Financial Services Authority

FINAL NOTICE

To: Seymour Pierce Limited

Of: 20 Old Bailey
London
EC4M 7EN

Date: 8 October 2009

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

1. THE PENALTY

1.1. The FSA gave Seymour Pierce Limited (SPL) a Decision Notice on 23 September 2009 which notified SPL that, pursuant to section 206 of the Financial Services and Markets Act 2000 (the Act), the FSA had decided to impose on it a financial penalty of £154,000. This penalty is in respect of SPL's breach of Principle 3 of the FSA's Principles for Businesses between December 2001 and February 2007 (the Relevant Period).

1.2. SPL has confirmed that it will not be referring the matter to the Financial Services and Markets Tribunal.

1.3. Accordingly, for the reasons set out below and having agreed with SPL the facts and matters relied on, the FSA imposes a financial penalty on SPL in the amount of £154,000.

1.4. SPL agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (Stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £220,000 on SPL.

2. REASONS FOR THE ACTION

2.1. During the Relevant Period, SPL breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Specifically, SPL failed to properly assess the internal fraud risks around its Settlements department (Settlements) and to implement effective controls to mitigate these risks. In particular:

(1) SPL did not adequately monitor changes made by Settlements staff to static data on client accounts (e.g. the client's name, address, bank account and payment instructions).

(2) SPL did not adequately control dormant client accounts to mitigate the increased risk of fraud associated with such accounts. In particular, no steps were taken to monitor transactions on dormant client accounts.

(3) SPL did not adequately reconcile its internal accounts. This limited its ability to identify errors or frauds involving these accounts.

2.2. As a result of SPL's failings, an employee in Settlements (Mr A), was able to steal approximately £150,000 without detection from the firm's internal and private client accounts. This was done in thirty-six separate transactions, over a three year period. The majority of the transactions involved unauthorised changes to static data on client accounts and/or the misuse of dormant client accounts. One transaction involved Mr A transferring a personal dealing loss that he himself had incurred into one of SPL's internal accounts. He also diverted to his personal bank account some of the firm's principal trading profits, dealing commission and interest on a number of occasions.

2.3. The FSA considers these failings to be particularly serious because:

(1) The FSA requires firms to have in place robust systems and controls over staff who have access to client accounts and over payments made from them. This applies in particular to dormant accounts which carry an increased risk of fraud because they are not likely to be monitored by the account holders.

(2) The frauds were not sophisticated in nature. SPL could have taken further simple measures to prevent the frauds occurring or detect them earlier.

(3) SPL's systems and controls failings allowed frauds to be committed against the firm and its clients, and exposed them to an unacceptable risk of further fraud.

(4) SPL's controls around Settlements remained weak over a long period during which the profile of fraud in the financial services sector and the FSA's focus on firms' anti-fraud systems and controls has increased significantly.

2.4. SPL's failings therefore merit the imposition of a financial penalty. In deciding the level of disciplinary sanction, the FSA recognises that the following circumstances serve to mitigate the seriousness of SPL's failings:

(1) SPL uncovered the frauds after it had dismissed Mr A. The firm took steps to notify the appropriate authorities and cooperated fully with the FSA's investigation.

(2) During 2005, SPL introduced an electronic order management system which had the effect of deterring Mr A from continuing to perpetrate one category of frauds on the firm.

(3) After it discovered the frauds, SPL was pro-active in instructing a firm of consultants to review its systems and controls and in implementing robust processes.

(4) SPL has taken steps to ensure that none of its clients suffered a loss as a result of the frauds.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

Statutory provisions

3.1. The reduction of financial crime and the protection of consumers are statutory objectives for the FSA under section 2(2) of the Act.

3.2. Section 206(1) of the Act provides that:

"*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.*"

FSA Principles

3.3. The FSA's Principles for Businesses are general statements of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.

3.4. Principle 3 states that:

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

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

4. FACTS AND MATTERS RELIED ON

The firm

4.1. SPL is a corporate finance firm incorporated in 1987 which undertakes, amongst other things, institutional client and private client stockbroking. It has been authorised by the FSA since 1 December 2001, with permission to carry out a range of investment related regulated activities.

4.2. At the start of the Relevant Period, SPL's private client business consisted of only a small number of private clients (legacy private clients). These legacy private clients had remained with the firm after the closure of the private client department in 1997. In May 2005, SPL rebuilt its private client business operations following the transfer to SPL of a private client team from a related company.

Settlements

4.3. Throughout the Relevant Period, trades executed by SPL on behalf of its institutional clients and private clients were settled by a third party firm pursuant to a settlements, clearing and custody arrangement. This involved a tripartite contractual relationship between SPL, the third party firm and each client. Under this arrangement, SPL retained responsibility for all aspects of the client relationship and Settlements continued to play an important role in the administration of accounts set up on the third party firm's settlement system (System B), which SPL was licensed to use.

4.4. During the Relevant Period, Settlements was a small team which consisted of Mr A and one or two other members of staff. Settlements staff had access rights to System B which enabled them to manually enter details of executed trades, and change static data on client accounts in accordance with clients' instructions. Once SPL executed trades and inputted details onto System B, the third party firm:

(1) assumed responsibility for settlement;

(2) assumed direct responsibility to clients for the handling and safekeeping of client money and assets; and

(3) the trades resided on the third party firm's balance sheet.

Relevant accounts

4.5. Throughout the Relevant Period, monies and assets belonging to SPL's institutional and private clients were held in bank accounts in the name of the third party firm, and responsibility for reconciling all accounts held by SPL's institutional and private clients rested with the third party firm. The holdings and related trades were administered by SPL via client accounts set up on System B.

4.6. SPL also operated a number of its own 'internal' accounts set up on System B, including: an 'Errors Account' used for booking trades when there had been a dealing error; a 'Warehouse Account' used for administrative convenience to aggregate trades where an institutional client gave the firm an order which needed to be executed in tranches; a 'Corporate Account' used for allocating new stock holdings to client

accounts; and a 'Placing Account' used for allocating stock relating to a corporate finance placing to a party that was not an existing client of the firm.

4.7. SPL also had use of a 'Trading Account' established and maintained by the third party firm for all correspondent broker firms that used System B. The Trading Account was used for posting trades that various SPL institutional clients executed with the firm on a 'riskless principal' basis (see paragraph 4.10(1) below).

The frauds

4.8. Between May 2003 and April 2006, Mr A stole a total of £149,165 by way of thirty-six separate transactions. Around half of this amount was from SPL and around half from SPL's legacy private clients.

Frauds against private clients

4.9. Three transactions involved Mr A stealing a total of £73,884 from SPL's legacy private clients between December 2004 and February 2005. The three legacy private client accounts involved were all dormant:

(1) One account held the proceeds of securities that had been sold in November 1998. The proceeds remained on the account accruing interest at six-monthly intervals. In December 2004, Mr A manipulated payment instructions on the account so that the total balance of £4,426 was automatically paid out to his personal bank account by the third party firm.

(2) A second account held a balance that had been accruing interest at six-monthly intervals since March 1998. In December 2004, Mr A manipulated payment instructions on the account so that the total balance on the account of £16,787 was automatically paid out to his personal bank account.

(3) A third account held securities since November 1999. In 2004, Mr A changed details on System B to transfer the securities initially to a dormant institutional client account that he had converted in October 2002 for his own use and then to his personal dealing account. Staff personal dealing accounts were set up to pay away cleared funds automatically. Therefore, when the securities were redeemed in February 2005, the proceeds of £52,670 were automatically paid to Mr A's personal bank account.

Frauds against SPL

4.10. Thirty-three transactions involved Mr A stealing a total of £75,281 from SPL between May 2003 and April 2006:

(1) Twenty-four transactions related to 'riskless principal' trading profits that the firm had earned. Trading on a riskless principal basis involved SPL buying stock from (or selling to) a client in the firm's own name (as opposed to acting as an agent) at one price and simultaneously selling the stock to (or buying from) another client at a different price. SPL traded on this basis when clients insisted that they did not want to pay agency broking commission and that instead SPL should make its profit from the difference between the buying and

selling price. These trades should have been booked onto the Trading Account. However, instead Mr A booked the trades onto the dormant institutional client account referred to in paragraph 4.9(3) above. Mr A had manipulated payment instructions on this dormant account in October 2002 so that the monies were automatically paid out by the third party firm via cheques sent to his home address. Mr A stole a total of £39,127 from the firm in this way between May 2003 and March 2005. After this date Mr A was deterred from diverting any further riskless principal trading profits for his own benefit due to the implementation by SPL of a computerised front office order management system.

(2) Seven transactions related to interest that was due to the firm. Institutional clients normally settled their transactions on a delivery-versus-payment basis. This meant that balances would not normally be left on their accounts and no interest would accrue. However, where interest did accrue on these accounts, SPL's terms of business made it clear that it would be due and payable to SPL. Mr A was able to commit six of the seven frauds by manipulating payment instructions on client accounts where interest had accrued. This resulted in the monies being automatically paid either directly to his personal bank account or by cheque sent to his home address. The other fraud involved the diversion of interest that had accrued on SPL's internal Placing Account to Mr A's personal bank account. Mr A stole a total of £22,257 from the firm in this way between October 2004 and September 2005.

(3) One transaction involved Mr A transferring, into the firm's Warehouse Account, a loss that he had incurred on his personal dealing account. SPL employees were permitted to be SPL clients and to maintain accounts set up on System B through which they could buy and sell securities, in accordance with the firm's personal dealing procedures. Mr A sold stock in his own name in March 2005, incurring a loss of £2,883 on a corresponding purchase trade that he had instructed the firm's front office to effect but which he had not settled. He then transferred both trades (and the resulting loss) from his personal dealing account into the firm's internal Warehouse Account by misleading an employee at the third party firm and misusing his access rights to System B.

(4) One transaction related to dealing commission that SPL had earned on the sale of an institutional client's shares. Mr A was able to commit this fraud by incorrectly booking the dealing commission to the client's account and manipulating payment instructions so that the monies were automatically paid to his personal bank account. Mr A stole a sum of £11,015 from the firm in this way in April 2006.

Static data monitoring

4.11. Static data is information held on a client account which does not often change, such as the client's name and address and the client's payment instructions. SPL's Settlements team was responsible for making changes to static data on accounts set up on System B in accordance with client instructions. There was therefore a material risk that static data might be improperly altered by Settlements staff and it was necessary for SPL to mitigate this risk.

4.12. Static data on client accounts could be set up to facilitate payment in one of two ways: 'Pay away funds' – accounts set up to pay out cleared funds arising on the account automatically either as they arose or at pre-set intervals; or 'Retain funds' – accounts set up to retain any cleared funds arising on the account indefinitely.

4.13. For accounts set up on System B to retain funds, SPL sought to control payments out by requiring payment instructions to be authorised by a member of the firm's Finance department (Finance). However, this control by Finance did not apply where an account was set up to pay away funds automatically. A dishonest member of staff in Settlements might therefore circumvent this control by improperly changing the status of the account from 'retain funds' to 'pay away funds' and changing the payee's details to those of an account that he controlled. It was therefore important that SPL monitored changes to payment instruction static data on client accounts.

4.14. Throughout the Relevant Period, a daily exception report was generated which detailed all changes to static data made on accounts set up on System B. This report was accessible to members of SPL's Compliance department (Compliance) and Settlements for monitoring purposes. However, prior to February 2004 it was only accessed by Mr A at SPL. After February 2004, Compliance also accessed the report to carry out sample checks of the client's categorisation on the system and to ensure that all new accounts had received Compliance sign-off. After SPL's new private client department opened in May 2005, these reviews were extended to include sample checks against details contained in the application forms of new clients. However, during the Relevant Period Compliance's reviews of the daily exception reports did not focus on changes made to static data on existing accounts. As a result, if Settlements staff manipulated static data on older client accounts, it was unlikely that this activity would be discovered by Compliance.

4.15. Thirty-three of the frauds committed by Mr A between May 2003 and April 2006 involved unauthorised changes to static data made by Mr A on twelve client accounts. In this way, SPL's failure to adequately monitor static data changes facilitated the theft of £92,107.

Dormant account monitoring and control

4.16. A dormant account is an account on which there has been no trading activity for a period of at least two years or that is otherwise known to be inactive. Dormant client accounts carry an increased risk of fraud because they are not likely to be monitored by the clients who hold them. The risk of misuse applied to all dormant accounts, whether they were institutional client accounts or private client accounts.

4.17. During the Relevant Period, SPL did not adequately control dormant client accounts to prevent them being misused. The majority of the legacy private client accounts that remained open during the Relevant Period were dormant. This was therefore a particularly high risk category of accounts that required SPL's attention. Significant efforts were made by SPL to contact legacy private clients and return any balances on their accounts following the closure of the old SPL private client department in 1997. However, SPL was unable to close thirty-eight legacy private client accounts, some of which continued to hold client money or assets. SPL was unable to locate and obtain instructions from those legacy private clients, and accordingly those legacy accounts

remained. Despite the fraud risks posed by these legacy accounts, SPL allowed them to be left open on System B without putting in place a process for monitoring any activity on them.

4.18. Twenty-six of the frauds committed by Mr A between May 2003 and March 2005, involved the misuse of a total of four dormant institutional client and/or legacy private client accounts. In this way, SPL's failure to adequately monitor and control dormant accounts facilitated the theft of £108,891.

Reconciliation of internal accounts

4.19. It was necessary for SPL to monitor its internal accounts in order to identify any errors in the booking of entries onto System B by Settlements staff and to identify any manipulative practices involving these accounts. However, there was no process in place at SPL during the Relevant Period to adequately govern this area.

4.20. As part of his responsibilities, SPL expected Mr A to regularly reconcile the firm's internal accounts. However, for at least fifteen months during the Relevant Period he did not reconcile these accounts at all. He was not challenged by SPL over the fact that he had not been reconciling these accounts until around October 2005. The fact that the reconciliations had not been completed for a substantial period of time then made it difficult and time-consuming for him to complete them. This gave Mr A an apparently plausible excuse to delay further, which SPL accepted.

4.21. Two of the frauds committed by Mr A involved the misuse of SPL internal accounts, namely the Placing Account (theft of £1,505 interest in October 2004) and the Warehouse Account (transfer of a £2,883 personal dealing loss in March 2005).

4.22. Twenty-four of the frauds (theft of riskless principal trading profits of £39,127 between May 2003 and March 2005) involved monies that should have been booked to the Trading Account. This was not one of SPL's internal accounts, but SPL should have taken steps to ensure that the booking of entries that should have been posted to this account by Settlements was being monitored. As explained in paragraph 4.10(1) above, SPL introduced an electronic order management system in 2005. However, before this system was introduced, SPL should have mitigated fraud risk in this area, for example, by independently reconciling trades executed by its front office against those booked by Settlements.

4.23. If SPL had taken proper steps to ensure that such reconciliations were completed during the Relevant Period, it is likely that Mr A would have been deterred from committing some of the frauds. Effective and independent monitoring of internal account reconciliations would have also led to his fraudulent activity being detected earlier.

Discovery of issues

4.24. In July 2006, SPL dismissed Mr A. The replacement that SPL recruited in August 2006 was asked to reconcile the firm's internal accounts as a priority. In January 2007, when reconciling the Warehouse Account, Mr A's replacement discovered one of the frauds. Further investigations by SPL in the following months uncovered the remaining frauds.

5. PRINCIPLE BREACHES

5.1. By reason of the facts and matters set out above, SPL breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Specifically, SPL failed to properly assess the internal fraud risks around Settlements and to implement effective controls to mitigate these risks. In particular:

(1) SPL did not adequately monitor changes made to payment instructions on client accounts by Settlements staff.

(2) SPL did not adequately control dormant client accounts to mitigate the increased risk of fraud associated with such accounts. In particular, no steps were taken to monitor transactions on dormant client accounts.

(3) SPL did not adequately reconcile its internal accounts, both to identify any errors in the booking of entries and to identify any frauds involving these accounts.

6. FACTORS RELEVANT TO DETERMINING THE ACTION

Relevant guidance on sanction

6.1. The FSA has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case. The principal purpose of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this 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 benefits of compliant behaviour.

6.2. In determining the financial penalty, the FSA has had regard to guidance contained in the Decision Procedure and Penalties Manual (DEPP) which came into force as part of the FSA's Handbook of Rules and Guidance (the FSA Handbook) on 28 August 2007. The FSA has also had regard to guidance contained in the Enforcement Manual (ENF) which formed part of the FSA Handbook during the Relevant Period.

6.3. DEPP 6.5 sets out some of the factors that may be of particular relevance in determining the appropriate level of a financial penalty. Chapter 13 of ENF contains the equivalent guidance that was in effect during the Relevant Period. DEPP 6.5.1 G and ENF 13.3.4 G both state that the criteria listed in DEPP 6.5 and ENF 13.3 respectively are not exhaustive and all relevant circumstances of the case will be taken into consideration. In determining whether a financial penalty is appropriate

and the amount, the FSA will therefore consider all the relevant circumstances of the case.

Deterrence

6.4. Reducing the extent to which it is possible for a firm to be used for a purpose connected with financial crime and the protection of consumers are two of the FSA's four statutory objectives. These objectives are endangered by firms who fail to implement robust systems and controls over staff who have access to client accounts.

6.5. The FSA considers that the financial penalty imposed on SPL will promote high standards of regulatory conduct within the firm and deter it from committing further breaches in the future. The FSA also considers that the financial penalty will help deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

The nature, seriousness and impact of the breaches in question

6.6. The FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number and duration of the breaches and whether the breaches revealed serious or systemic weakness of the management systems or internal controls.

6.7. The FSA considers that SPL's breaches are of a serious nature. In particular, they facilitated significant levels of fraud on the firm and its private clients, continued over a prolonged period, and involved inadequacies in basic anti-fraud controls.

The extent to which the breach was deliberate or reckless

6.8. The FSA does not consider that the misconduct on the part of SPL was deliberate or reckless.

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

6.9. The FSA has taken into account SPL's size and financial resources. SPL's turnover during the year ending 30 September 2008 was £14.3 million.

The amount of benefit gained or loss avoided

6.10. SPL did not profit from its breaches. On the contrary, the firm itself suffered losses as a result of the frauds.

Conduct following the breach

6.11. The FSA recognises that the following circumstances serve to mitigate the seriousness of SPL's failings:

(1) SPL itself uncovered the frauds after it had dismissed Mr A. The firm took steps to notify the appropriate authorities promptly and cooperated fully with the FSA's investigation.

(2) During 2005, SPL introduced an electronic order management system which had the effect of deterring Mr A from continuing to perpetrate one category of frauds on the firm.

(3) After it discovered the frauds, SPL was pro-active in instructing a firm of operational risk consultants to review its systems and controls. It has since implemented robust processes aimed at ensuring that the work of Settlements is independently and effectively monitored.

(4) SPL has ensured none of its clients suffered a loss as a result of the frauds.

Previous action taken by the FSA

6.12. The FSA has taken into account penalties imposed by the FSA on other authorised persons for similar breaches.

Conclusion

6.13. The FSA considers in all the circumstances that the seriousness of the breaches of Principle 3 by SPL merits a substantial financial penalty. In determining the financial penalty the FSA has considered the need to deter other firms from committing similar breaches.

6.14. The FSA imposes a financial penalty of £154,000. This takes into account the 30% stage 1 early settlement discount.

7. DECISION MAKERS

7.1. The decision which gave rise to the obligation to give this notice was made by the Settlement Decision Makers on behalf of the FSA.

8. IMPORTANT

8.1. This Final Notice is given to SPL in accordance with section 390 of the Act.

Manner of and time for payment

8.2. The financial penalty must be paid in full by SPL to the FSA by no later than 22 October 2009, 14 days from the date of the Final Notice.

If the financial penalty is not paid

8.3. If all or any of the financial penalty is outstanding on 23 October 2009, the FSA may recover the outstanding amount as a debt owed by SPL and due to the FSA.

Publicity

8.4. 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 SPL or prejudicial to the interests of consumers.

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

FSA contacts

8.6. For more information concerning this matter generally, SPL should contact Bill Sillett (direct line: 020 7066 5880 / fax: 020 7066 5881) of the Enforcement Division of the FSA.

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William Amos
Head of Department
FSA Enforcement Division