
FINAL NOTICE

To: Matthew Sebastian Piper
Of: 11.5 Fournier Street, London, E1 6QE
Individual
Reference Number: MSP01040
Date: 13 May 2009

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice that it has taken the following action:

1. THE ACTION

- 1.1. The FSA gave Matthew Sebastian Piper ("Mr Piper") a Decision Notice dated 30 April 2009 which notified Mr Piper that the FSA had decided to impose on him:
- (1) a prohibition order pursuant to section 56 of the Financial Services and Markets Act 2000 ("the Act"), prohibiting Mr Piper from performing any function in relation to any regulated activity carried on by any authorised or exempt person or exempt professional firm on the grounds that Mr Piper is not a fit and proper person; and
 - (2) A financial penalty of £105,000 pursuant to section 66(2)(b) of the Act for being knowingly concerned in a contravention by Morgan Stanley & Co International Plc ("Morgan Stanley") of Principle 2 (Skill, Care and Diligence) of the FSA's Principles for Businesses ("the Principles").

- 1.2. Mr Piper has confirmed that he will not be referring the matter to the Financial Services and Market Tribunal.
- 1.3. Accordingly, for the reasons set out below and having agreed with Mr Piper the facts and matters relied on, the FSA imposes on Mr Piper the prohibition order and fine as set out above.
- 1.4. Mr Piper agreed to settle at an early stage of the FSA's investigation. He therefore qualifies for a 30% (stage 1) reduction in the financial penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £150,000 on him.

2. REASONS FOR THE ACTION

Summary

2.1. This notice is issued to Mr Piper in the light of his conduct during the period December 2007 to May 2008 (the "Relevant Period"), during which Mr Piper was employed as a trader by Morgan Stanley on its Investment Grade Trading Desk ("the IGT Desk"). During this period, Mr Piper deliberately:

- (1) mis-marked positions on his trading books. Morgan Stanley made a negative adjustment to his marks of \$120 million¹;
- (2) excluded Morgan Stanley's Valuation Review Group ("the VRG") from a key part of Morgan Stanley's control process;
- (3) sought to hide losses by manipulating the process by which traders challenged valuations used by the VRG; and
- (4) took further steps to avoid detection when the VRG raised questions on certain of his² positions

which conduct demonstrates a lack of honesty and integrity such that he is therefore not a fit and proper person to perform functions in relation to regulated activities.

2.2. Morgan Stanley failed to conduct its business with due skill, care and diligence by failing to use effectively its existing controls over the IGT Desk and as a result it failed to price certain of Mr Piper's positions accurately and failed to prevent or detect his mis-marking in a timely manner. By virtue of his deliberate misconduct,

¹ Mr Piper calculates the value of his mis-marking at the lower level of at least \$77.75 million.

² References in this Notice to "Mr Piper's positions", "his positions" and similar are simply for ease of understanding. Mr Piper was a proprietary trader and the positions were legally held by Morgan Stanley.

Mr Piper was knowingly concerned in certain of these breaches of Principle 2 by Morgan Stanley.

- 2.3. The FSA views Mr Piper's misconduct as particularly serious because he was a senior and experienced trader who was fully aware of his responsibilities to mark his books in line with the market. The mitigating effect of his early admissions as to his misconduct (on which see paragraph 6.3 below) and his co-operation with Morgan Stanley and the FSA since then is tempered by the fact that the VRG had already begun to raise questions on certain of his positions.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

Statutory provisions

- 3.1. The FSA's statutory objectives, set out in Section 2(2) of the Act, are market confidence, public awareness, the protection of consumers and the reduction of financial crime.
- 3.2. The FSA has the power pursuant to section 56 of the Act to make an order prohibiting an individual from performing a specified function, any function falling within a specified description, or any function, if it appears to the FSA that that individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated activities.
- 3.3. Section 66 of the Act provides that:
 - (1) The FSA may impose a penalty on a person of such amount as it considers appropriate if:
 - (a) it appears to the FSA that he is guilty of misconduct; and
 - (b) the FSA is satisfied that it is appropriate in the circumstances to take action against him.
 - (2) A person is guilty of misconduct if, while an approved person:
 - (a) he has failed to comply with a statement of principle issued under section 64 of the Act; or
 - (b) he has been knowingly concerned in a contravention by the authorised person on whose application he was approved of a requirement imposed on that authorised person by or under the Act.

Fit and Proper Test for Approved Persons

- 3.4. The purpose of the part of the FSA Handbook entitled Fit and Proper Test for Approved Persons ("FIT") is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function. In this instance the criteria set out in FIT are relevant in considering whether the FSA will exercise its powers to make a prohibition order in respect of an individual in accordance with the Enforcement Guide ("EG") paragraph 9.9.
- 3.5. FIT 1.3.1G provides that the FSA will have regard to a number of factors when assessing the fitness and propriety of a person, including the person's honesty and integrity. FIT 2.1.1G provides that, in determining a person's honesty and integrity, the FSA will have regard to matters including, but not limited to, those set out in FIT 2.1.3G.
- 3.6. FIT 2.1.3G refers to various matters, including: whether the person has contravened any of the requirements and standards of the regulatory system (FIT 2.1.3G(5)); whether the person has been dismissed, or asked to resign and resigned, from employment or from a position of trust, fiduciary appointment or similar (FIT 2.1.3G(11)); or whether, in the past, the person has been candid and truthful in all his dealings with any regulatory body and whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards (FIT 2.1.3G(13)).

Principles for Businesses

- 3.7. Principle 2 (Skill, Care and Diligence) provides that a firm must conduct its business with due skill, care and diligence.

Enforcement Policy

- 3.8. The FSA's policy in relation to the decision to make a prohibition order is set out in Chapter 9 of EG. Extracts from chapter 9 of EG are set out in Annex A.
- 3.9. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the part of the FSA Handbook entitled Decision Procedure and Penalties Manual ("DEPP"). Extracts from DEPP are set out in Annex A.

4. FACTS AND MATTERS RELIED ON

Background

- 4.1. Morgan Stanley is a company authorised by the FSA and is part of a major global financial group whose headquarters are in New York. During the Relevant Period, Mr Piper was an FSA approved person (controlled function 30) employed by Morgan Stanley as a trader on the IGT Desk in London, where he traded in European credit default swap indices ("index") and credit default swap index options ("index options")

on certain i-Traxx indices. The trades which are the subject-matter of this Notice were all proprietary trades carried out by Mr Piper on behalf of Morgan Stanley and were therefore not conducted by Mr Piper in the course of carrying out his controlled function.

- 4.2. The role of the VRG was to test the books and records of the firm by reviewing traders' marks independently of the relevant business unit. In April 2008 the VRG introduced an enhanced mark verification process (the enhanced verification process) and began a general review of Mr Piper's marks.
- 4.3. This review led Morgan Stanley to question particular marks made by Mr Piper, following which Mr Piper met with management and informed them that he had been mis-marking his positions by at least \$77.75 million. As a result he was suspended from his employment with Morgan Stanley on 21 May 2008.
- 4.4. On 18 June 2008 Morgan Stanley reported its results for the second quarter of 2008. The results announcement included reference to a "*\$120 million negative adjustment to marks previously taken in a trader's books that did not comply with Firm policies*". The trader in question was Mr Piper.
- 4.5. Following an internal investigation by Morgan Stanley, Mr Piper was dismissed from his employment on 12 September 2008.

Mr Piper's mis-marking

- 4.6. Mr Piper mis-marked his positions in two main ways:
 - (1) He mis-marked his index positions primarily by adjusting the index curves for those positions; and
 - (2) He mis-marked his index option positions primarily by manipulating the volatility marks for those positions.
- 4.7. The purpose of the mis-marking was to conceal substantial losses that were accruing to his positions. As noted above, following its review of the positions, Morgan Stanley made a negative adjustment to his marks of \$120 million.

Concealment of mis-marking from the VRG

Restriction of the VRG's access to external consensus data

- 4.8. A key part of Morgan Stanley's controls over the way in which these positions were priced was for Mr Piper to regularly email an independent third party provider to obtain external consensus data, copying in the VRG so that it could oversee the process and use results obtained in the monthly mark review of the index option positions.

- 4.9. In early 2008 Mr Piper took steps that restricted the VRG's access to this external consensus data. Specifically, from the beginning of 2008 he ceased copying the VRG into his exchanges with the third party data provider. This hindered the VRG's ability to conduct effective reviews, which thereby assisted Mr Piper to conceal his mis-marking.

Manipulation of challenge process

- 4.10. As part of the mark review process traders had a right to challenge valuations used by the VRG by providing the VRG with alternative reference data, which the VRG had the discretion to accept or reject. Since traders were able to choose which valuations to challenge, the process was open to manipulation particularly as the market became more volatile.
- 4.11. Mr Piper sought to hide losses by only correcting valuations being used by the VRG on his positions that he could demonstrate were too low and not correcting those that he knew to be too high.

Further steps to avoid detection by the VRG

- 4.12. During April and May 2008, the VRG carried out a more thorough review of certain of Mr Piper's index option positions which resulted in it detecting significant discrepancies in his marking of those positions. Mr Piper cooperated with the VRG to an extent by correcting certain of the identified mis-marks while, at least on certain occasions, simultaneously creating new mis-marks in order to minimise the financial impact of the corrections (on the profit and loss analysis of his books).

5. ANALYSIS OF BREACHES

- 5.1. Mr Piper's conduct, in deliberately mis-marking his positions and deliberately taking steps to avoid detection by the VRG, demonstrates a lack of honesty and integrity such that he is not a fit and proper person to carry out regulated activities.
- 5.2. In addition by virtue of his deliberate misconduct, Mr Piper was knowingly concerned in the following failures by Morgan Stanley to use its controls effectively in breach of Principle 2:
- (1) Mr Piper's involvement in the gathering of external consensus data was a fundamental part of Morgan Stanley's controls over the way its positions were priced. Mr Piper knew that the VRG should also have been involved in the process by which the data was gathered but he took steps (which he knew had not been challenged effectively) that hindered the VRG's ability to oversee the process and thus restricted its access to data. As a consequence, and as he knew, he had caused the failure of this key element of Morgan Stanley's controls. He was therefore knowingly concerned in Morgan Stanley's failure to conduct its business with due skill, care and diligence in this regard; and

- (2) As a result of various failings including the one described above, Morgan Stanley failed, in breach of Principle 2, to price certain positions held by Mr Piper accurately and failed to prevent or detect his mis-marking in a timely manner. Given his knowing concern in the above failing, Mr Piper was knowingly concerned in Morgan Stanley's Principle 2 failure to prevent or detect his mis-marking in a timely manner.

6. ANALYSIS OF THE SANCTION

General

- 6.1. In taking the action, the FSA has considered, amongst other things, the seriousness and nature of Mr Piper's misconduct, the number and duration of his breaches, and the likely effect of the action on him.
- 6.2. The FSA considers the following to be aggravating factors:
 - (1) Mr Piper was a senior and experienced trader in a position of trust who was fully aware of his responsibilities to mark his books in line with the market; and
 - (2) His misconduct was deliberate, frequent and repeated, taking place over a six month period.
- 6.3. The FSA considers the following to be mitigating factors:
 - (1) Shortly after certain of his positions were queried by Morgan Stanley in May 2008, Mr Piper admitted that he had been mis-marking and subsequently co-operated fully with investigations by Morgan Stanley and the FSA;
 - (2) Since 21 May 2008 Mr Piper has accepted that his conduct was improper; and
 - (3) No previous regulatory action has been taken against Mr Piper by the FSA.
- 6.4. Mr Piper maintains that his conduct is also mitigated by what he alleges was pressure placed on him to mis-mark. The FSA has not concluded that he was subject to any such pressure. In any event, the FSA does not consider this to be a relevant factor as Mr Piper was a senior and experienced trader who was fully aware of his responsibilities to mark his books in line with the market.

Prohibition

- 6.5. The FSA's effective use of the power to prohibit individuals who are not fit and proper from carrying out functions in relation to regulated activities helps the FSA to work towards its regulatory objectives of protecting consumers, promoting public awareness, maintaining confidence in the financial system and reducing financial crime.

- 6.6. The FSA is satisfied that Mr Piper is not a fit and proper person to perform regulated activities and should therefore be prohibited from performing any controlled function under section 56 of the Act. The FSA has had regard to the guidance in EG 9 in deciding that a prohibition order is appropriate in this case.

Financial penalty

- 6.7. The principal purpose for which the FSA imposes sanctions is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant behaviour.
- 6.8. In determining the financial penalty, the FSA has considered the need to deter well-remunerated individuals such as Mr Piper from engaging in this type of activity.
- 6.9. The FSA has taken all the circumstances of this case into account in deciding that the imposition of a financial penalty in this case is appropriate, and the level of the penalty imposed is proportionate. The FSA has had particular regard to the guidance set out in DEPP 6.

7. CONCLUSION

- 7.1. The FSA considers that because of the nature and seriousness of Mr Piper's misconduct, and the risk he poses to confidence in the market generally, it is appropriate for the FSA to exercise its powers to make the prohibition order against Mr Piper.
- 7.2. In addition, the FSA considers that because of the nature and seriousness of his misconduct, and in order to promote high standards of regulatory conduct by helping to deter other persons from committing similar breaches, it is appropriate to impose a financial penalty of £105,000 on Mr Piper.

8. DECISION MAKERS

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

9. IMPORTANT

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

Manner and time of payment

- 9.2. The FSA is in possession of evidence that it would cause Mr Piper serious financial hardship or financial difficulties if he was required to pay the full payment in a single instalment. Accordingly the financial penalty of £105,000 must be paid in full in instalments as follows:

- (1) The first instalment of £50,000 to be paid in full by Mr Piper to the FSA no later than 27 May 2009, being no less than 14 days from the date of this Final Notice;
- (2) The second instalment of £35,000 to be paid in full by Mr Piper to the FSA no later than 27 November 2009; and
- (3) The third instalment of £20,000 to be paid in full by Mr Piper to the FSA no later than 27 May 2010.

If the financial penalty is not paid

- 9.3. If any or all of the instalments of the financial penalty is outstanding after its due date for payment, the full amount outstanding of the financial penalty shall then become immediately due and payable including all future instalments, and the FSA may recover the outstanding amount as a debt owed by Mr Piper and due to the FSA.

Publicity

- 9.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to Mr Piper or prejudicial to the interests of consumers.
- 9.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

- 9.6. For more information concerning this matter generally, you should contact Karen Lee (direct line: 020 7066 1316) or Dan Enraght-Moony at the FSA (direct line: 020 7066 0166).

Jamie Symington
Head of Department
FSA Enforcement Division

Annex A

Relevant Rules, Guidance and Other Regulatory Provisions

1. Enforcement Guide

- 1.1. EG 9.3-9.7 sets out the FSA's general policy in deciding whether to make a prohibition order and/or withdraw an individual's approval. The FSA will consider all the relevant circumstances including whether other enforcement action should be taken or has been taken already against that individual by the FSA. In some cases the FSA may take other enforcement action against the individual in addition to seeking a prohibition order.
- 1.2. EG 9.4 provides that the FSA has the power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual's lack of fitness and propriety is relevant. Depending on the circumstances of each case, the FSA may seek to prohibit individuals from performing any class of function in relation to any class of regulated activity, or it may limit the prohibition order to specific functions in relation to specific regulated activities. The FSA may also make an order prohibiting an individual from being employed by a particular firm, type of firm, or any firm.
- 1.3. EG 9.5 provides that the scope of a prohibition order will depend on the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of the risk which he poses to consumers or to the market generally.
- 1.4. EG 9.8-9.14 sets out additional guidance on the FSA's approach to making prohibition orders against approved persons and/or withdrawing such persons' approvals.
- 1.5. EG 9.8 provides that when the FSA has concerns about the fitness and propriety of an approved person, it may consider whether it should prohibit the person from performing functions in relation to regulated activities, withdraw its approval, or both. In deciding whether to withdraw its approval and/or make a prohibition order, the FSA will consider in each case whether its regulatory objectives can be achieved adequately by imposing disciplinary sanctions or by issuing a private warning.
- 1.6. EG 9.9 provides that when it decides whether to make a prohibition order against an approved person and/or withdraw its approval, the FSA will consider all the relevant circumstances of the case. These may include, but are not limited to:
 - (1) The matters set out in section 61(2) of the Act.
 - (2) Whether the individual is fit and proper to perform functions in relation to regulated activities. The criteria for assessing the fitness and propriety of

approved persons are set out in FIT 2.1(Honesty, integrity and reputation); FIT 2.2 (Competence and capability); and FIT 2.3 (Financial soundness).

- (3) Whether, and to what extent, the approved person has:
 - (a) failed to comply with the Statements of Principle issued by the FSA with respect to the conduct of approved persons; or
 - (b) been knowingly concerned in a contravention by the relevant firm of a requirement imposed on the firm by or under the Act (including the Principles and other rules);
 - (5) The relevance and materiality of any matters indicating unfitness.
 - (6) The length of time since the occurrence of any matters indicating unfitness.
 - (7) The particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates.
 - (8) The severity of the risk which the individual poses to consumers and to confidence in the financial system.
 - (9) The previous disciplinary record and general compliance history of the individual including whether the FSA, any previous regulator, designated professional body or other domestic or international regulator has previously imposed a disciplinary sanction on the individual.
- 1.7. EG 9.10 provides that the FSA may have regard to the cumulative effect of a number of factors which, when considered in isolation, may not be sufficient to show that the individual is fit and proper to continue to perform a controlled function or other function in relation to regulated activities. It may also take account of the particular controlled function which an approved person is performing for a firm, the nature and activities of the firm concerned and the markets within which it operates.
- 1.8. EG 9.11 states that it is not possible to produce a definitive list of matters which the FSA may take into account when considering whether an individual is not a fit and proper person to perform a particular, or any, function in relation to a particular, or any, firm. EG 9.12 sets out a list of examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order or withdraw the approval of an approved person, including:
- (1) Providing false or misleading information to the FSA: including information relating to identity, ability to work in the United Kingdom, and business arrangements;
 - (2) Failure to disclose material considerations on application forms;

- (3) Severe acts of dishonesty, e.g. which may have resulted in financial crime;
- (4) Serious lack of competence; and
- (5) Serious breaches of the Statements of Principle for approved persons, such as failing to make terms of business regarding fees clear or actively misleading clients about fees; acting without regard to instructions; providing misleading information to clients, consumers or third parties; giving clients poor or inaccurate advice; using intimidating or threatening behaviour towards clients and former clients; failing to remedy breaches of the general prohibition or to ensure that a firm acted within the scope of its permissions.

1.9. EG 9.13 provides that certain matters which do not fit squarely, or at all, within the matters referred to above may also fall to be considered and that in these circumstances the FSA will consider whether the conduct or matter in question is relevant to the individual's fitness and propriety.

2. Decision Procedure and Penalties Manual

2.1. DEPP 6.1.2 G provides that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market 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. Financial penalties and public censures are therefore tools that the FSA may employ to help it to achieve its regulatory objectives.

DEPP 6.2 Deciding whether to take action

2.2. DEPP 6.2.4 G provides that the FSA may take disciplinary action against an approved person where there is evidence of personal culpability on the part of that approved person. Personal culpability arises where the behaviour was deliberate or where the approved person's standard of behaviour was below that which would be reasonable in all the circumstances at the time of the conduct concerned.

2.3. DEPP 6.2.6 G lists some additional considerations that may be relevant when deciding whether to take action against an approved person pursuant to section 66 of the Act, including:

- (1) The approved person's position and responsibilities. The FSA may take into account the responsibility of those exercising significant influence functions in the firm for the conduct of the firm. The more senior the approved person responsible for the misconduct, the more seriously the FSA is likely to view the misconduct, and therefore the more likely it is to take action against the approved person.
- (2) Whether disciplinary action would be a proportionate response to the nature and seriousness of the breach by the approved person.

DEPP 6.5 Determining the appropriate level of financial penalty

- 2.4. DEPP 6.5.2 G lists a number of factors which may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act. The relevant factors are set out below.
- 2.5. When determining the appropriate level of penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business (DEPP 6.5.2 G (1)).
- 2.6. The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached. Among the relevant considerations are the duration and frequency of the breach and the loss or risk of loss caused to consumers, investors or other market users (DEPP 6.5.2 G (2)).
- 2.7. The FSA will have regard to the extent to which the breach was deliberate or reckless. The FSA will regard as more serious a breach which is deliberately or recklessly committed. If the FSA decides that the breach was deliberate or reckless, it is more likely to impose a higher penalty on a person than would otherwise be the case (DEPP 6.5.2 G (3)).
- 2.8. The matters to which the FSA may have regard in determining whether a breach was deliberate or reckless include, but are not limited to, the following:
 - (a) whether the breach was intentional, in that the person intended or foresaw the potential or actual consequences of its actions; and
 - (b) whether the person has given no apparent consideration to the consequences of the behaviour that constitutes the breach.
- 2.9. When determining the amount of a penalty to be imposed on an individual, the FSA will take into account that individuals will not always have the resources of a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than on a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individual are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level (DEPP 6.5.2 G (4)).

- 2.10. A person's incentive to commit a breach may be greater where the breach is, by its nature, harder to detect. The FSA may, therefore, impose a higher penalty where it considers that a person committed a breach in such a way as to avoid or reduce the risk that the breach would be discovered, or that the difficulty of detection (whether actual or perceived) may have affected the behaviour in question (DEPP 6.5.2 G (7)).
- 2.11. The FSA may take the previous disciplinary record and general compliance history of the person into account. This will include whether the FSA has taken any previous disciplinary action against the person, and the general compliance history of the person (DEPP 6.5.2 G (9)).
- 2.12. The FSA and the person 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 penalty which might otherwise have been payable will be reduced to reflect the stage at which the FSA and the person concerned reach an agreement (DEPP 6.5.2 G (13)).