FINAL NOTICE

To: **Nilesh Shroff**

Individual Reference Number: **NAS01059**

Date: **22 May 2009**

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

1. THE ACTION

1.1. The FSA gave Nilesh Shroff a Decision Notice on 12 May 2009 which notified him that, for the reasons set out below, the FSA had decided to impose on Nilesh Shroff:

(1) a prohibition order pursuant to section 56 of the Financial Services and Markets Act 2000 ("the Act"), prohibiting Mr Shroff 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 Shroff is not a fit and proper person; and

(2) a financial penalty of £140,000 pursuant to section 66(2)(b) of the Act for being knowingly concerned in a contravention by Morgan Stanley UK Ltd ("Morgan Stanley") of Principle 6 (Customers' interests) of the FSA's Principles for Businesses (the "Principles"). Mr Shroff was solely responsible for that contravention. For the avoidance of doubt, neither Morgan Stanley

nor companies related to it, nor any other individuals employed by it are subject to criticism as a result of the facts referred to in this Notice.

1.2. Mr Shroff has confirmed that he will not be referring the matter to the Financial Services and Markets Tribunal. Accordingly, for the reasons set out below and having agreed with Mr Shroff the facts and matters relied on, the FSA imposes a prohibition order in the above terms and a financial penalty of £140,000 on him. The prohibition order has effect from 26 May 2009.

1.3. Mr Shroff has agreed to settle at an early stage of the FSA's investigation. He therefore qualifies for a 30% (stage 1) reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £200,000 on him.

2. REASONS FOR THE ACTION

Summary

2.1. The FSA has concluded, on the basis of the facts and matters described below, that Mr Shroff is not a fit and proper person to perform any functions in relation to regulated activities carried on by any authorised persons because he has fallen below minimum regulatory standards in terms of honesty and integrity with respect to FSA regulated activities.

2.2. In summary, while employed at Morgan Stanley as executive director, risk-trading programme, Mr Shroff disadvantaged Morgan Stanley's clients on seven occasions between June and October 2007 by partially 'pre-hedging' programme trades without the clients' consent. He did so in the knowledge that such pre-hedging was expressly prohibited by Morgan Stanley's policies and that the likely result would be to disadvantage Morgan Stanley's clients. Five of the clients were categorised as intermediate customers and Mr Shroff's failure to treat them fairly thus caused Morgan Stanley to breach Principle 6.

2.3. This pre-hedging caused the mid-prices of most of the stocks traded in to move against the client before the trade was struck. This caused detriment to the clients and by definition to the underlying investors in the clients' funds.

2.4. The FSA views Mr Shroff's conduct as serious because:

(1) He abused his position of responsibility as a senior trader and the trust placed in him by clients and by his employer.

(2) Out of the ten relevant trades between June and October 2007 examined by Morgan Stanley, Mr Shroff pre-hedged seven trades. His misconduct was therefore repeated.

(3) Mr Shroff was aware of FSA guidance and Morgan Stanley's policies in relation to pre-hedging but nonetheless he breached them.

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.

3.3. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated activities.

3.4. 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

3.5. 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. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.

3.6. In this instance the criteria set out in FIT are relevant in considering whether the FSA may exercise its powers to make a prohibition order in respect of an individual in accordance with EG 9.9.

3.7. FIT 1.3.1 G provides that the FSA will have regard to a number of factors when assessing the fitness and propriety of a person. The most important considerations will be the person's honesty, integrity and reputation, competence and capability and financial soundness.

3.8. FIT 2.1.1 G provides that, in determining a person's honesty, integrity and reputation, the FSA will have regard to matters including, but not limited to, those set out in FIT 2.1.3 G.

3.9. FIT 2.1.3 G refers to various matters, including: whether the person has contravened any of the requirements and standards of the regulatory system (FIT 2.1.3 G (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 2.1.3 G (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 2.1.3 G 13)).

Principles for Businesses

3.10. Principle 6 (Customers' interests) provides that a firm must pay due regard to the interests of its customers and treat them fairly.

Enforcement Policy

3.11. The FSA's policy in relation to the decision to make a prohibition order is set out in Chapter 9 of the Enforcement Guide ("EG"). Extracts from chapter 9 of EG are set out in Annex A.

3.12. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the the part of the FSA Handbook entitled Decision Procedure and Penalties Manual ("DEPP"). Extracts from DEPP are set out in Annex A.

3.13. The FSA has also had regard to the provisions of the FSA's Enforcement Manual ("ENF") which were in force during the period in which part of Mr Shroff's misconduct occurred, and which set out the FSA's policy on the imposition and amount of penalties during that period.

4. FACTS AND MATTERS RELIED ON

Background

4.1. Mr Shroff had been employed in the securities industry since 1995. He first started programme trading in 1999. He joined Morgan Stanley in September 2006. He was approved from 16 October 2006 to exercise the controlled function of investment adviser (CF21) with Morgan Stanley & Co International plc and Morgan Stanley Securities Ltd (converted from 1 November 2007 to the customer function (CF30)). His approval was withdrawn on 21 December 2007. Mr Shroff's trading activities that are the subject of this Notice fell outside the scope of his controlled function and hence outside the scope of the Statements of Principle for Approved Persons.

4.2. At the material time, Mr Shroff's position at Morgan Stanley was executive director, risk-trading programme and his role included the management of the programme trading risk book and the facilitation of programme trades on behalf of clients. This involved the preparation of pricing and the execution of trades and the ongoing management of the risk portfolio. The overall objective of the risk book was to manage risk from customer trades.

Programme trading

4.3. ‘Programme trading’ is the term used to describe a transaction or series of transactions by an institution when acquiring or disposing of an entire portfolio or a material part of a portfolio. Programme trades can be all ‘one way’ or a combination of buys and sells.

4.4. All the programme trades made on behalf of clients referred to in this Notice were made on a principal (rather than agency) basis. For a principal trade, typically a number of brokers will be asked to tender to acquire the portfolio from or for the institution, quoting a premium or discount to the mid-price for each security at a designated strike time, which is known as the ‘snap’. The premium or discount (the “risk fee”) is expressed in a number of basis points (“bps”), i.e. one-hundredths of a percentage point. Transactions with brokers are often conducted via an institution’s centralised dealing desk.

4.5. Principal trades are attractive to customers who want to undertake a large number of trades at the same time but do not want to assume the risk of the share prices moving against them in the period between the commencement and completion of trading. The broker assumes that risk in return for the risk premium.

4.6. The execution of a principal programme trade usually involves the following steps:

(1) The customer provides limited information about its portfolio (e.g. sectors and percentages of average daily volume (“ADV”)) to a number of brokers to enable them to assess the risk and quote for the trade, but without disclosing the component securities and, usually, whether the customer is a buyer or a seller in respect of each;

(2) The customer receives the quotes from the brokers;

(3) The customer reviews the quotes and awards the trade to one of the brokers;

(4) The customer communicates the award to the winning broker and a snap time is agreed;

(5) The customer provides the broker with the full details of the component securities and indicates whether they are buying or selling; sometimes this information is provided before the snap but more usually afterwards. In the case of the trades referred to in this notice, details of the portfolios were provided to Morgan Stanley before the snap;

(6) Each stock is supplied to or purchased from the customer by the broker at the snap time at the quoted premium or discount to the mid-market price.

Pre-hedging of programme trades

4.7. 'Pre-hedging' refers to trading by a broker for his firm's benefit in advance of the snap using information provided by the customer.

4.8. On 5 April 2004 the FSA imposed a fine on a broker firm for breaches of the Principles in relation to the pre-hedging of programme trades. The FSA's press release contained the following statement on pre-hedging:

"By pre-hedging the programme trade [the firm] *ultimately disadvantaged its customer, a fund manager, in the price they paid for the trade, and the underlying investors in the relevant funds. A firm which proposes to engage in pre-hedging should ensure that it informs the customer in advance that it might trade in the component securities based upon the information supplied or can otherwise demonstrate that its participation in the market does not disadvantage the customer. It is expected that firms have in place systems and controls to minimise the impact that any pre-hedging by the firms is likely to have on the customer's interests.*

The FSA views these obligations as fundamental to maintaining efficient, orderly and clean markets".

4.9. Mr Shroff was aware of the 2004 fine and understood that unauthorised pre-hedging of programme trades was contrary to the Principles.

4.10. Morgan Stanley's UK Institutional Sales and Trading Compliance Manual (dated February 2005), which was provided to Mr Shroff on joining the firm, stated as follows:

"Integrity and Fair Dealing

The Firm and its representatives should observe high standards of integrity, fair dealing and market conduct at all times and comply with both the letter and the spirit of all applicable laws, rules regulations and codes of conduct. Customers should be dealt with honestly and fairly at all times. You should refrain from any conduct which might advantage the Firm at the expense of a customer …

Front –Running

DO NOT trade for the Firm … if you know that the Firm has received a customer order …".

4.11. At the material time Morgan Stanley's specific policy in relation to programme trades was that it did not pre-hedge such trades. That policy was unwritten but it had been communicated verbally to Mr Shroff.

4.12. Compliance notices issued by Morgan Stanley also stressed the importance of managing conflicts of interest, mitigating the risk of potential damage to customers' interests and treating customers fairly at all times.

The trade for "Customer A"

4.13. Customer A instructed Morgan Stanley to make a programme trade on its behalf on 16 October 2007. At the time of the trade, Customer A was categorised as an 'intermediate customer' (meaning that it was a customer for the purposes of Principle 6 of the FSA's Principles for Businesses and that Morgan Stanley was obliged to pay due regard to its interests and treat it fairly).

11 October 2007

4.14. On 11 October 2007, Mr B, who handled the trade at Customer A, contacted a salesman on Morgan Stanley's programme sales desk about the process for executing a programme trade.

4.15. During the conversation Mr B made it clear that he was looking to minimise the cost of the trade to Customer A. He said, *"I'll put together as much data as I can without just totally opening the portfolio to you, although I'd even consider that if it was really going to help. Pricing is paramount for me really"*. The salesman had told Mr B *"As a simple rule of thumb you are going to get a better price the more info we've got"*.

15 October 2007

4.16. On the morning of 15 October 2007 Mr B sent an email to Morgan Stanley's programme trading sales desk with a spreadsheet containing generic information about the composition of his portfolio. This listed the number of stocks, values and average daily volumes by market sector.

4.17. In the afternoon of 15 October Mr Shroff sent Mr B a Bloomberg message saying *"I think we can get you into the mid 20's but not to trade today"*. 'The mid 20s' was a reference to the risk fee, expressed as the number of basis points that would be charged for carrying out the programme trade.

16 October 2007

4.18. At 08:19 on 16 October 2007 Mr B sent Mr Shroff a Bloomberg message saying *"can you have another look at firming up a price for me please once you feel that things have tightened up enough"*.

4.19. At 08:46 Mr Shroff sent Mr B a Bloomberg message saying *"Price is 26bp"*. At 09:15, following further discussions about pricing, Mr Shroff sent Mr B a Bloomberg message saying *"You must appreciate that I have already bought* [sic] *my pricing down to try and accommodate your request. We will do the trade at 24bp if it really helps you out"*.

4.20. At 09:33 Mr B sent the salesman an email with a spreadsheet containing full details of the stocks to be bought or sold in the programme trade. By 09:36:32 the salesman had loaded the details on to Morgan Stanley's systems and Mr Shroff had access to the details by 09:38:48.

4.21. At 09:41:12 Mr Shroff sent a wave of orders to the market in respect of 23 of the stocks in Customer A's portfolio. The wave was comprised of less liquid stocks and stocks of a relatively wide bid/offer spread; the prices of these stocks were therefore more likely to be affected by Mr Shroff's orders than stocks of higher liquidity. He set the volumes of the orders within the wave by reference to the volume contained within Customer A's portfolio and at a maximum of 1% of ADV. His bids or offers were in the same direction as the trades within Customer A's portfolio. The trading engine was programmed to trade 'at best' subject to a price limit, which meant that the orders would be executed immediately if there was sufficient liquidity.

4.22. At 09:41:36 Mr Shroff sent a second identical wave of orders to the market.

4.23. At 09:42:22 Mr Shroff sent a third identical wave of orders to the market.

4.24. At 09:42:47 Mr Shroff sent a fourth wave of orders to the market. This wave differed from the first three but only because Mr Shroff submitted orders in all but one of the stocks in Customer A's portfolio. It was not intended for this wave to be any different to the previous three waves.

4.25. At 09:42 the salesman called Mr B and they agreed to snap Customer A's trade at 09:43.

4.26. At precisely 09:43 Mr Shroff sent a fifth wave of orders to the market that coincided with the snap. This wave was limited to twenty of the twenty-three stocks that had been included in the first three waves. For the remaining three stocks, the trades undertaken as a result of the first four waves had already filled the volume of stocks held in Customer A's portfolio.

4.27. Orders in the fifth wave were again set at a maximum of 1% of ADV and the bids and offers were in the same direction as the trades to be undertaken by Customer A. However, there was a difference in terms of pricing. Mr Shroff priced the orders at one 'tick' (an incremental price movement, the size of which varies on a stock by stock basis) away from the current bids and offers, but within the prevailing bid/offer spread. The orders were likely to compress the bid/offer spreads to one tick and thus to move the mid-prices of the 20 stocks against Customer A.

4.28. In the case of the fifth wave, trades would not all have been executed automatically, although some were as other market participants entered bids or offers that matched Mr Shroff's orders.

4.29. By 09:43 the mid-prices of approximately 80% of the stocks in Customer A's portfolio had moved against the customer i.e. where Customer A was a buyer the mid-prices had risen meaning that Customer A would pay more for the shares, and where Customer A was a seller the mid-prices had fallen meaning that Customer A would receive less for its shares. This would have caused detriment to Customer A of £98,000 or 16bps, had the snap time not been moved and any detriment to Customer A removed, as described below.

4.30. The salesman and Mr B remained on the telephone after agreeing to snap Customer A's trade at 09:43 and as the salesman prepared to count down to the snap, Mr B asked him *"They're not moving any stocks, are they? I've just noticed everything's* *come in"*. The salesman replied *"they shouldn't be no. No because they wouldn't have struck it yet"*. Mr B then drew attention to the fact that his P&L had moved and he asked *"Are you sure they haven't moved any of the stocks?"*. The salesman replied, *"they wouldn't … because they're not allowed to … I hope he hasn't. I'd be angry"*. Mr B emphasised that the whole portfolio had moved against him. He described the situation as an *"outrage"*.

4.31. The salesman looked into the matter with Mr Shroff and the trading desk. As a result of this discussion, at 10:29 Morgan Stanley offered to move the snap back to 09:33, the time that Mr B had sent the spreadsheet containing the stocks in Customer A's portfolio. This removed any possibility that Mr Shroff's trading had moved the mid-prices. The offer was accepted by Mr B.

Mr Shroff's dismissal by Morgan Stanley

4.32. Morgan Stanley instructed a law firm to investigate the execution of the Customer A trade. During this investigation Mr Shroff continued in his regular role and responsibilities. On 28 December 2007 Morgan Stanley dismissed Mr Shroff for gross misconduct, with effect from 21 December 2007. The amount paid to him for 2007 was significantly reduced because of his misconduct, and he was required to forfeit his company stock units.

The other programme trades in June – October 2007

4.33. Following Mr Shroff's dismissal, Morgan Stanley carried out a further review of the nine other principal programme trades Mr Shroff had transacted in the period from June to October 2007 where details of the portfolios were made available to the firm before the snap. Of these nine trades, six showed similar characteristics to the Customer A trade, i.e. principal trading by Mr Shroff in constituent stocks in the same direction as the client prior to the snap which caused detriment to the client. Five of these six clients were categorised as intermediate customers. None of the clients gave permission for Mr Shroff to pre-hedge the trade.

4.34. Mr Shroff told the FSA that his motive in pre-hedging the trades was to establish a trading level for the stocks by testing the market in them, because he thought that price formation had not taken place. He accepted that this was likely to move the prices of the stocks against his clients, but said that he thought any movements would not be significant.

5. ANALYSIS OF BREACHES

5.1. On seven occasions between June and October 2007, Mr Shroff partially pre-hedged programme trades that he was to carry out on behalf of clients, without the clients' consent and in breach of Morgan Stanley's express prohibition of such pre-hedging. As a result of this pre-hedging, Mr Shroff disadvantaged those clients by moving the mid-prices against them. This price movement effectively represented an additional cost to the clients of which neither the clients nor Morgan Stanley were aware.

5.2. Mr Shroff was aware that the FSA had disciplined another firm for pre-hedging programme trades without client consent, and that pre-hedging was forbidden by

Morgan Stanley's internal policy. His repeated pre-hedging of programme trades was therefore carried out in the knowledge that it was prohibited by the FSA and by Morgan Stanley. The FSA has therefore concluded that his actions were deliberate. As an experienced trader, he would also have known that his orders were likely to move mid-prices in his favour and thus were likely to disadvantage his clients and the underlying investors in their funds.

5.3. The FSA has concluded that Mr Shroff failed to act with integrity and acted dishonestly by deliberately and repeatedly pre-hedging programme trades without client consent. This goes directly to impugn Mr Shroff's honesty and integrity with respect to FSA regulated activities and therefore to demonstrate that he is not a fit and proper person to carry out regulated activities.

5.4. Five of the six clients involved were categorised as intermediate customers and Mr Shroff's failure to treat them fairly thus caused Morgan Stanley to breach Principle 6. Mr Shroff was knowingly concerned in that breach, in that he was solely responsible for it.

6. ANALYSIS OF THE SANCTION

General

6.1. In deciding to take the action described in this notice, the FSA has considered, amongst other things, the seriousness and nature of Mr Shroff'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 Shroff was a senior trader in a position of responsibility, which he abused. He therefore represents a substantial risk to confidence in the financial system.

(2) His misconduct was repeated, occurring in seven out of the ten relevant transactions examined between June and October 2007.

6.3. The FSA has taken account, in mitigation, of Mr Shroff's compliance history and the fact that he has not previously been the subject of disciplinary action.

Prohibition

6.4. 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.

6.5. The FSA is satisfied that Mr Shroff 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

6.6. 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.

6.7. Mr Shroff's conduct was repeated and in breach of Morgan Stanley policy, and it disadvantaged clients. He did not treat customers fairly. He was solely responsible for causing Morgan Stanley to breach Principle 6.

6.8. In setting the penalty the FSA has also taken into account Mr Shroff's dismissal by Morgan Stanley, and the level of remuneration he received for 2007.

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 Shroff'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 a Prohibition Order against Mr Shroff.

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 £140,000 on Mr Shroff.

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 Shroff in accordance with section 390 of the Act.

Manner of and time for Payment

9.2. The financial penalty must be paid in full by Mr Shroff to the FSA by no later than 5 June 2009, 14 days from the date of the Final Notice.

If the financial penalty is not paid

9.3. If all or any of the financial penalty is outstanding on 6 June 2009, the FSA may recover the outstanding amount as a debt owed by Mr Shroff 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 you 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, Mr Shroff should contact Celyn Armstrong (direct line: 020 7066 2818 /fax: 020 7066 2819).

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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);

(4) The relevance and materiality of any matters indicating unfitness.

(5) The length of time since the occurrence of any matters indicating unfitness.

(6) 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.

(7) The severity of the risk which the individual poses to consumers and to confidence in the financial system.

(8) 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)).