
FINAL NOTICE

To: Threadneedle Asset Management Limited

Firm
Reference
Number: 122194

Address: Cannon Place
78 Cannon Street
London
EC4N 6AG
United Kingdom

Date: 10 December 2015

1. ACTION

- 1.1. For the reasons given in this notice, the Authority hereby imposes on Threadneedle Asset Management Limited ("TAML" or "Firm") a financial penalty of £6,038,504. This penalty is for TAML's breaches of Principles 3 and 11 during the period June 2010 to 29 February 2012 ("Relevant Period").
- 1.2. TAML agreed to settle at an early stage of the Authority's investigation. TAML therefore qualified for a 20% stage 2 discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £7,548,130 on TAML.

2. SUMMARY OF REASONS

- 2.1. In June 2010, an internal report brought a number of weaknesses in the fixed income area of TAML's front office to the Firm's attention.
- 2.2. On 5 April 2011, the Authority wrote to TAML following an ARROW visit identifying the Authority's concerns in relation to the Firm's fixed income area. The concerns included the number of errors in the area and fund managers initiating, booking

and executing their own trades. The Authority raised, among other issues, similar concerns to those identified in the Firm's internal report.

- 2.3. In the RMP the Authority asked TAML to take action to address the concerns raised and by 30 June 2011 to explain the actions it had taken to address those concerns. The Firm issued a report to the Authority ("RMP Response") on 29 June 2011 stating that it had appointed members of staff ("Specified Individuals") to be responsible "for all aspects of dealing" on the Emerging Markets and High Yield desks and that the Specified Individuals had taken on those responsibilities.
- 2.4. However, the Specified Individuals had not taken on all the responsibilities outlined in the RMP Response and fund managers on those desks continued to initiate, execute and book their own trades.
- 2.5. Approximately one month after the Firm submitted the RMP Response, on 3 August 2011, a fund manager on the Emerging Markets desk initiated, executed and booked a \$150 million trade to purchase Argentine warrants on behalf of three Threadneedle funds at four times their market value ("Unauthorised Transaction"). The fund manager was neither the manager of the funds nor did he have authority to make the trades.
- 2.6. TAML's back office prevented the Unauthorised Transaction from settling. Had the Unauthorised Transaction settled, it could have exposed the funds to a £70 million loss. Other parties were involved in the transaction which was part of a wider matter. That matter was the subject of High Court proceedings in which it was noted that there had been an intended fraud upon TAML. The Firm may have been obliged to compensate the funds for the loss requiring it to call on its insurance cover. The Unauthorised Transaction led the Authority to ask the Firm to submit a report identifying the processes and controls in place at the time of the Unauthorised Transaction. Following that, on 28 October 2011, TAML informed the Authority that the RMP Response "did not fully reflect" the actual dealing practice on the Emerging Market and High Yield desks and apologised "*unreservedly for this*".
- 2.7. The Authority required TAML to appoint a Skilled Person to review the systems, processes and controls in its fixed income trading area. The Skilled Person reviewed relevant TAML systems, processes and controls and identified deficiencies which form the basis of this notice.
- 2.8. The Authority takes this action because:
 - (1) TAML breached Principle 3 between June 2010 and 29 February 2012 by failing to take reasonable care to organise and control its affairs responsibly and effectively failing to put in place adequate controls in the fixed income area of its front office to mitigate the risk of erroneous trading highlighted by the Authority and the Firm's own report; and
 - (2) TAML breached Principle 11 between 30 June 2011 and 28 October 2011 because it did not accurately describe the trading processes in place on the Emerging Markets and High Yield desks in its RMP response to the Authority.
- 2.9. TAML breached Principle 3 because it failed to:
 - (1) Put in place adequate preventive and detective controls by either segregating the trading duties on the Emerging Markets and High Yield

desks, or ensuring that appropriate front office controls were in place to mitigate the risks posed by the lack of segregation. In particular:

- (a) TAML's preventive controls were inadequate because they failed to:
 - (i) Restrict fund managers' ability to initiate, execute and book trades on funds other than their own without obtaining express recorded consent;
 - (ii) properly calibrate pre-trade soft alerts on trades;
 - (iii) enforce a requirement for fund managers to provide a rationale for overriding a soft alert; and
 - (iv) code appropriate hard stops in its trading system which could prevent unauthorised trades in excess of those limits from proceeding to settlement.
 - (2) TAML's detective controls were inadequate because they failed to:
 - (a) test the evidence fund managers provided to prove that they had achieved best execution;
 - (b) put in place a written policy which formally required fund managers to review trades booked the previous day on the funds for which they were responsible and confirm in writing that they had done so; and
 - (c) require fund managers, in the absence of the segregation of trading duties, to obtain explicit approval to place trades with non-standard settlement terms.
- 2.10. TAML breached Principle 11 because it did not accurately describe the trading processes in place on its Emerging Markets and High Yield trading desks when it responded to the Authority in the RMP Response on 30 June 2011 and it did not correct its response until 28 October 2011.
- 2.11. TAML's failures were serious because the deficiencies allowed the fund manager to:
- (1) initiate, execute, and book eight trades which were at variance with market price, for which the Firm could not evidence best execution and which caused the Firm to have to make a £595,000 provision to the relevant fund to cover the losses; and
 - (2) initiate, execute, and book an Unauthorised Transaction which, had it settled, could have caused a £70 million loss to the relevant funds, the provision for which would have required the Firm to make a claim on its insurance policy.
- 2.12. The ARROW and RMP process, now known as the Firm Systematic Framework, is fundamental to the Authority's approach to supervision. The Authority must be able to rely upon the accuracy of the representations firms make during that process to allow it to carry out its regulatory responsibilities efficiently and effectively. TAML's reporting failures were serious and they breached Principle 11 because they risked undermining the effectiveness of this important supervisory tool.

- 2.13. Unauthorised trading risks undermining trust and confidence in the UK financial markets and exposes investors to the risk of loss. Consequently, it is important for firms to put in place adequate controls to mitigate the risk of unauthorised trading.
- 2.14. The controls in the fixed income area of the TAML front office did not mitigate the risk of unauthorised trading.
- 2.15. In July 2013, the date of its final review, the Skilled Person found that TAML had improved its controls and that it had put in place appropriate controls to address the weaknesses the Skilled Person had originally identified.
- 2.16. For these reasons, the Authority imposes a financial penalty of £6,038,504 for breaches of Principles 3 and 11.

3. DEFINITIONS

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

- (1) **Act** means the Financial Services and Markets Act 2000, as amended.
- (2) **ARROW Letter** means the letter dated 5 April 2011 in which the Authority set out the results of the Authority's ARROW assessment. Attached to the ARROW letter was the RMP which outlined specific actions the Authority required TAML to take.
- (3) **AUM** means assets under management.
- (4) **Authority** means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority.
- (5) **DEPP** means the Authority's Decision Procedure and Penalties Manual.
- (6) **EG** means the Authority's Enforcement Guide.
- (7) **Fixed Income Central Dealing Desk** means the central dealing desk in TAML's fixed income trading area.
- (8) **Operational Risk Report** means the internal TAML report dated June 2010 identifying options TAML could take to address weaknesses in its front office dealing controls.
- (9) **Principles** mean the Principles for Businesses set out in the Authority's Handbook.
- (10) **Relevant Period** means 1 June 2010 to 29 February 2012.
- (11) **RCSA** means Risk and Control Self-Assessments.
- (12) **RMP** means risk mitigation programme, a list of specific actions the Authority required TAML to take following the Authority's ARROW visit, set out as appendix 3 to the ARROW Letter.
- (13) **RMP Response** means the report dated 29 June 2011 responding to the areas of concern the Authority outlined in its ARROW Letter and RMP.

- (14) **Skilled Person's Report** means the report dated 28 September 2012 of the Skilled Person whom the Authority required TAML to appoint pursuant to s166 of the Act.
- (15) **TAML** or **Firm** means Threadneedle Asset Management Limited.
- (16) **Unauthorised Transaction** means the trade to purchase Argentine warrants that a fund manager initiated, executed and booked on 3 August 2011.

4. FACTS AND MATTERS

4.1. This section describes:

- (1) TAML's business and trading processes generally;
- (2) the trading process in TAML's fixed income trading area;
- (3) the warning signs which put TAML on notice of the deficiencies in its fixed income trading area;
- (4) the ARROW letter, the RMP and the RMP Response; and
- (5) the Unauthorised Transaction and the events leading up to it.

Threadneedle Asset Management Limited's business and trading process generally

4.2. TAML is a UK based investment management firm and is part of the Threadneedle Group of companies ("Group"). As at June 2014, the Group had assets under management of £92.8 billion and had a presence in 17 countries. TAML manages assets for a variety of clients, including pension schemes, insurance companies, private investors, corporations and mutual funds.

TAML's trading area

- 4.3. TAML used a trading area of 12 investment desks: five fixed income desks, six equities desks and a managed funds operations desk.
- 4.4. The Emerging Markets and High Yield trading desks in the fixed income investment area are the focus of this notice. Together, the combined TAML revenue on those desks represented approximately 3.7% of total TAML revenue for the Relevant Period.
- 4.5. TAML also used a Fixed Income Central Dealing Desk, a desk separate from the investment desks. The Fixed Income Central Dealing Desk executed and booked trades for some of the fixed income investment desks during the Relevant Period.

The segregation of trading duties

4.6. If a firm decides to use segregation of trading duties, a fund manager (sitting on an investment desk) initiates an order to buy or sell a security or other instrument and the dealer (sitting on the Central Dealing Desk) executes and books the order. On execution the order becomes a "trade" (an agreement between the buyer and seller to purchase a defined number of units in the security on a date certain) which a back office "settles" by instructing the custodian to exchange money for the security. This separation of trading duties

operates as a preventive control because the central dealer acts as a check on the fund manager.

The trading process in TAML's fixed income trading area

- 4.7. This section identifies each stage in the trading process and for each stage:
- (1) explains how TAML implemented the general trading process; and
 - (2) identifies the deficiencies in TAML's controls and processes during the Relevant Period.

Stage 1 – Trade initiation

- 4.8. The first stage in the trading process is the fund manager's decision to buy or sell a stock or other instrument for the funds he manages.
- 4.9. Having made the decision to buy or sell, the fund manager initiates the trade by entering an order into an order management system.
- 4.10. On the Emerging Markets and High Yield desks, fund managers had access to the systems which allowed them to initiate orders not only on the funds for which they were the designated fund managers, but also allowed them to initiate orders on funds for which they were neither the designated nor the deputy fund manager.
- 4.11. While TAML used a team approach to investment, it expected fund managers to obtain approval for placing orders for funds other than their own, but its order approval process did not require the designated fund manager to document this authorisation. Moreover, TAML's systems did not produce a notification when someone other than the designated fund manager initiated an order.
- 4.12. Once the fund manager initiates the trade, the trade goes through pre-trade compliance checking. Trading limits are a typical preventive control and a firm can code order (or other) limits as "hard stops" or as "soft alerts".
- 4.13. Hard stops prevent an order from going through to the next stage of the process until (or unless) a separate person or system permits the order to proceed. Such stops can be to prevent "fat finger" errors or mandate or other compliance breaches. Soft alerts or limits do not prevent orders from going to the next stage because fund managers can override them. Soft alerts can nonetheless be used to alert the fund manager to take notice of a particular issue.
- 4.14. TAML's mandate compliance system performed a pre-trade compliance check to determine whether the fund manager's order complies with TAML's house and client investment restrictions and other regulatory restrictions. If the order breached any of these, the system issued a pre-trade compliance soft alert. If this resulted in a breach of mandate or regulatory requirements, TAML would have investigated and escalated this as part of post-trade mandate compliance.
- 4.15. TAML did not code sufficient hard limits into its order entry systems and fund managers could override soft limits without putting in a reason for overriding the limit into the system. More specifically:
- (1) The only restrictions TAML hard-coded into its mandate compliance system were securities on its "restricted list". It only implemented "fat finger" restrictions, restrictions based on order or fund value, from October 2011.

- (2) These restrictions still had some limitations. At 29 February 2012, to allow appropriate orders to go through, TAML lifted fat finger restrictions for 60 minutes for all orders on the fund. This meant that fat finger restrictions would not be effective in controlling inappropriate orders. The Firm addressed this problem by lifting fat finger restrictions on an order by order basis. That restriction meant that only independently approved orders which otherwise would have exceeded fat finger limits could be processed.
- (3) Because TAML did not appropriately calibrate soft alerts, there were a high number of false positive alerts which fund managers generally overrode without providing an explanation. This meant that TAML relied too heavily on its post-trade compliance systems.

Stage 2 – Execution and booking

- 4.16. The second stage in the trading process is trade execution and booking. As part of this stage, the dealer (or the fund manager, if trading duties are not segregated) executes the trade in the market with a broker. Once orders are filled, trades are allocated to the relevant funds, affirmed in the firm's order management system and then sent (or "booked") to the back office for confirmation matching and the back office sends the instructions to the custodian for settlement.
- 4.17. TAML's Fixed Income Central Dealing Desk executed fixed income, money market, Foreign Exchange, Exchange Traded Derivatives and Over the Counter derivative orders. However, TAML's Fixed Income Central Dealing Desk did not execute and book orders from the Emerging Markets or High Yield desks until September 2011. Until then, the fund managers on those desks could not only initiate orders, but they could also execute and book trades. As at December 2010, TAML decided not to adopt centralised dealing but to appoint specified individuals to carry out dealing on those desks. TAML's decision not to segregate trading duties on the Emerging Markets and High Yield Desks was one of the factors that left the Firm vulnerable to erroneous transactions, a risk that an employee in TAML's operational risk area warned the Firm about in June 2010.
- 4.18. Until September 2011, fund managers on TAML's Emerging Markets and High Yield fund management desks initiated, executed and booked orders for their own trades. As from September 2011, trade bookings on these two desks were transferred to the Fixed Income Central Dealing Desk which carried out a reasonableness check on trades prior to booking them. With effect from November 2011, Emerging Market trade executions were carried out by the central dealing desk and, from July 2012, for High Yield trade executions. Therefore trading duties were fully segregated on the Emerging Market Desk in November 2011 and the High Yield Desk in July 2012.
- 4.19. TAML also left access rights open to three dealers (on the Fixed Income Central Dealing Desk) to initiate, execute and book trades in TAML's order management system until 29 February 2012.
- 4.20. Firms must take all reasonable steps to obtain best execution for their clients taking into account a variety of factors including price and speed of execution.
- 4.21. TAML employed a variety of best execution processes and procedures. However, the processes and procedures had the following weaknesses:

- (1) TAML required fund managers to obtain and enter competing quotes into the order management system. Up to October 2011, the front office compliance team did not carry out testing to verify the integrity of best execution quotes. During the period 30 May 2011 to 1 July 2011 (inclusive) fund managers initiated, executed and booked:
 - (a) 165 trades on the Emerging Markets Desk; and
 - (b) 288 trades on the High Yield Desk.
- (2) As at 29 February 2012, when TAML's front office compliance team asked dealers for evidence of best execution, dealers could provide them with copied and pasted Bloomberg chat extracts. These copied and pasted extracts could have been modified. In March 2012, TAML started to require screen prints instead.
- (3) TAML did not regularly perform best execution monitoring for OTC derivatives.

Stage 3 – Settlement

- 4.22. The third stage in the trading process is the settlement of the trade. It is at settlement that monies exchange hands between the buyer and seller. An asset management firm's "back office" generally instructs the custodian to settle trades.
- 4.23. TAML segregated trade matching and confirmation and settlement from its front office to a separate outsourced middle and back office. The back office operated processes to ensure that before any instructions to release funds were given to a custodian there was a confirmation from both TAML's front office and from the broker which exactly matched the trade details. In the absence of a matching confirmation, no instruction should be given to the custodian to release funds. If there was a discrepancy, it should be escalated. The back office also performed post-trade price discrepancy checks and set up new securities (i.e., securities that TAML had not previously traded).

Stage 4 – Post-trade monitoring

- 4.24. The fourth stage in the trading process is post-trade monitoring which is carried out by the post-trade compliance function and fund managers. However, although a firm's post-trade controls may identify inappropriate transactions, they may do so too late, when the firm is committed to the trade, or at or even after settlement when the firm transfers its clients' monies to the counterparty. This could result in a loss to the Firm and clients.
- 4.25. TAML historically relied on post-trade compliance more than pre-trade compliance monitoring. The following sub-sections identify weaknesses in some of TAML's post-trade controls and processes.

Fund manager post-trade reports and fund manager reviews

- 4.26. TAML produced a daily trades report overnight which identified the previous day's trades in order to assist fund managers to review their funds. It made the reports available to fund managers to review. Fund managers, however, did not consistently review these reports nor did TAML have a written policy which required them to do these reviews. There were inconsistencies in both the approach and the level of formality in the post-trade report reviews.

Non-standard settlement terms

- 4.27. The settlement term is the number of days within which the trade settles. Settlement periods can be varied, but are standard for particular instruments and currencies. For example, T+1 is the standard settlement term for transactions in US and UK treasuries and T+3 is the standard settlement term for bonds including Argentine warrants. Reduced settlement periods can reduce a firm's opportunity to identify and correct unauthorised or erroneous trades.
- 4.28. Prior to the Unauthorised Transaction, TAML did not require dealers on the Central Dealing Desk to document and retain the reasons for non-standard settlement terms. TAML undertook no formal post-trade reviews of non-standard terms. However, following the Unauthorised Transaction the booking of trades from the Emerging Market and High Yield desks was passed to the Fixed Income Central Dealing Desk, all trades were subject to a "reasonableness check" by the dealers which included the reasons for non-standard settlement.

Warnings to take action

Market Watch Newsletters identified segregation of trading duties as a way to mediate the risk of unauthorised trading

- 4.29. Using segregation of trading duties as a way to mitigate the risk of unauthorised trading is an issue the Authority raised with firms as early as 2008. That year the Authority published two Market Watch Newsletters to raise firms' awareness of systems and controls failures which could leave them vulnerable to unauthorised trading activity. The newsletters used an actual well publicised unauthorised rogue trading incident as an example to illustrate the Authority's concerns.
- 4.30. Market Watch Newsletter 25 (March 2008) described the facts underlying the incident and urged firms to consider:
- (1) when to escalate consideration of a trader who has a high number of cancelled and amended trades in a period;
 - (2) whether their controls capture trades booked at off market rates; and
 - (3) whether they can enhance segregation of duties to limit the likelihood of malicious action by a single unauthorised user.
- 4.31. Market Watch Newsletter 29 (October 2008) summarised the Authority's key findings from its discussions with firms about the actions they had taken after the unauthorised trading incident that was the subject of the March 2008 newsletter. The newsletter noted that the three most common factors firms identified as potential gaps in their risk management were mandatory vacations for traders, IT access and 'cancel and correct' trades. It also urged firms to consider regular fraud testing mechanisms and making tests as close to real life as possible, even going so far as to include fictitious transactions in production systems.
- 4.32. Before the Authority published the Market Watch Newsletters, TAML considered the issues arising from the well-publicised "rogue trader" incident and whether a similar incident could occur at Threadneedle.

Operational Risk Report – June 2010

- 4.33. In June 2010, TAML prepared an Operational Risk Report concerning TAML's fixed income trading area. The report identified:

- (1) deficiencies in TAML's fixed income dealing processes;
 - (2) the risks that the dealing process deficiencies posed to TAML; and
 - (3) "broad solutions" the firm could consider to improve the control deficiencies the report identified.
- 4.34. Among other deficiencies, the Operational Risk Report noted that:
- (1) fund managers did not consistently provide a broad enough range of broker prices to demonstrate best execution; and
 - (2) fund managers were able to override soft alerts in its mandate compliance tool in order to place an order with a broker which TAML had not approved.
- 4.35. The Operational Risk Report noted that the deficiencies *"have the potential to cause significant damage to Threadneedle's reputation, cause financial loss or breach regulations"* and that *"a number of peer group firms have publicly suffered from failing to control the risks that Threadneedle are currently facing"*.
- 4.36. The Operational Risk Report specifically identified the Emerging Markets and High Yield desks as two of the desks whose non-centralised dealing model left TAML *"materially exposed"* to a number of risks including the potential use of a non-approved broker, inability to meet best execution regulations, by-passing pre-trade mandate checks, late deal execution, placing incorrect deals in the market, booking incorrect trades, failure to allocate trades correctly and allowing fund managers on desks in that area to initiate, execute and book trades. However, the Operational Risk Report did not make direct reference to fraud risk.
- 4.37. The Operational Risk Report set out alternatives that TAML could take to improve its fixed income trading area processes. The report said that it could either strengthen its manual processes, centralise all dealing (which would require it to add specialist dealers to its Emerging Markets, High Yield and Derivatives desks) or develop a *"decentralised controlled dealing"* alternative as a way of reducing the risks in its fixed income trading area.
- 4.38. In December 2010, TAML decided to implement decentralised dealing on the Emerging Markets and High Yield desks. This was not fully implemented on those desks but following the Unauthorised Transaction, TAML implemented centralised dealing.

Consideration of front office fraud risk

- 4.39. In addition to the Operational Risk Report which had identified the risks inherent in the fixed income trading area, TAML also conducted its own internal Risk Control and Self Assessments ("RCSA").
- 4.40. Prior to the Unauthorised Transaction, TAML identified a variety of risks in its RCSAs, including the risk of *"erroneous fund manager activity"*. It assigned this risk a *"major"* residual impact score and a *"rare"* residual likelihood score. Under TAML's risk assessment methodology, this meant that the Firm accepted this level of risk and that no further action was required. The Firm had identified, in this assessment, the segregation of trading duties between fund managers and dealers as an appropriate control. However, at the time of these assessments, segregation of trading duties was not fully in place. Later risk assessments recognised that the *"rare"* likelihood score was too low.

The ARROW letter, the RMP and the RMP Response

- 4.41. As part of its supervisory process, on 10 March 2011, the Authority issued a draft ARROW Letter and RMP to TAML. The letter summarised the “key issues” that arose from the Authority’s risk assessment. These were, the Firm’s toleration of fund management error, late bookings and the nature and frequency of errors within the Fixed Income trading area. TAML responded by letter dated 23 March 2011 and stated: *“We note that you have correctly identified that we have plans in place to address this. However, to clarify we would point out that it is not Threadneedle’s intention to introduce a centralised dealing desk for the Fixed Income department. We have already created the ‘Liquid Markets Trading Group’ who have responsibility for executing and booking transactions in cash and money markets, foreign exchange, government bonds and investment grade credit. We are in the process of appointing an individual in each of the other desks (Emerging Market Debt, High Yield and Commodities) who will formally be responsible for trading on each of these desks. This will be in place and operational by end of Q3 2011”*. (“TAML’s March 2011 Letter”)
- 4.42. The Authority sent a final version of the ARROW Letter and RMP on 5 April 2011. The ARROW Letter and RMP identified TAML’s front office operating controls as an area of concern and within that the fixed income area as a particular area of concern.
- 4.43. The Authority divided its concerns about TAML’s front office operating controls into two areas: *“pre-trade compliance”* (fund managers could override *“soft alerts”* and *“hard warnings”* in the firm’s mandate compliance tool) and *“Fixed Income: Manual processes”* (fund managers booked trades late and the firm failed to introduce adequate controls and planned upgrades to the systems within the fixed income department).
- 4.44. The Authority’s ARROW Letter and RMP echoed some of the same concerns TAML’s own internal Operational Risk Report had raised about the fixed income trading area nine months before. In particular, it noted that the fixed income department *“relies on a number of manual processes, including fund managers placing their own trades”*. It went on to say that these have *“created a high risk environment where errors, including late booking of trades, are persistently occurring”* and that these *“repeated errors heighten the risk of loss to customers and Threadneedle”*.
- 4.45. The RMP identified specific steps TAML needed to take to improve its front office controls. The Authority summarised those steps under the heading: *“Front Office operating controls: pre-trade compliance & Fixed Income Processes”*. Under the *“action”* for this issue, the Authority:
- (1) instructed TAML to *“implement the necessary improvements to its Front Office Systems and controls, in particular within Fixed Income, focussing on pre-trade compliance checking, all manual processes and Fixed Income fund managers placing their own trades”*; and
 - (2) required *“a report to the [Authority] detailing the action taken and the evidence that supports the... assertion that controls within the Front Office are adequate”*.
- 4.46. The Authority instructed TAML to take these actions and required the report to be provided to the Authority by 30 June 2011.

- 4.47. Prior to the receipt of the ARROW letter and the RMP, TAML had made the decision not to implement centralised dealing but to appoint Specified individuals to be responsible for dealing on the Emerging Markets and High Yield desks.
- 4.48. TAML established working groups to respond to each section of the RMP. The working group responsible for responding to the Authority's concerns regarding the fixed income dealing area started work on 29 March 2011. The working group created a number of versions of the RMP Response.
- 4.49. By 29 June, the draft RMP Response had been approved. Asked to clarify whether TAML had fully implemented the new dealing arrangements on the specialist desks (including the Emerging Market and High Yield desks), some managers who were members of the working group looked again at the way they had described these facts in the draft RMP Response.
- 4.50. At that point, the draft RMP Response said that Specified Individuals would be responsible for all aspects of dealing on the Emerging Market and High Yield desks.
- 4.51. However, it did not accurately reflect the facts because:
- (1) The Specified Individuals had not taken on all the responsibilities identified in the RMP Response because they were neither undertaking the dealing of all the transactions on the desk, nor did they consider themselves responsible for the transactions conducted by others.
 - (2) The Specified Individual who was supposed to take on the dealing responsibilities on the Emerging Markets Desk had no previous dealing experience before TAML placed him in the dealing role and provided on-going training to him. Moreover, TAML did not make it clear to him that he was responsible for undertaking all the dealing on that desk. Nor did it provide him with a document setting out his role and responsibilities.
 - (3) TAML did not provide a document clearly setting out his responsibilities to the Specified Individual who was supposed to take on the dealing responsibilities on the High Yield Desk. That individual did, however, have experience in dealing on the kinds of securities traded on that desk and he understood that he was responsible for executing trades on that desk.
 - (4) TAML did not maintain management information which would allow it to monitor which individuals actually *executed* trades. However, TAML did have information about which individual *booked* trades. During the week beginning 27 June 2011 (the beginning of the week of the RMP Response):
 - (a) the Specified Individual on the Emerging Markets Desk only booked 56% of the trades on that desk, moreover he did not execute or book trades for all the instruments traded on that desk;
 - (b) the Specified Individual on the High Yield Desk only booked 72% of the trades on that desk.
 - (5) Fund managers on the Emerging Markets Desk and High Yield Desk continued to initiate, execute and book trades.
- 4.52. Some members of the working group discussed the draft RMP Response in a series of emails:

- (1) The initial communication on 29 June, asked whether everything due by 30 June had been completed and in particular, "*whether the specialist dealing for the Commodities, EMD [Emerging Market Debt] and HY [High Yield] desks had been implemented and was working as that was one of the things that had a 30 June deadline. It does not appear to be up and running yet so I guess we with [sic] need to correct that understanding or come up with another date by which it will be up and running*".
- (2) A response was sent stating, "We need to leave out commodities for which this structure does not work" and (about the Specified Individuals on the Emerging Market and High Yield desks), "*we will have the function in place by 30 June, but we cannot word it so strongly as to suggest that a single person does all those functions all the time. We can say that the trading functions will be coordinated thru one person, but there will be others that under the direction of the desk head others [sic] will be doing some of these things.*"
- (3) A reply was sent which said, "*Message received. I'd be surprised if we could change the wording now as it has been reviewed and approved... so we may need to think of something else.*"
- (4) A response was then sent stating, "*Well, I suppose 'responsible' could be interpreted rather broadly if we are pressed on it. We could say the person 'oversees' the trading effort and is therefore responsible for all if it.*"

4.53. TAML has stated that the change to paragraph (2) above was intended to convey the fact that the Specified Individual would be the "go to" person for these activities, but have the ongoing support of fund managers on the desk while they gradually took on an increasing amount of dealing on these desks and that fund managers would therefore continue to be able to execute trades. This was not made sufficiently clear in the RMP Response.

4.54. Some members of the working group changed the wording in the draft RMP Response to reflect the situation on the commodities desk, but their changes did not accurately describe the underlying factual position on the Emerging Market and High Yield desks. They changed the language:

- (1) from: "*These individuals **will have taken on** all of the above responsibilities by 30th June 2011. They will receive continuing support from Desk Heads and fund managers*". (emphasis added)
- (2) to: "*These individuals **have now taken on** all the above responsibilities. They will receive continuing support from fund managers and **oversight from the Desk Heads and the Head of Fixed income***". (emphasis added)

4.55. The final version of the RMP Response dated 29 June 2011 that was provided to the Authority on 30 June 2011 incorporated this change. It said:

- (1) "*for Threadneedle's Emerging Market Debt and High Yield Debt desks a member of staff has been appointed to be responsible **for all aspects of dealing** including: (emphasis added)*
 - (a) *Following all dealing related procedures and policies;*

- (b) *Seeking approval for the use of new instrument and transaction types;*
 - (c) *Pre-trade compliance checking;*
 - (d) *Pre-trade allocation;*
 - (e) *Trade execution;*
 - (f) *Post-trade allocation amendments where permissible (e.g. in the case of a partially filled orders)*
 - (g) *Prompt trade booking;*
 - (h) *Onward transmission of orders for matching and settlement; and*
 - (i) *Addressing all dealing and trading related queries or problems.*
- (2) *These individuals **have now taken on all of the above responsibilities.** They will receive continuing support from fund managers and oversight from the Desk Heads and the Head of Fixed Income.” (Emphasis added)*
- (3) *On the basis of the material set out in this report above . . . [we are] satisfied of...the adequacy of Threadneedle’s Front Office Controls”.*

The Unauthorised Transaction

4.56. One month after the RMP Response was submitted to the Authority, a fund manager on the Emerging Markets Desk placed a series of unauthorised trades to purchase Argentine warrants on behalf of Threadneedle funds. Although TAML’s outsourced back office prevented the settlement of the trade, and so prevented a loss of USD110m (£70m), which would have required TAML to claim on its insurance, the Unauthorised Transaction illustrates some of the weaknesses in the fixed income area of TAML’s front office. The specific steps the fund manager took and the back office actions in discovering the Unauthorised Transaction are set out below. The steps leading up to the Unauthorised Transaction are set out in a high court judgment involving a number of parties in which the court found that TAML had been the subject of an intended fraud.

1 August 2011

4.57. On 1 August 2011, the fund manager made two attempts at booking the trade for Argentine warrants across three Threadneedle funds. The fund manager was neither the designated fund manager nor a fund manager for those funds. The warrants had issuances in USD and Argentine Pesos.

4.58. The fund manager executed the order at an “off market” price with a TAML approved broker by placing the order in USD even though the particular warrants were priced in Argentine Pesos. (Pricing the warrants in USD instead of Argentine Pesos inflated their value by the exchange rate difference of approximately 4:1). He cancelled the orders at 18:59.

4.59. TAML’s front office did not identify the fact that the Fund Manager placed and cancelled these orders on 1 August 2011.

2 August 2011 – back office review

- 4.60. On 2 August, TAML's back office emailed the fund manager to tell him that it had received a trade confirmation from the broker, but that it had not received confirmation from the fund manager. The fund manager emailed the back office and explained that he had cancelled the trade.

3 August 2011 – the Unauthorised Transaction

- 4.61. On 3 August at 17:19, toward the end of the working day, the fund manager:
- (1) initiated, executed (with the same TAML approved broker) and booked orders to buy Argentine warrants across the same three Threadneedle funds at approximately the same price, \$150 million, that he had agreed to pay for the warrants when he aborted the trades on 1 August 2011.
 - (2) agreed a non-standard T+1 settlement date for the Argentine warrants with the broker, when the standard settlement period for transactions in Argentine warrants is T+3.
- 4.62. A few minutes later, at 17:27, the fund manager initiated an order to sell the Argentine warrants across the same three Threadneedle funds at the same price at which he tried to buy them. However, no sell trade was executed.

In initiating the buy trade the fund manager overrode erroneous pre-trade alerts that warned him that he was attempting to purchase 1,176% of the issuer's debt for the same fund as on 1 August 2011.

Identification of the Unauthorised Trade

4 August 2011

- 4.63. At 08:10 on 4 August, TAML's outsourced back office identified the Unauthorised Transaction on its overnight unprocessed trades repair queue. The Unauthorised Transaction "fell out" of TAML's straight-through-processing system and appeared on the "repair" queue for trades requiring manual intervention because TAML had not previously traded the instruments and so required it to be set up in its systems.
- 4.64. The back office had a new security set-up process to ensure that the new security being set up was the correct security. The back office could use a number of indicators including the name of the issuer, maturity dates and currency. In this case, the back office used the trade price to check whether it was setting up the right security. This, in turn, raised questions about the currency being used to price the trade.
- 4.65. The new security set-up process identified the Unauthorised Transaction. This was not, however, its purpose. The purpose of the process was to ensure that static data for newly traded securities is correctly set up in the back office systems. The process was not designed as a check on off-market prices. Having identified it, the back office raised a query with TAML's front office and both areas investigated the transaction and the trade was stopped.
- 4.66. As explained above, although TAML's new security set up process identified the issues which uncovered the Unauthorised Transaction, TAML did not design this process for the purpose of identifying unauthorised or erroneous transactions. The process would not have identified the Unauthorised Transaction if TAML had previously traded the Argentine warrants.

- 4.67. If TAML had previously traded the Argentine warrants, the trade would have been subject to TAML's valuation process. This twice daily process compares traded prices against independent market prices (at midday and midnight each day). This check identifies pricing discrepancies outside set tolerances (1% for fixed income) which the back office investigates and escalates to TAML's oversight team before 09:30 the following morning. The Unauthorised Transaction would have appeared as a significant discrepancy warranting further investigation.
- 4.68. However, these processes are separate to the settlement process. They are not required to be completed before settlement occurs. It would be possible, if a trade has progressed through the confirmation and matching system, for T+1 and same day settling trades to be instructed for settlement before these systems completed their checks and identified any discrepancies.
- 4.69. Therefore, because these pricing checks were not designed to identify unauthorised transactions and errors before settlement instructions are sent, and these checks are not connected to the settlement process, front office controls are important.
- 4.70. However, for the transaction to settle, it would still require TAML's instruction and the broker's trade confirmations to match.
- 4.71. TAML's back office prevented the Unauthorised Transaction from settling. TAML's front office controls did not, however, prevent the Unauthorised Transaction and it exposed weaknesses in the front office detective controls. In particular:
- (1) Segregation of trading duties and access rights
 - (a) TAML did not have segregation of trading duties on the Emerging Markets Desks which could have provided a check on the fund manager's ability to execute and book, as well as initiate, the trades. This allowed the fund manager to initiate, execute and book the trades on 1 and 3 August (nor did TAML have segregation of trading duties on the High Yield Desk); and
 - (b) Although the fund manager should have sought approval to trade on the funds that were not his funds and its order approval form required fund managers to obtain approval from the designated fund manager, TAML did not have a control in place to enforce this requirement. This allowed the fund manager to execute and book, as well as initiate, the trades on 1 and 3 August.
 - (2) Standard settlement dates
 - (a) The standard settlement for Argentine Warrants is T + 3. However, since the fund manager was both initiating and executing the order, he was able to book the three executions for T + 1 settlement. TAML did not have controls which required fund managers, in the absence of segregation of trading duties, to escalate this change for approval.
- 4.72. TAML made improvements to its front office controls and the Skilled Person verified those improvements.

TAML notifies the Authority of the Unauthorised Transaction

- 4.73. On 8 August 2011 TAML notified the Authority that it was investigating a transaction and that it had suspended a member of the investment department. On 8 September 2011 it provided the Authority with a report (dated 26 August 2011) outlining some of the facts underlying the Unauthorised Transaction. The report did not provide the Authority with information about the measures TAML had taken to enhance its front office's processes and controls.
- 4.74. On 23 September 2011, the Authority asked TAML to describe the changes to the processes and controls that TAML had already implemented in the front office, as well as any future mitigating actions that were planned or being considered.
- 4.75. On 29 September 2011 TAML provided the Authority with a response which said that "*booking of the trades [on the Emerging Markets and High Yield desks could] can now only be undertaken by the central dealing desk, who [sic] also scrutinise initiated trades*". It also stated that the scope for a review of relevant processes had been agreed, but that the timing of the review was still being finalised.
- 4.76. The Authority asked TAML for additional details about the Unauthorised Transaction by letter dated 12 October 2011. In that letter, the Authority asked TAML for comprehensive answers to the questions it had raised.
- 4.77. In particular, the Authority was concerned about why, given the improvements TAML stated that it had made in its RMP Response, the processes and controls in its Emerging Markets and High Yield desks appeared to be deficient. The Authority asked TAML to explain when it had actually implemented the changes it said it had made in the RMP Response.
- 4.78. TAML responded to the Authority's letter in two reports, one dated 21 October 2011 and another dated 28 October 2011. Among other things, the 28 October 2011 report identified TAML's dealing processes and controls and explained that the RMP Response "*did not fully reflect the actual dealing practices on the High Yield and Emerging Market desks at the end of June 2011*" because although the Specified Individual had been carrying out the execution and booking of trades, he was not the only individual on that desk carrying out those activities and he was not carrying them out for all trades going through that desk. TAML stated that it "*sincerely regrets that this was not made clear to its FSA supervisors in its RMP response*".
- 4.79. In the meantime, having discovered the fund manager's Unauthorised Transaction, TAML reviewed all the trades he carried out during his employment. It identified eight trades which were at variance with the market price and where it could not provide evidence of best execution. TAML's controls had not previously identified these trades. On this basis, TAML made a provision of £595,000 in the relevant fund to cover the loss to the fund and notified the Authority. TAML subsequently reviewed all trades carried out on the Emerging Markets desk and found no other best execution failings.
- 4.80. In addition, TAML subsequently reduced the incentive payments for certain senior managers to account for their involvement in the RMP Response.

5. FAILINGS

- 5.1. The regulatory provisions relevant to this Final Notice are referred to in Annex A.
- 5.2. TAML's failings constitute breaches of the following Principles:

- (1) Principle 3 (risk management systems and controls); and
- (2) Principle 11 (relations with regulators).

Principle 3 breaches

- 5.3. Principle 3 requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 5.4. TAML breached Principle 3 between June 2010 and 29 February 2012 because:
 - (1) TAML failed to take reasonable care to organise and control its affairs responsibly and effectively by failing to put in place adequate controls in the fixed income area of the front office to mitigate the risk of erroneous trading highlighted by the Authority and the Firm's own reports.
 - (2) It failed to put in place adequate preventive and detective controls which either segregated the trading duties on its Emerging Markets and High Yield desks, or put in place appropriate controls to mitigate the risks posed by the lack of segregation. More specifically:
 - (a) TAML's mitigating preventive controls were inadequate because they failed to:
 - (i) restrict fund managers' ability to initiate, execute and book trades on funds other than their own without express recorded consent;
 - (ii) properly calibrate pre-trade soft alerts on trades;
 - (iii) enforce a requirement for fund managers to provide a rationale for overriding a soft alert; and
 - (iv) code appropriate hard stops in its trading system which could prevent unauthorised trades in excess of those limits from proceeding to settlement.
 - (b) TAML's detective controls were inadequate because they failed to:
 - (i) test the evidence fund managers provided to prove that they had achieved best execution;
 - (ii) put in place a written policy which formally required fund managers to review trades booked the previous day on the funds for which they were responsible and to confirm in writing that they had done so; and
 - (iii) require fund managers, in the absence of the segregation of trading duties, to obtain explicit approval to place trades with non-standard settlement terms.
 - (3) The controls and process deficiencies on the Emerging Markets Desk exposed the funds on that desk to the Unauthorised Transaction because:

- (a) TAML did not have segregation of trading duties on the Emerging Markets Desk which could have provided a check on the fund manager's ability to execute and book, as well as initiate, the trades.
- (4) TAML did not have a control or process to require fund managers to obtain approval to change standard settlement dates.

Principle 11 breach

- 5.5. Principle 11 requires a firm to deal with its regulators in an open and cooperative way and to disclose to the Authority appropriately anything relating to the firm of which the Authority would reasonably expect notice.
- 5.6. TAML breached Principle 11 because:
 - (1) TAML provided the Authority with an inaccurate RMP Response for the following reasons:
 - (a) TAML stated that the Specified Individuals had taken on the responsibilities outlined in the RMP Response when they had not completely taken on those responsibilities.
 - (b) TAML's RMP Response failed to make clear that the fund managers on the Emerging Markets and High Yield desks no longer executed and booked trades on those desks when in fact the Senior Managers who drafted the response were aware that the fund managers on those desks continued to execute and book trades on those desks until TAML began to transfer that responsibility to the Fixed Income Central Dealing Desk from September 2011.
 - (2) Between 30 June 2011 and 28 October 2011 TAML failed to correct its RMP Response.

6. SANCTION

Financial penalty

- 6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. For conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms. The Relevant Period here is from June 2010 to 13 July 2012 so the five-step penalty framework applies in this case.
- 6.2. In all the circumstances, the Authority considers that it is appropriate to impose a separate financial penalty for the Principle 3 and the Principle 11 breaches.

The Principle 3 breach

Step 1: disgorgement

- 6.3. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.

- 6.4. The Authority has not identified any financial benefit that TAML derived directly from its breach.
- 6.5. Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.6. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.
- 6.7. The Authority considers that the revenue generated on the Emerging Markets and High Yield trading desks is indicative of the harm or potential harm caused by TAML's breach. The period of TAML's breach was from June 2010 to 29 February 2012. The Authority considers the revenue for this period to be £45,983,000.
- 6.8. In deciding on the percentage of the revenue that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:
- Level 1 – 0%
 - Level 2 – 5%
 - Level 3 – 10%
 - Level 4 – 15%
 - Level 5 – 20%
- 6.9. In assessing the seriousness level, the Authority takes into account the factors identified in DEPP 6.5A.2G. Of these, the Authority considers the following to be relevant:
- (1) TAML derived no profits directly from the breach (although it is recognised that an unquantified cost saving may have resulted from the failure to have adequate controls);
 - (2) the weaknesses in TAML's systems and controls related to two fixed income desks, but these weaknesses were present across several of the front office processes on these desks;
 - (3) the importance of adequate front office controls had been made clear to TAML by the Authority; and
 - (4) the deficiencies in the controls meant there was scope for the potential facilitation of financial crime.
- 6.10. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 3 and so the Step 2 figure is 10% of £45,983,000.
- 6.11. Step 2 is therefore £4,598,300.

Step 3: mitigating and aggravating factors

- 6.12. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.
- 6.13. The Authority has identified the followings factors which aggravate the breach:
- (1) The Authority had made firms aware of the risk of unauthorised trading in its Market Watch Newsletters in 2008. The Authority had raised concerns with the Firm about its front office controls.
 - (2) The Firm's Operational Risk Report had identified the risks in the fixed income trading area in the front office and in the Emerging Market and High Yield desks in particular.
- 6.14. The Authority considers that the fact that some third party reports gave the Firm some positive assurance about its control structure generally, even if they did not specifically address the particular front office controls deficiencies which left the fund vulnerable to the Unauthorised Transaction, mitigates the breach.
- 6.15. The Authority considers that these factors taken together are sufficient to warrant a 10% uplift in the Step 2 figure.
- 6.16. Step 3 is therefore £5,058,130.

Step 4: adjustment for deterrence

- 6.17. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.18. The Authority considers that the Step 3 figure of £5,058,130 represents a sufficient deterrent to TAML and others, and so has not increased the penalty at Step 4.
- 6.19. Step 4 is therefore £5,058,130.

Step 5: settlement discount

- 6.20. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.21. The Authority and TAML reached agreement at Stage 2 and so a 20% discount applies to the Step 4 figure.
- 6.22. Step 5 is therefore £4,046,504.
- 6.23. The Authority therefore imposes a financial penalty of £4,046,504 for breaching Principle 3.

The Principle 11 Penalty

Step 1: disgorgement

- 6.24. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.25. The Authority has not identified any financial benefit that TAML derived directly from its breach.
- 6.26. Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.27. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.
- 6.28. The Authority considers that the revenue generated by TAML is not an appropriate indicator of the harm or potential harm caused by its breach of Principle 11. The breach relates to a failure to notify the Authority of information it would reasonably expect to be notified of, and the breach is not related to revenue. The Authority has not identified an alternative indicator of the harm or potential harm caused by TAML's breach and so, pursuant to DEPP 6.5A.2G (13), has determined the appropriate Step 2 amount by taking into account those factors which are relevant to an assessment of the level of seriousness of the breach.
- 6.29. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5A.2G lists the factors. The Authority considers the following factors to be relevant to the seriousness of TAML's Principle 11 breach.

Impact of the breach

- 6.30. The breach lasted from 30 June 2011 until 28 October 2011.

Nature of the breach

- 6.31. The statement related to the Emerging Markets and High Yield trading desks in the fixed income trading area at TAML (representing approximately 5% of the Firm's Assets Under Management ("AUM") as at 30 June 2011.
- 6.32. The breach had the potential to affect the Authority, but not consumers directly.
- 6.33. The ARROW and RMP process, now known as the Firm Systematic Framework, is fundamental to the Authority's approach to supervision. The Authority must be able to rely upon the accuracy of the representations firms make during that process to allow it to carry out its regulatory responsibilities efficiently and effectively. TAML's breach of Principle 11 is serious because it risked undermining the effectiveness of this important supervisory tool.
- 6.34. The Authority has not found that TAML acted deliberately. However, TAML should have recognised that the RMP Response was inaccurate because it did not reflect the dealing process on the Emerging Market and High Yield desks.

- 6.35. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 3 and so the Step 2 figure is £2,490,000.

Step 3: mitigating and aggravating factors

- 6.36. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.
- 6.37. The Authority considers that there are not sufficient mitigating or aggravating factors not already discussed in the assessment of the seriousness of the case to suggest a change in penalty.
- 6.38. Step 3 is therefore £2,490,000.

Step 4: adjustment for deterrence

- 6.39. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.40. The Authority considers that the Step 3 figure of £2,490,000 represents a sufficient deterrent to TAML and others, and so has not increased the penalty at Step 4.

Step 5: settlement discount

- 6.41. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.42. The Authority and TAML reached agreement at Stage 2 and so a 20% discount applies to the Step 4 figure.
- 6.43. Step 5 is therefore £1,992,000.
- 6.44. The Authority therefore imposes a total financial penalty of £1,992,000 on TAML for breaching Principle 11.

Total penalty

- 6.45. The Authority therefore imposes on TAML a penalty of £6,038,504 which consists of:
- (1) £4,046,504 for conduct attributable to the Principle 3 breach; and
 - (2) £1,992,000 for conduct attributable to the Principle 11 breach.

7. PROCEDURAL MATTERS

Decision maker

- 7.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.
- 7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for Payment

- 7.3. The financial penalty must be paid in full by Threadneedle Asset Management Limited to the Authority by no later than 24 December 2015, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 7.4. If all or any of the financial penalty is outstanding on 25 December 2015, the Authority may recover the outstanding amount as a debt owed by Threadneedle Asset Management Limited and due to the Authority.

Publicity

- 7.5. 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 Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.
- 7.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contacts

- 7.7. For more information concerning this matter generally, contact Allegra Bell (020 7066 8110), Maria Gouvas (020 7066 3552), Angela Pascoe (020 7066 6516) or Kerralie Wallbridge (020 7066 6548) of the Enforcement and Market Oversight Division of the Authority.

Anthony Monaghan

Project Sponsor

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS AND PUBLICATIONS

1. Statutory Provisions

1.1. Section 206 of the Act

Section 206 of the Act gives the Authority power to impose a penalty it considers appropriate on an authorised person, if the Authority considers that an authorised person has contravened a relevant requirement.

1.2 Section 1B(1) of the Act

Section 1B(1) of the Act provides that in discharging its general functions, the Authority must, so far as it is reasonably possible, act in a way which is compatible with its strategic objective and advances one or more of its operational objectives. The Authority's strategic objective is ensuring that the relevant markets function well. (Section 1B(2) of the Act). The Authority has three operational objectives. (Section 1B(3) of the Act). Two of the Authority's operational objectives are relevant in this matter, the consumer protection objective and the integrity objective.

1.3 Section 1C of the Act

Section 1C of the Act is the consumer protection objective. Its object is to secure an appropriate degree of protection for consumers. This action advances Authority's consumer protection objective because it demonstrates the importance of putting in place adequate controls to prevent fund managers from making erroneous trades which could diminish the value of consumers' fund investments.

1.4 Section 1D of the Act

Section 1D of the Act is the integrity objective. Its object is to protect and enhance the integrity of the UK financial system. This action advances the Authority's integrity objective because the "*integrity*" of the UK financial system includes "*its not being used for a purpose connected with financial crime*" and the "*orderly operation of the financial markets*".

2. Regulatory Provisions

2.1 Relevant Handbook provisions

In exercising its power to issue a financial penalty, the Authority must have regard to the relevant provisions in the Handbook of rules and guidance ("Handbook"). The relevant Handbook provisions in this matter are the Principles for Businesses ("Principles"), the Decision, Procedure and Penalties Manual ("DEPP"), and the Enforcement Guide ("EG").

2.2 The Principles

The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Handbook. They derive their authority from the Act's rule-making powers and reflect the Authority's regulatory objectives. The relevant Principles in this matter are Principle 3 and Principle 11, both as were in effect during the Relevant Period.

(1) Principle 3

Principle 3 provided, *"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems"*.

(2) Principle 11

Principle 11 provided, *"A firm must deal with its regulators in an open and cooperative way, and must disclose to the [Authority] appropriately anything relating to the firm of which the [Authority] would reasonably expect notice"*.

2.3 The Decision, Procedure and Penalties Manual

The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. For conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms. The conduct that is the subject matter of this action took place after 6 March 2010.

2.4 The Enforcement Guide

The Authority's approach to taking disciplinary action is set out in Chapter 2 of EG. The Authority's approach to financial penalties is set out in Chapter 7 of EG. EG 7.1 states that the effective and proportionate use of the Authority's powers to enforce the requirements of the Act, the rules and other matters will play an important role in the Authority's pursuit of its regulatory objectives. EG 7.1 also states that imposing financial penalties shows that the Authority is upholding regulatory standards and helps to maintain market confidence and deter financial crime.

3. Publications

3.1 Market Watch Newsletter 25 (March 2008). This newsletter described a rogue trader incident and the steps firms should consider taking to avoid similar incidents.

3.2 Market Watch Newsletter 29 (October 2008). This newsletter summarised the Authority's key findings from its discussions with firms about the actions they had taken after the unauthorised trading incident that was the subject of the March 2008 newsletter.