliance function.

Disciplinary record and compliance history

19.10 Although Deutsche has not itself been subject to any previous enforcement action, a subsidiary (formerly known as Morgan Grenfell & Co Limited) has been subject to such previous action.

Previous action taken by the FSA and other regulatory authorities

19.11 The FSA has taken into account previous action against firms for breaches of Principles 2 and 5. This action has included the imposition of financial penalties. The FSA has taken these penalties into account.

DECISION MAKER

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

IMPORTANT

21 This Final Notice is given to Deutsche in accordance with section 390 of the Act.

Manner of and time for Payment

22 The financial penalty must be paid in full to the FSA by no later than 24 April 2006, 14 days from the date of the Final Notice.

If the financial penalty is not paid

23 If all or any of the financial penalty is outstanding on 25 April 2006, the FSA may recover the outstanding amount as a debt owed by Deutsche and due to the FSA.

Publicity

24 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 Final 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 Deutsche or prejudicial to the interests of consumers.

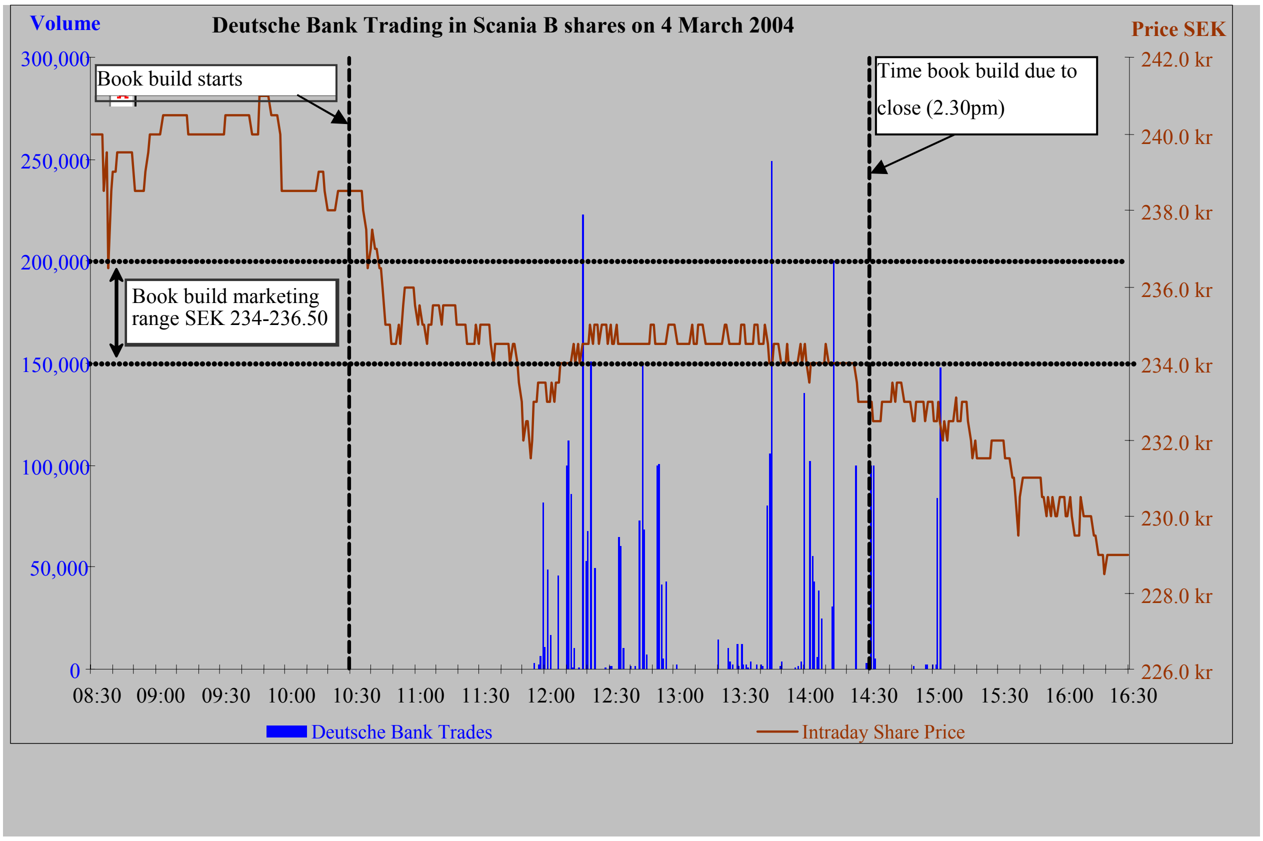
25 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

26 For more information concerning this matter generally, you should contact Stephen Robinson at the FSA (direct line: 020 7066 1338 /fax: 020 7066 1339).

Tracey McDermott
Enforcement Division

APPENDIX A


Volume
Deutsche Bank Trading in Scania B shares on 4 March 2004
Price SEK
300,000
250,000
200,000
150,000
100,000
50,000
0
242.0 kr
240.0 kr
238.0 kr
236.0 kr
234.0 kr
232.0 kr
230.0 kr
228.0 kr
226.0 kr
Book build starts
Time book build due to close (2.30pm)
Book build marketing range SEK 234-236.50
08:30 09:00 09:30 10:00 10:30 11:00 11:30 12:00 12:30 13:00 13:30 14:00 14:30 15:00 15:30 16:00 16:30
Deutsche Bank Trades
Intraday Share Price