Financial Services Authority

FINAL NOTICE

To: **Graeham Stuart Sampson**

Reference: **GSS01074**

Date: **19 October 2012**

ACTION

1. For the reasons given in this Notice, the FSA hereby imposes on Mr Sampson a financial penalty of £17,850 for breaches of Statement of Principle 6 in his capacity as an approved person at MPAS during the relevant period.

2. Mr Sampson agreed to settle at an early stage of the FSA's investigation. Mr Sampson therefore qualified for a 30% discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have sought to impose a financial penalty of £25,500 on Mr Sampson.

SUMMARY OF REASONS

3. Mr Sampson was approved to perform CF1 (Director) at MPAS from 29 August 2008 to 13 May 2011. Between 30 September 2009 and 13 May 2011, he failed to act with due skill, care and diligence in managing the elements of MPAS' business for which he was responsible in his controlled function, in breach of Statement of Principle 6. In particular, he failed to correctly calculate MPAS' regulatory capital position. As a result, MPAS operated in breach of its regulatory capital requirement for approximately 15 months without its board, parent firm or the FSA being aware of this fact.

4. The failure arose because Mr Sampson did not take reasonable care to:

   (a) understand the capital requirements in chapter 5 of IPRU(INV), to which MPAS was subject. He failed to apply a key component of the requirements and made fundamental errors in applying another key component;

   (b) adequately monitor MPAS' liquid capital resources on an ongoing basis; or

   (c) ensure that he discounted illiquid assets when reporting the firm's liquid capital position to the FSA.

5. The result was that Mr Sampson failed to identify that MPAS was operating with a regulatory capital deficit between 30 September 2009 and 31 December 2010. Once the regulatory capital deficit was identified, Mr Sampson arranged for a capital injection into MPAS from the group of which MPAS was part.

6. Through his failure to ensure the firm had sufficient regulatory capital to act as a protective buffer, Mr Sampson exposed MPAS to the risk of being unable to fulfil financial obligations as they fell due in the event that MPAS was wound up. MPAS' financial failure could have given rise to a risk of detriment in respect of the members of its SIPP schemes.

7. The nature and seriousness of the breaches outlined above warrant the imposition of a financial penalty on Mr Sampson, pursuant to section 66 of the Act. The penalty reflects the need to send out a strong message of deterrence to other individuals who exercise significant influence functions at SIPP scheme operators, and the potential risks to customers' pensions.

DEFINITIONS

8. The definitions below are used in this Final Notice.

(a) the "Act" means the Financial Services and Markets Act 2000;

(b) "CASS" means the FSA's Client Assets sourcebook;

(c) "CF1" means the controlled function of Director;

(d) "DEPP" means the FSA's Decision Procedure and Penalties Manual;

(e) the "FSA" means the Financial Services Authority;

(f) "GABRIEL" means the FSA's Gathering Better Regulatory Information Electronically reporting system;

(g) "IPRU(INV)" means the FSA's Interim Prudential sourcebook for Investment Businesses;

(h) "MPAS" means Montpelier Pension Administration Services Limited;

(i) "Mr Sampson" means Graeham Stuart Sampson;

(j) the "relevant period" is the period from 30 September 2009 to 13 May 2011;

(k) "SIPP" means self invested personal pension;

(l) the "Statements of Principle" means the FSA's Statements of Principle and Code of Practice for Approved Persons;

(m) "Supervision" means the FSA's Supervision Division;

(n) "SYSC" means the FSA's Senior Management Arrangements, Systems and Controls sourcebook; and

(o) the "Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

FACTS AND MATTERS

Background

9. MPAS was a SIPP scheme operator and administrator based in Leicester. Between December 2008 and December 2010, the number of SIPPs administered by MPAS grew from approximately 360 to more than 1,400.

10. Mr Sampson is a qualified accountant. He was the Finance Director at MPAS, which was part of a group. Mr Sampson was responsible for the financial control of 13 firms within the group. At MPAS he was responsible for:

    (a) updating the board on the firm's financial position;

    (b) influencing decisions at board level in relation to financial management;

    (c) assessing the impact of the firm's business strategy on its financial resources and capital position;

    (d) monitoring capital resources to ensure compliance with regulatory capital requirements; and

    (e) reporting financial information to the FSA every quarter through the GABRIEL system.

11. As part of a thematic review, Supervision visited MPAS in October 2010 and identified extensive failings. During the following months, MPAS liaised with the FSA to try to remedy these failings.

12. MPAS sold its two SIPP schemes to another operator in May 2011. Mr Sampson remained in post at MPAS unpaid for around six weeks to assist with the orderly sale and transition of the schemes. Mr Sampson's approval in relation to MPAS was withdrawn voluntarily in May 2011 and MPAS' authorisation was cancelled in October 2011.

Calculation of MPAS' capital requirement

13. MPAS' capital requirement was calculated according to the provisions of Chapter 5 of IPRU(INV), which deals with investment firms. IPRU(INV) sets minimum capital and risk management standards to mitigate the risk that firms will be unable to meet their liabilities and commitments to consumers and counterparties.

14. Under IPRU(INV) Chapter 5, MPAS was required to hold a level of liquid capital which reflected the costs it could incur during a thirteen week winding-up period. MPAS' total liquid capital requirement was calculated by adding together two components:

    (a) its Expenditure Based Requirement, calculated by taking a set fraction of the firm's annual expenditure (less specified types of expenditure); and

    (b) its Other Assets Requirement, calculated by taking a set percentage of the value of certain readily realisable assets.

15. Having interviewed Mr Sampson and analysed the data he submitted in MPAS' returns, the FSA found that Mr Sampson had made an error in the way he calculated the Expenditure Based Requirement and had misconstrued the Other Assets Requirement.

Expenditure Based Requirement

16. IPRU(INV) Chapter 5 permits a firm to discount certain types of expenditure, including 'other appropriations of profits', when calculating its Expenditure Based Requirement. By deducting these types of expenditure, a firm reduces the amount of expenditure which is subject to the calculation. The effect of this is to reduce the total liquid capital which the firm must hold.

17. As part of its group's tax mitigation strategy, MPAS was charged notional rent costs by another group company as a way of transferring profits. When calculating MPAS' Expenditure Based Requirement, Mr Sampson discounted these rent costs based on his interpretation that they could be classed as 'other appropriations of profit'. This was incorrect; the costs were not 'other appropriations of profits' but running costs of the business within the group structure. The costs should not have been deducted. Further, the rent costs which Mr Sampson incorrectly deducted were artificially high. Therefore the impact on the Expenditure Based Requirement was more significant.

18. By incorrectly deducting the costs (which in any event were artificially high), Mr Sampson routinely calculated and reported an Expenditure Based Requirement which was too low.

Other Assets Requirement

19. The purpose of the Other Assets Requirement is to require a firm to hold a level of liquid capital which reflects the risk attached to certain types of liquid assets. To identify MPAS' total capital requirement, Mr Sampson needed to add its Other Assets Requirement to its Expenditure Based Requirement. However, he never calculated an Other Assets Requirement and therefore never reported it in any of the returns he submitted to the FSA.

20. It is stated in the opening paragraph of the relevant table in IPRU(INV) Chapter 5 that the Other Assets Requirement is *not* applicable to illiquid assets. Mr Sampson interpreted the Other Assets Requirement as being applicable *only to* illiquid assets. This interpretation was incorrect.

21. Mr Sampson inherited an Excel spreadsheet to assist in calculating MPAS' total capital requirement. The spreadsheet made no reference to the Other Assets Requirement. Mr Sampson did not identify this deficiency at any point.

22. Therefore, the FSA finds that Mr Sampson did not take sufficient care to read the rules in IPRU(INV) Chapter 5 and ascertain for himself that MPAS was subject to the Other Assets Requirement.

Impact of errors

23. Due to his incorrect application of the Expenditure Based Requirement and failure to calculate the Other Assets Requirement, Mr Sampson routinely calculated a total capital requirement for MPAS which was too low. Consequently he submitted returns to the FSA which indicated that MPAS was meeting its capital requirement, when in reality it was in breach.

24. Throughout the period from September 2009 to December 2010, MPAS did not have adequate regulatory capital to meet the FSA's minimum standards for authorised firms.

This created a risk that MPAS could not meet its liabilities as they fell due in the event that MPAS was wound up.

Mr Sampson's approach to capital monitoring

25. Mr Sampson was also responsible for ensuring that MPAS held sufficient liquid capital to meet its total capital requirement. He therefore had to monitor the amount of liquid capital MPAS held. Mr Sampson estimated that he spent an average of two hours a week performing his Finance Director duties at MPAS.

26. MPAS underwent a period of growth between 2008 and 2010, increasing the number of SIPPs under its administration from approximately 300 to 1,400. This caused MPAS' expenditure to increase substantially. The impact of increased expenditure was a higher Expenditure Based Requirement, and therefore MPAS was required to hold more capital.

27. Towards the end of 2009, Mr Sampson identified that the firm needed to increase its liquid capital to meet its growing capital requirement. He arranged for £100,000 share capital to be injected into the firm. However, this amount was not sufficient to ensure that MPAS met its growing capital requirement in subsequent months.

28. For the quarters ended March 2010 and June 2010, GABRIEL automatically populated returns for MPAS which contained an irrelevant capital test. Mr Sampson therefore submitted returns containing the wrong capital test for these quarters. However, outside of the reporting process Mr Sampson was still responsible for ensuring that MPAS, as a matter of fact, continued to hold sufficient liquid capital to meet its regulatory capital requirement.

29. In March 2011, Mr Sampson submitted corrected returns for the quarters ended March 2010 and June 2010. In these returns, he reported that MPAS' liquid capital had decreased from around £47,000 in January 2009 to -£5,000 in June 2010. Given that MPAS' total capital requirement was at least £99,000 during this period, this meant that the firm was operating with a regulatory capital deficit of over £100,000 by 30 June 2010. Mr Sampson had not identified, reported or taken steps to remedy the capital deficit.

30. Mr Sampson submitted a return for the quarter ended September 2010 which indicated that MPAS was meeting its regulatory capital requirement. However, FSA Supervision

raised concerns about the accuracy of the return following their visit to MPAS in October 2010. In fact, Mr Sampson had completed two data items incorrectly. Had he reported these items accurately, the return would have shown that MPAS continued to breach its regulatory capital requirement.

31. During ongoing discussions with Supervision, Mr Sampson submitted a return for the quarter ended December 2010 in which he calculated that MPAS' liquid capital had reduced to £1,000 while its total capital requirement had increased to £186,000. Therefore, according to Mr Sampson's calculations, MPAS' regulatory capital deficit had grown to £185,000 by the end of 2010. Mr Sampson did not take any action to address the deteriorating capital position until late 2010.

32. MPAS was in regular contact with Supervision from December 2010, and in the first quarter of 2011 Mr Sampson arranged an injection of share capital and a subordinated loan to improve MPAS' liquid capital position.

Failure to deduct illiquid assets from liquid capital calculation

33. Under IPRU(INV) Chapter 5, a firm must deduct illiquid assets when calculating whether it holds sufficient liquid capital to meet its capital requirement.

34. Mr Sampson regularly reviewed MPAS' management accounts. He knew that MPAS held illiquid assets throughout the relevant period, since the accounts included fixed (i.e. illiquid) assets.

35. However, Mr Sampson failed to deduct illiquid assets in the returns he submitted to the FSA for the quarters ended September 2009, December 2009 and September 2010 (the original returns for March 2010 and June 2010 having been populated with an incorrect capital test). This means that either Mr Sampson failed to understand a self-evident part of the liquid capital test or he carelessly failed to complete the "*less illiquid assets*" data item in three returns.

36. By failing to deduct illiquid assets, Mr Sampson again calculated and reported a capital position which was more favourable than in reality. After Supervision visited MPAS in October 2010, Mr Sampson began to deduct illiquid assets in the returns he submitted.

FAILINGS

37. The relevant statutory provisions and regulatory requirements are set out in the Annex to this Notice.

38. Mr Sampson breached Statement of Principle 6 by failing to exercise due skill, care and diligence in managing the business of MPAS, for which he was responsible in his controlled function. Specifically, he failed to discharge adequately his responsibility to monitor MPAS' capital resources and report accurate data to the FSA.

39. As an approved person performing a Finance Director role, Mr Sampson was responsible for MPAS' compliance with regulatory capital requirements. Given his professional background and qualifications, he could reasonably have been expected to understand the regulatory capital requirements and take adequate steps to ensure that MPAS complied with them.

40. Mr Sampson did not take sufficient care to inform himself about the capital requirements applicable to MPAS. As a result, he inaccurately calculated the firm's Expenditure Based Requirement and failed entirely to calculate or report an Other Assets Requirement. This meant that the returns which he submitted to the FSA were materially inaccurate. In fact, MPAS operated in breach of its regulatory capital requirement for around 15 months without the knowledge of MPAS' board, its parent firm or the FSA.

41. As a director of MPAS, Mr Sampson was involved in implementing a business growth strategy between 2009 and 2010. He did not take reasonable care to assess the impact of increased expenditure and operating losses on the firm's capital adequacy, which led to MPAS falling into capital deficit.

42. Mr Sampson also failed to deduct illiquid assets from MPAS' liquid capital calculations, which had the effect of further masking the capital deficit.

43. Mr Sampson was responsible for allowing MPAS to operate without adequate financial resources for a sustained period, in breach of the FSA's Threshold Conditions. His lack of understanding of MPAS' capital requirement continued until his approval to perform CF1 (Director) was withdrawn in May 2011.

44. No actual consumer detriment occurred as a result of Mr Sampson's actions. However, through his carelessness and his failure to ensure the firm had sufficient regulatory capital to act as a protective buffer, Mr Sampson exposed MPAS to the risk of being unable to fulfil financial obligations as they fell due in the event that MPAS was wound up. Customers' pensions were therefore exposed to risk because, in the event of MPAS' financial failure:

(a) Her Majesty's Revenue and Customs could have imposed a deregistration charge on MPAS' SIPP schemes, resulting in significant tax liabilities for members;

(b) customers may have incurred costs and/or charges in transferring their SIPPs to another scheme operator; and

(c) customers may have been prevented from effecting transactions during a period when their SIPPs were being transferred to another scheme operator.

45. Mr Sampson failed to exercise due skill, care and diligence through his lack of understanding of MPAS' capital resources and requirements, in breach of Statement of Principle 6.

SANCTION

Financial penalty

46. The FSA imposes a financial penalty on Mr Sampson for breaching Statement of Principle 6. As the gravamen of his misconduct took place after 6 March 2010, the FSA's new penalty regime applies.

47. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

48. In determining whether a financial penalty is appropriate, the FSA is required to consider all the relevant circumstances of a case. A financial penalty is an appropriate sanction in this case, given the nature of the breach and the need to send out a strong message of deterrence to others.

Calculation of financial penalty under DEPP

49. The FSA's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the FSA applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5B sets out the details of the five-step framework that applies in respect of financial penalties imposed on individuals in non-market abuse cases.

Step 1 - disgorgement

50. Pursuant to DEPP 6.5B.1G, at Step 1 the FSA seeks to deprive an individual of the financial benefit derived directly from the breach, where it is practicable to quantify this.

51. Mr Sampson did not derive any financial benefit directly from the breach. The Step 1 figure is therefore zero.

Step 2 – the seriousness of the breach

52. Pursuant to DEPP 6.5B.2G, at Step 2 the FSA determines a figure that reflects the seriousness of the breach. That figure is based on a percentage of the individual's relevant income. The individual's relevant income is the gross amount of all benefits received by the individual from the employment in connection with which the breach occurred, and for the period of the breach.

53. In the period from 30 September 2009 to 13 May 2011, Mr Sampson's relevant income totalled £127,500. The FSA notes that Mr Sampson spent approximately two hours per week on MPAS' business and the remaining time on other group entities. However, Mr Sampson's entire group salary has been taken into account and is relevant here.

54. In deciding on the percentage of relevant income that forms the basis of the Step 2 figure, the FSA considers the seriousness of the breach and chooses a percentage between 0% and 40%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level.

55. For penalties imposed on individuals in non-market abuse cases there are the following five levels:

Level 1 – 0%

Level 2 – 10%

Level 3 – 20%

Level 4 – 30%

Level 5 – 40%

56. In assessing the seriousness level, the FSA takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly.

57. Mr Sampson is guilty of a Level 3 breach for the purposes of Step 2, since:

(a) he held a senior position at MPAS and was responsible for MPAS' compliance with regulatory capital requirements;

(b) the breach put MPAS' authorisation at risk, and created a risk of loss for up to 1,400 customer SIPPs;

(c) he repeated the reporting errors every quarter and continuously failed to monitor MPAS' capital position sufficiently;

(d) he acted carelessly, but not recklessly or deliberately (such behaviour tends to be considered a Level 4 or Level 5 breach);

(e) the FSA has not previously taken disciplinary action against him; and

(f) he took steps to improve MPAS' regulatory capital position once the regulatory capital deficit had been identified after the Supervisory visit.

58. A Level 3 breach equates to 20% of Mr Sampson's relevant income. The penalty figure after Step 2 is therefore £25,500.

<u>Step 3 – mitigating and aggravating factors</u>

59. Pursuant to DEPP 6.5B.3G, at Step 3 the FSA may increase or decrease the amount of the financial penalty arrived at after Step 2 (but not including any amount to be disgorged in

accordance with Step 1) to take into account factors which aggravate or mitigate the breach.

60. The FSA notes that Mr Sampson lacked experience in carrying out controlled functions; this was the first role for which he had sought FSA approval. He has developed a better understanding of the relevant requirements during the FSA's investigation, and has expressed a willingness to undertake training in the event that he performs a similar role at an authorised firm in future. Following identification of the capital breach, Mr Sampson remained in post at MPAS unpaid for around six weeks to assist with the orderly sale and transition of the schemes.

61. However, there are no material aggravating or mitigating factors which lead the FSA to revise the level of penalty at Step 3. The penalty figure after Step 3 is therefore £25,500.

Step 4 – adjustment for deterrence

62. Pursuant to DEPP 6.5B.4G, if the FSA considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the breach, or others, from committing further or similar breaches, then the FSA may increase the penalty.

63. The figure calculated after Step 3 represents a sufficient deterrent. The penalty figure after Step 4 is therefore £25,500.

Step 5 – settlement discount

64. Pursuant to DEPP 6.5B.5G, if the FSA and the individual on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the FSA and the individual reached agreement.

65. Mr Sampson has agreed to settle at an early stage of the investigation, and is therefore entitled to a discount of 30%. The penalty figure after Step 5 is therefore £17,850.

CONCLUSION

66. On the basis of the facts and matters described above, Mr Sampson's conduct as a CF1 (Director) at MPAS fell short of the minimum regulatory standards required of an

approved person. Having regard to all the circumstances, it is appropriate and proportionate to impose a financial penalty of £17,850 on Mr Sampson.

PROCEDURAL MATTERS

Decision maker

67. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

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

Manner and time of payment

69. The financial penalty must be paid by Mr Sampson to the FSA in eleven instalments. The first instalment of £850 must be paid within 14 days of the date of this Notice. This will be followed by ten further instalments of £1,700 at three monthly intervals.

If the financial penalty is not paid

70. If all or any part of an instalment is outstanding on the day after it is due to be paid, the FSA may recover the outstanding amount as a debt owed by Mr Sampson and due to the FSA.

Publicity

71. 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 Sampson or prejudicial to the interests of consumers.

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

FSA contacts

73. For more information concerning this matter generally, contact Rachel West (direct line: 020 7066 0142; fax: 020 7066 0143) of the Enforcement and Financial Crime Division of the FSA.

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Bill Sillett

Project Sponsor

FSA Enforcement and Financial Crime Division

ANNEX

STATUTORY PROVISIONS, REGULATORY GUIDANCE AND POLICY

Statutory provisions

1. The FSA's regulatory objectives are set out in section 2(2) of the Act and include the protection of consumers.

2. Section 66 of the Act provides that the FSA may take action to impose a penalty on an individual of such amount as it considers appropriate where it appears to the FSA that the individual is guilty of misconduct and it is satisfied that it is appropriate in all the circumstances to take action. Misconduct includes failure, while an approved person, to comply with a statement of principle issued under section 64 of the Act or to have been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under the Act.

Handbook provisions

3. In exercising its power to impose a financial penalty, the FSA must have regard to relevant provisions in the FSA Handbook of rules and guidance. The main provisions relevant to the action specified above are set out below.

Statements of Principle and the Code of Practice for Approved Persons

4. The Statements of Principle and the Code of Practice for Approved Persons ("APER") sets out the Statements of Principle as they relate to approved persons and descriptions of conduct which, in the opinion of the FSA, do not comply with a Statement of Principle. APER further describes factors which, in the opinion of the FSA, are to be taken into account in determining whether or not an approved person's conduct complies with a Statement of Principle.

5. APER 3.1.3G states that when establishing compliance with or a breach of a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour to be expected in that function.

6. APER 3.1.4G provides that an approved person will only be in breach of a Statement of Principle where he is personally culpable, that is in a situation where his conduct was

deliberate or where his standard of conduct was below that which would be reasonable in all the circumstances.

7. APER 3.1.6G provides that APER (and in particular the specific examples of behaviour which may be in breach of a generic description of conduct in the code) is not exhaustive of the kind of conduct that may contravene the Statements of Principle.

8. The Statement of Principle relevant to this matter is Statement of Principle 6, which provides that an approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.

9. APER 3.1.8G provides, in relation to applying Statements of Principle 5 to 7, that the nature, scale and complexity of the business under management and the role and responsibility of the individual performing a significant influence function within the firm will be relevant in assessing whether an approved person's conduct was reasonable.

10. APER 3.3.1E states that in determining whether or not the conduct of an approved person performing a significant influence function complies with Statements of Principle 5 to 7, the following are factors which, in the opinion of the FSA, are to be taken into account:

    (a) whether he exercised reasonable care when considering the information available to him;

    (b) whether he reached a reasonable conclusion which he acted on;

    (c) the nature, scale and complexity of the firm's business;

    (d) his role and responsibility as an approved person performing a significant influence function; and

    (e) the knowledge he had, or should have had, of regulatory concerns, if any, arising in the business under his control.

11. APER 4.6 lists types of conduct which, in the opinion of the FSA, do not comply with Statement of Principle 6. These include a person failing to take reasonable steps to adequately inform himself about the affairs of the business for which he is responsible.

Interim Prudential Sourcebook for Investment Businesses ("IPRU(INV)")

12. The rules and guidance in IPRU(INV) assist the FSA in meeting the statutory objectives of protecting consumers and maintaining market confidence, by setting minimum capital and other risk management standards which mitigate the possibility that firms will be unable to meet their liabilities and commitments to consumers and counterparties.

13. Under chapter 5 of IPRU(INV), an investment management firm must ensure that, at all times, its financial resources are not less than its financial resources requirement.

14. This requirement is the sum of its expenditure based requirement, position risk requirement, counterparty risk requirement, foreign exchange requirement and other assets requirement. The details of these requirements are set out in IPRU(INV) chapter 5 tables 5.2.2(1) to 5.2.3(5)(e).

Decision Procedure and Penalties Manual ("DEPP")

15. The FSA has had regard to the guidance on the imposition and amount of penalties set out in Chapter 6 of the current version of DEPP. All references to DEPP in this subsection of the Notice refer to the current DEPP guidance.

16. DEPP 6.4.1 provides that the FSA will consider all the relevant circumstances of the case when deciding whether to impose a financial penalty.

17. DEPP 6.5B.1 sets out the five steps for calculating financial penalties for individuals in non-market abuse cases.

Step 1 - disgorgement

18. The FSA will seek to deprive an individual of the financial benefit derived directly from the breach (which may include the profit made or loss avoided) where it is practicable to quantify this.

Step 2 – the seriousness of the breach

19. The FSA will determine a figure which will be based on a percentage of an individual's "relevant income". "Relevant income" will be the gross amount of all benefits received

by the individual from the employment in connection with which the breach occurred (the "relevant employment"), and for the period of the breach.

20. This approach reflects the FSA's view that an individual receives remuneration commensurate with his responsibilities, and so it is reasonable to base the amount of penalty for failure to discharge his duties properly on his remuneration. The FSA also believes that the extent of the financial benefit earned by an individual is relevant in terms of the size of the financial penalty necessary to act as a credible deterrent. The FSA recognises that in some cases an individual may be approved for only a small part of the work he carries out on a day-to-day basis. However, in these circumstances the FSA still considers it appropriate to base the relevant income figure on all of the benefit that an individual gains from the relevant employment, even if his employment is not totally related to a controlled function.

21. Having determined the relevant income the FSA will then decide on the percentage of that income which will form the basis of the penalty. In making this determination the FSA will consider the seriousness of the breach and choose a percentage between 0% and 40%.

22. In deciding which level is most appropriate to a case against an individual, the FSA will take into account various factors which will usually fall into the following four categories:

(a) factors relating to the impact of the breach;

(b) factors relating to the nature of the breach;

(c) factors tending to show whether the breach was deliberate; and

(d) factors tending to show whether the breach was reckless.

23. Factors relating to the impact of a breach committed by an individual include the loss or risk of loss caused to consumers.

24. Factors relating to the nature of a breach by an individual include:

(a) the nature of the rules, requirements or provisions breached;

(b) the frequency of the breach;

(c) whether the individual held a senior position within the firm;

(d) the extent of the responsibility of the individual for the business areas affected by the breach; and

(e) whether the individual took any steps to comply with FSA rules, and the adequacy of those steps.

<u>Step 3 – mitigating and aggravating factors</u>

25. The FSA may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

26. The following factors may have the effect of aggravating or mitigating the breach:

(a) the conduct of the individual in bringing (or failing to bring) quickly, effectively and completely the breach to the FSA's attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the individual showed during the investigation of the breach by the FSA, or any other regulatory authority allowed to share information with the FSA;

(c) whether the individual took any steps to stop the breach, and when these steps were taken;

(d) any remedial steps taken since the breach was identified, including whether these were taken on the individual's own initiative or that of the FSA or another regulatory authority; and

(e) the previous disciplinary record and general compliance history of the individual

<u>Step 4 – adjustment for deterrence</u>

27. If the FSA considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the breach, or others, from committing further or similar breaches then the FSA may increase the penalty. Circumstances where the FSA may do this include:

(a) where the FSA considers the absolute value of the penalty too small in relation to the breach to meet its objective of credible deterrence;

(b) where previous FSA action in respect of similar breaches has failed to improve industry standards;

(c) where the FSA considers it is likely that similar breaches will be committed by the individual or by other individuals in the future; and

(d) where a penalty based on an individual's income may not act as a deterrent, for example, if an individual has a small or zero income but owns assets of high value.

<u>Step 5 – settlement discount</u>

28. The FSA and the individual on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the FSA and the individual concerned reached an agreement.