
FINAL NOTICE

To: **Toronto Dominion Bank (London Branch)**
Of: **Triton Court, 14 Finsbury Square, London, EC2A 1DB**
Date: **15 December 2009**

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

1. THE PENALTY

- 1.1. The FSA gave Toronto Dominion Bank (London Branch) (“Toronto Dominion”) a Decision Notice on 15 December 2009 which notified Toronto Dominion that pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA had decided to impose a financial penalty of £7 million on Toronto Dominion in respect of breaches of Principle 2 and Principle 3 of the FSA’s Principles for Businesses which occurred between July 2006 and June 2008 (“the Relevant Period”).
- 1.2. Toronto Dominion confirmed on 11 December 2009 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below and having agreed with Toronto Dominion the facts and matters relied on, the FSA imposes a financial penalty on Toronto Dominion in the amount of £7 million.
- 1.4. The penalty imposed is discounted by 30% pursuant to the stage 1 early settlement discount scheme. Were it not for this discount, the FSA would have imposed a financial penalty of £10 million.

2. REASONS FOR THE ACTION

Summary

- 2.1. Toronto Dominion breached Principle 2 by failing to conduct its business with due skill, care and diligence and breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 2.2. The breaches arise from a number of serious failings in the systems and controls concerning trading book pricing and marking within the Credit Products Group (“CPG”) business of Toronto Dominion during the Relevant Period.
- 2.3. These failings came to light following the notification to an individual within CPG (“the Trader”) of Toronto Dominion’s intention to make him redundant. After his departure his trading books, which contained credit default swap index and tranche positions, were passed to another trader who discovered certain pricing issues. These issues gave rise to an announcement on 4 July 2008 stating that a negative valuation adjustment of CAD\$96 million had subsequently been made to the Trader’s books.
- 2.4. In breach of Principle 3, Toronto Dominion failed to ensure clear segregation of roles and responsibilities, appropriate management reporting, as well as adequate product knowledge or experience of back office staff.
- 2.5. In breach of Principle 2, Toronto Dominion failed to effectively use its existing systems and controls over what was a complex business dealing in sophisticated and often illiquid financial products. As well as failing to use its existing systems and controls, it failed appropriately to escalate issues that may have led to earlier detection of the pricing issues. As a result, Toronto Dominion failed to price certain positions held by the Trader accurately and failed to prevent or detect these pricing issues in a timely manner.
- 2.6. Toronto Dominion has previously been the subject of FSA Enforcement action for failings in its systems and controls concerning the pricing of financial products by one of its traders. In light of this, the FSA’s expectations of the firm are that it would take special and particular care to implement and apply proper controls in that area in future. The failings in this matter demonstrate that Toronto Dominion has not responded adequately to previous disciplinary action taken by the FSA and that a fine of much higher order is demanded.

Relevant statutory and regulatory provisions

- 2.7. The FSA is empowered pursuant to section 206 of the Act, if it considers that an authorised person has contravened a requirement imposed on him by or under the Act, to impose on him a penalty in respect of the contravention, of such amount as it considers appropriate.
- 2.8. Pursuant to section 2(2) and section 3 of the Act, one of the FSA’s statutory objectives is market confidence: maintaining confidence in the financial system.

- 2.9. The eleven Principles for Businesses, which are requirements under section 138 of the Act, represent a general statement of fundamental obligations of firms authorised by the FSA under the regulatory system.
- 2.10. Principle 2 of the FSA’s Principles for Businesses states that:
“A firm must conduct its business with due skill, care and diligence.”
- 2.11. Principle 3 of the FSA’s Principles for Businesses states that:
“A Firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.”
- 2.12. The FSA’s approach to exercising its main enforcement powers is set out in the Enforcement Guide.

Relevant context

- 2.13. The FSA considers that firms should take care to price financial instruments correctly. Particular care must be taken to price derivatives and other complex and often illiquid products accurately. If a firm does not have the resources to supervise an activity adequately it should not undertake it.
- 2.14. In addition to past Enforcement action in this area, the FSA has previously warned of the risks surrounding the pricing of financial instruments. For example, in the Financial Risk Outlook dated January 2008, the FSA warned that market participants should continue to ensure that operational and compliance areas were sufficiently resourced to cope effectively with business volumes and market volatility. The report commented that *“it is vital that firms continue to meet their regulatory requirements and maintain their improved performance in operational areas.”*
- 2.15. In November 2007 Toronto Dominion was fined £490,000 (discounted from £700,000 for early settlement) for a breach of Principle 3 concerning systems and controls failings in relation to one of its trading books. The matter occurred when a fixed income trader, Simon Brignall, attributed false values to his trading positions and created fictitious trades to hide significant losses on his trading book. This resulted in a loss to Toronto Dominion of CAD \$8.8 million.

Facts and matters relied on

- 2.16. Toronto Dominion is a company authorised by the FSA and is the London branch of the Toronto-Dominion Bank, a global financial group (“the Group”) whose headquarters are in Toronto. The CPG business was based in London with other trading operations in New York and Toronto.
- 2.17. Within CPG, the Trader was responsible for trading off the run credit default swap index and tranche products (“the Products”). In the main, he was the only person on the desk who traded the Products on a day to day basis.
- 2.18. All CPG trading positions were subject to a month end Independent Price Verification (“IPV”) process. The objective of the IPV process was to reveal any error or bias in pricing and should have resulted in the elimination of inaccurate marks. During the

Relevant Period, responsibility for checking all trading positions against independently priced quotes rested with the Global Middle Office (“GMO”). The IPV checking of the Trader’s Products was primarily undertaken by GMO in Toronto.

- 2.19. On 23 June 2008 the Trader was given notice of Toronto Dominion’s intention to make him redundant. During the transition of his trading books to a new trader, pricing issues were uncovered. After conducting preliminary enquiries, Toronto Dominion reported the matter to the FSA and a subsequent downward valuation of CAD\$96 million to the books was announced to the market on 4 July 2008. Toronto Dominion then commissioned a wide ranging review into the matter (“the Review”). The Review concluded with a number of failings which either contributed to the pricing issues not being detected or which might have increased the chance of detection. The key findings are set out below in four distinct areas, the management responsibility for which primarily lay outside of the London branch.

Key Review Findings

Failures by GMO in conducting in the IPV process

- 2.20. The Review found that contrary to the IPV policy, GMO accepted market quotes forwarded by the Trader as being independent for the purposes of month end price verification of the Products. It transpired that the Trader altered the market quotes he had obtained from dealers to be similar to the positions at which he marked his books. Thus, as these quotes were accepted as being independent, no subsequent pricing issues were detected in the monthly IPV process.
- 2.21. It was identified that GMO relied upon the altered market quotes for a period of nearly two years; from July 2006 to June 2008. Within this period, the Review also found that there was some confusion as to the segregation of duties and responsibilities inside GMO.
- 2.22. In addition to the above, not only did GMO accept market quotes from the Trader, but they specifically requested him to obtain quotes for use in the IPV process. This situation arose due to GMO not sufficiently challenging the explanation that some quotes, particularly for “off the run” CDO index and tranche positions, could only be obtained by the Trader himself. At the time, GMO considered “coverage” of the portfolio to be more important than meeting the requirements of the IPV policy.
- 2.23. An unexpected staff turnover in GMO led to the responsibility of conducting the IPV on the Trader’s books changing hands in 2007. This staff change presented an opportunity for challenge, but actually resulted in allowing the practice of accepting forwarded quotes from the Trader to continue. The new member of staff was not provided with a formal handover or additional training and did not previously have any knowledge or experience of such IPVs.
- 2.24. During 2007 GMO staff responsible for conducting the IPV on the Trader’s books had concerns about the activities of the Trader which included:
 - a) An observation that a Bloomberg quote provided to GMO contained the header “Edit & Fwd” and it may have been possible for the quote to have been altered by the Trader.

- b) The Trader frequently asked GMO to communicate directly by telephone rather than by using email with several individuals copied in.
 - c) Compared to other desk heads, the Trader appeared to be anxious about the monthly IPV results and often forwarded quotes and telephoned very late at night.
- 2.25. Despite the above, the Review identified that GMO failed adequately to investigate or escalate these concerns which resulted in allowing the practice of accepting the quotes forwarded by the Trader to continue.
- 2.26. The Review found that the pricing issues related only to the Trader's books alone and was not widespread across CPG.

Failures in the Internal Audit process

- 2.27. CPG was subject to an Internal Audit in middle to late 2007. An initial finding noted that, in some cases, GMO accepted dealer quotes directly from the front office and that there was no independence in this. This finding was not included in the final Internal Audit report circulated to CPG's senior management. The Review concluded that there was a lack of clear accountability and responsibility to resolve and document all outstanding audit issues. The issue relating to the lack of independent market quotes was not sufficiently followed up with management, communicated amongst the audit team, finalised and reported according to its significance.

Failures relating to Market Risk Control

- 2.28. Market Risk Control ("MRC") was a function within the Group that was responsible for the IPV policies and signing off the IPV results. It was independent of GMO and managed outside of the London branch. In considering any control failings that might have increased the chance of detection of the pricing issue, the Review found that:
- a) MRC had expressed concerns over the methodology and reporting of the IPV process, however these were not appropriately escalated.
 - b) There was a lack of formal process for review and sign off for the CPG IPV results.
 - c) MRC and GMO had a poor relationship which hindered communication, discussion and escalation of issues.

Failures relating to collateral management

- 2.29. Credit default swap index and tranche positions are usually subject to daily collateral calls. In theory, any pricing discrepancy between Toronto Dominion and its counterparty should arise in a collateral dispute. The Group's collateral management team was operated separately to GMO and run from Toronto. The Review found there were a number of collateral disputes that occurred on the Trader's books and that they were primarily resolved by liaising directly with him. In considering any control failings that might have increased the chance of detection of the pricing issue, the Review concluded that there was:
- a) Failure to incorporate collateral disputes into management reporting.

- b) Lack of product knowledge in the collateral management team which meant that no effective challenge was made to the reasons for the Trader's collateral disputes.
- c) Failure to escalate large mark to market changes by the collateral management team.

Analysis of breaches

- 2.30. The FSA agrees with the findings of the Review. By reason of the facts and matters set out above, Toronto Dominion breached Principle 2 and Principle 3.
- 2.31. Toronto Dominion breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems appropriate to its business. A number of failings evidence a breach of Principle 3, which are summarised below:
 - a) There was confusion within GMO as to the segregation of duties and responsibilities in conducting the IPV process.
 - b) An unexpected turnover in staff in GMO led to the lack of a formal handover of duties to an individual who lacked previous knowledge and experience in conducting such IPV's.
 - c) There was a lack of formal process for review and sign off for the CPG IPV results.
 - d) There was a failure to incorporate collateral management disputes into management reporting.
 - e) There was a lack of product knowledge within the collateral management team to allow effective challenge of the Trader's reasons for the collateral disputes that regularly arose on his positions.
- 2.32. Toronto Dominion breached Principle 2 by failing to conduct its operations with due skill, care and diligence. A number of failings evidence a breach of Principle 2, which are summarised below:
 - a) GMO failed correctly to apply the established procedures in conducting the IPV on the Trader's books.
 - b) There was insufficient challenge by the GMO to explanations provided by the Trader regarding the sourcing of quotes from the market.
 - c) GMO failed adequately to investigate and escalate concerns that they had regarding the Trader.
 - d) Internal Audit failed appropriately to follow up, finalise and report the finding that GMO were accepting market quotes from the front office as independent.
 - e) Communication, discussion and escalation of issues were hindered as a result of the poor relationship between GMO and MRC.

- f) The team responsible for dealing with the collateral disputes failed to escalate large mark to market changes in the Trader's book.
- g) As a result of the above, Toronto Dominion failed to price certain positions held by the Trader accurately and failed to prevent or detect these pricing issues in a timely manner.

3. SANCTION

3.1. The FSA's policy on the imposition of financial penalties and public censures is set out in the FSA's Decision Procedure & Penalties manual (DEPP) and the Enforcement Guide. In determining the financial penalty, the FSA has had regard to this guidance. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring the firm who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.

3.2. The FSA considers that the seriousness of this matter merits the imposition of a significant financial penalty.

Previous disciplinary history

3.3. A key factor contributing to the seriousness of this case is that Toronto Dominion has already been the subject of previous FSA Enforcement action for failings in its systems and controls concerning the pricing of financial products by one of its traders.

3.4. In November 2007 Toronto Dominion was fined £490,000 (discounted from £700,000 for early settlement) for a breach of Principle 3 concerning systems and controls failings in relation to one of its trading books. The matter occurred when a fixed income trader, Simon Brignall, attributed false values to his trading positions and created fictitious trades to hide significant losses on his trading book. This resulted in a loss to Toronto Dominion of CAD \$8.8 million.

3.5. In addition to the fact that this second case also relates the appropriate pricing of financial instruments:

- a) The previous Enforcement action against Toronto Dominion was only concluded two years ago.
- b) The breaches in this matter were ongoing at the same time as the Brignall case came to light and was in the process of being investigated.
- c) The breaches in this matter are considered to be more serious than that of the Brignall case.
- d) Toronto Dominion provided the FSA with assurances that such a matter could not reoccur.

3.6. In light of the FSA's previous action against Toronto Dominion, its expectations of the firm are that it would take special and particular care to implement and apply proper controls in that area in future. The failings in this matter demonstrate that it

has not responded adequately to previous disciplinary action taken by the FSA and that a fine of much higher order is demanded.

Other factors

- 3.7. The additional factors that have been taken into account in determining the financial penalty to be imposed on Toronto Dominion include:
- a) There was a high risk that market confidence would be damaged by the sudden and unexpected writedown and revaluation of securities. It is therefore appropriate to impose significant fines on firms whose skill, care and diligence in carrying out proper supervision and oversight and whose management and control of businesses fall below expected standards in order to ensure that firms develop and maintain robust and effective internal policies and procedures.
 - b) The failings are individually egregious, but their cumulative effect over a range of business functions exacerbates the seriousness of the failings.
 - c) These products were often highly illiquid financial instruments requiring specialist knowledge and were, in the main, traded only by the Trader. Positions for these books were therefore inherently difficult to verify, particularly during the market turbulence from mid 2007 onwards. The nature of the Products and concentration of expertise created an inherent risk that pricing issues could arise. This should have led to particularly robustly enforced controls in this area.
 - d) The failings resulted in this matter remaining undetected by Toronto Dominion for a prolonged period of time; approximately two years.
 - e) This matter was only discovered by Toronto Dominion as a result of the Trader being made redundant, rather than through its systems and controls.
 - f) In deciding the level of penalty, the FSA has had regard to the size and financial resources of Toronto Dominion. It is a financial institution with a global presence and should have high levels of systems and controls commensurate with the requirement to adequately supervise a complex, highly profitable global business with a high level of risk.

Mitigating factors

- 3.8. In determining the level of financial penalty the FSA has taken into account the following mitigating factors:
- a) Since Toronto Dominion became aware of the problem in June 2008, it has treated the matter extremely seriously, directly involving both the Chairman and the Risk Committee of the Board of Directors of Toronto Dominion Bank Financial Group in addition to TD Securities' executive management in Toronto.
 - b) Toronto Dominion informed the FSA and promptly ensured public disclosure when it became aware of the pricing issues.

- c) From the beginning Toronto Dominion has been open and co-operative with the FSA, and commissioned a thorough review of the incident by external lawyers which it has shared with the FSA. Disciplinary action has been taken in respect of certain individuals and Toronto Dominion is pursuing a legal case against its former trader in respect of the bonuses paid to him.
- d) Toronto Dominion commissioned an extensive review by external consultants of its systems and controls framework in London, and also globally, leading to implementation of a comprehensive upgrade project.
- e) Simultaneously, Toronto Dominion conducted a complete review of its business strategies, leading to the decision to exit the credit trading business in London.

4. DECISION MAKERS

- 4.1. 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.

5. IMPORTANT

- 5.1. This Final Notice is given to Toronto Dominion in accordance with section 390 of the Act.

Manner of and time for payment

- 5.2. The financial penalty must be paid in full by Toronto Dominion to the FSA by no later than 29 December 2009, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 5.3. If all or any of the financial penalty is outstanding on 30 December 2009, the FSA may recover the outstanding amount as a debt owed by Toronto Dominion and due to the FSA.

Publicity

- 5.4. 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.
- 5.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

5.6. For more information concerning this matter generally, you should contact Helena Varney (direct line: 020 7066 1294) or Jeremy Parkinson (direct line: 020 7066 0224) of the Enforcement and Financial Crime Division of the FSA.

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Jamie Symington
FSA Enforcement Division