
FINAL NOTICE

To: **Toronto Dominion Bank (London Branch)**

Of: **Triton Court
14/18 Finsbury Square
London EC2A 1DB**

Date: **16 November 2007**

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 ACTION

1.1. The FSA gave Toronto Dominion Bank (London Branch) ("TD Bank"/"the Firm") a Decision Notice dated 12 November 2007 which notified TD Bank that for the reasons listed below and pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA has decided to impose a financial penalty of £490,000 on TD Bank in respect of breaches of the requirements of Principle 3 of the FSA's Principles for Businesses to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems. As TD Bank has confirmed that it will not be referring this matter to the Financial Services and Markets Tribunal, the FSA imposes the financial penalty for the reasons set out below.

1.2. These breaches occurred from at least the beginning of 2005 until 9 March 2007.

1.3. TD Bank has received the maximum level of discount afforded under the FSA's Discount Scheme, being 30%, reflecting the fact that TD Bank has agreed to settle at the earliest opportunity.

2. REASONS FOR THE ACTION

2.1. During the relevant period TD Bank breached Principle 3 by failing to take reasonable care to organise and control its affairs with adequate risk management systems.

2.2. The weaknesses in question facilitated a senior fixed income trader based in London ("the Trader") to mismark his positions from early 2005 until 9 March 2007, and to book fictitious trades during the period 26 February 2007 until 9 March 2007.

2.3. The net loss caused by the Trader was around CAD \$8.8MM (approximately GBP £3.8MM), all of which was borne by the Firm. No client or other third party suffered any loss and the Trader made no personal gain through his misconduct.

2.4. Defects in the Firm's systems and controls for ensuring that its trading positions were properly and consistently valued and that its traders were effectively supervised enabled the Trader to mismark his positions and enter fictitious trades.

2.5. Particular failings in the Firm's system and controls include:

- i absence of systems and controls ensuring independent price verification was performed on the Trader's book;
- ii failure to implement effective trade break escalation procedures for the business on the Trader's book; and
- iii lack of effective trading supervision.

2.6. The FSA considers these failings to be very serious, in particular because of the following:

- i The Firm's systems and controls had not detected the Trader's misconduct: the Trader admitted his misconduct to the Firm when he resigned.

- ii This was so even though the Trader had been mismarking his positions over a period extending to almost two years. That the Trader's misconduct could continue for such an extended period of time reveals serious and systemic weaknesses in the systems and internal controls relating to the Firm's fixed income business.
- iii Such serious inadequacies in systems and controls rendered the Firm vulnerable to be used for a purpose connected with financial crime.
- iv The mismarking of positions and the entering of fictitious trades were unsophisticated techniques for disguising losses which would have been straightforward to detect had the Firm taken reasonable care to ensure that the proper systems and controls were in place for the supervision of trading.

2.7. TD Bank's failures therefore merit the imposition of a financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognises that the following are mitigating features:

- i No clients of the Firm or any other third party suffered loss as a result of the failings identified.
- ii Prior to the Trader's resignation, the Firm formed the intention to standardise its independent price verification system for the business traded by the Trader. This caused the Trader to become concerned that enquiry would be made into his book which would reveal his losses. It was this fear of discovery which prompted the Trader to enter fictitious trades and ultimately to resign and admit to his misconduct.
- iii The Firm informed the FSA as soon as practicable on learning that the misconduct had taken place.
- iv The Firm co-operated fully with the FSA investigation, in particular by commissioning an internal audit investigation into the matter, in order to identify the control breakdowns which led to the loss and the reasons why it went undiscovered for an extended period of time. Internal audit produced a report, ("the Internal Audit Report"), which the Firm provided to the FSA.

- v The management of the Firm has responded to the failings identified in the Internal Audit Report by proposing and/or implementing a number of remedial steps, as set out in Part 5 of this Final Notice.

2.8. TD Bank has received full credit for settlement of the disciplinary case at an early stage; it has received a 30% discount for settling the case at stage one.

3. RELEVANT STATUTORY PROVISIONS

3.1. Under section 206(1) of the Act, if the FSA considers that an authorised person has contravened a requirement imposed by or under the Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

3.2. Principle 3 of the Principles for Businesses provides:

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

3.3. The Principles for Businesses constitute requirements imposed on authorised persons under the Act.

4. FACTS AND MATTERS RELIED ON

Background

4.1. On 9 March 2007, the Trader resigned from his position at TD Bank. On this date, he revealed that he had been hiding losses in his book for a period of almost two years. During the period June 2005 to February 2007, he had mis-priced positions, and from 26 February 2007, as well as mis-pricing positions, he had entered fictitious trades.

4.2. The Firm had not identified, through its own systems and controls, either the extent of mispricing of the trades or the fictitious trades. The Firm only became aware of these matters as a result of the Trader's admissions of 9 March 2007. However, prior to the Trader's resignation, the Firm formed the intention to standardise its independent price verification system for the business traded by the Trader. This caused the Trader to become concerned that enquiry would be made into his book which would reveal his losses. It was this fear of discovery which prompted the

Trader to enter fictitious trades and ultimately to resign and admit to his misconduct on 9 March 2007.

4.3. In response to this, TD Bank notified the FSA on 12 March 2007 (the next working day) and commissioned an internal audit investigation into the matter in order to identify the breakdown in controls which led to the loss and the reasons why the Trader's conduct had gone undetected for a period extending to almost two years.

4.4. The internal audit investigation confirmed the account which the Trader had given to the Firm of his misconduct:

i During the period 31 January 2005 until 31 December 2006, pricing differences ranged between CAD \$0.027MM and CAD \$1.075MM.

ii By 31 January 2007, pricing differences increased to CAD \$3.7MM and reached CAD \$4.4MM at 27 February 2007. At this point the Trader put on more risk in an attempt to make the losses back, and began to book fictitious trades to offset his actual position and to hide the full extent of the risks and losses in his book.

iii The loss hidden by these practices reached a peak of CAD \$11MM on 7 March 2007.

iv When the Trader closed his positions on 9 March 2007, the total loss had decreased to CAD \$8.8MM.

4.5. The Firm facilitated this course of conduct by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, contrary to Principle 3. Each of its failings is detailed below.

Absence of systems and controls ensuring independent price verification was performed on the Trader's book

4.6. No system or control was in place to ensure independent price verification ("IPV") was performed on the Trader's book. IPV is the process by which the marked to market valuations of financial instruments held within trading portfolios are independently verified.

- 4.7. The Firm had documented three policies relating to IPV (the *TD Securities Policy on the IPV of Trading Portfolios*; the *Fair Value Accounting Policy* and the *Fair Value Accounting Policy for Trading Portfolios in the Wholesale Bank*). The Policy on the IPV of Trading Portfolios states that each business line should have its own specific documented IPV procedures. The responsibility for creating these procedures was delegated to the Global Middle Office. However, IPV procedures specific to the business on the Trader's book were not subsequently created. In addition, the high level IPV processes set out in the policies listed above were not implemented in relation to the Trader's book.
- 4.8. The Trader was responsible for valuing his own positions which he should have done by inputting the London closing prices into Bloomberg which then fed the back office book of record system, MIS. However, the Trader mismarked the prices which he input and these prices were not subsequently subject to price verification by Operations.
- 4.9. Had the Trader's positions been properly marked each day, the CAD \$150,000 stop loss limit would have been exceeded. As a result of the fictitious trades, the daily VaR reported against the CAD \$750,000 daily VaR limit was incorrect.
- 4.10. The Firm's failure to implement and maintain a proper IPV procedure for the business on the Trader's book, facilitated the Trader's misconduct, allowing it to go undetected for a period extending to almost two years.

Failure to implement effective trade break escalation procedures for the business on the Trader's book

- 4.11. Until October 2006, the Firm failed to have any escalation procedure whatsoever in place for reporting trade breaks which occurred on the Trader's book.
- 4.12. Because TD Bank became aware that trade input errors had occurred on the Trader's book and that an excessive length of time was being taken to process trade corrections, an escalation procedure for trade breaks occurring on that book was documented in October 2006.

- 4.13. However, the Firm failed to ensure that these escalation procedures were properly implemented and followed. Therefore, although trade breaks were being identified daily and sent to the Trader for review, they were not escalated to his front office supervisor or beyond the vice president and director of Global Finance and Operations, nor were they reported to London Compliance, in contravention of the policy.
- 4.14. In addition, the Firm failed to ensure that appropriate supervision over the escalation procedure was maintained. The Firm did not ensure that the escalation procedure was followed consistently or correctly by the relevant personnel in Operations.
- 4.15. The Firm ought to have taken reasonable care to ensure that the trade break escalation procedure for the Trader's book was properly implemented, particularly since the Trader placed all relevant trades with brokers over the phone as opposed to through an electronic trading system that would also feed Bloomberg/MIS, which enabled him to delay putting trades into Bloomberg, which fed MIS.
- 4.16. Had an effective trade break escalation procedure been in place, the Trader's misconduct would not have been able to occur without detection for such an extended period of time. This is particularly the case after 26 February 2007, when larger volumes of trade breaks were being identified by Operations due to the Trader posting fictitious trades to the Firm's systems.

Lack of effective trading supervision

- 4.17. The Trader's book was not effectively supervised. In particular, when the London Market closed for the day, the book was not handed over to traders in North America, where the markets were still open, to oversee the positions.
- 4.18. In addition, in principle, TD Bank's fixed income business is governed by a matrix management structure which involves a dual reporting relationship whereby a trader is supervised both 'locally' by a person operating out of the same office as that trader, and 'functionally' by a person with an appropriate level of understanding of the product traded by the trader.

- 4.19. The Firm failed to take reasonable steps to ensure that either the functional or the local supervisor exercised effective supervisory control over the Trader's book. Had the Firm made it the responsibility of either supervisor to review the Trader's trading blotter, the spike in volume and size of his trades after 26 February 2007 would have been noted, and the Firm would have been alerted to the Trader's misconduct: by the end of February 2007, the number of contracts that the Trader had sold short was over four times greater than was usual on his book.
- 4.20. In addition, the Firm's holiday policy, which was intended to function as an additional supervisory control, was not properly implemented. The policy stipulated that traders must take 5 days' holiday per year during which they were not permitted to trade. The purpose of this policy, as it related to the Trader's book, was that the book would be handed over to another trader for oversight, trading and valuation whilst the Trader was on holiday.
- 4.21. However, the Firm did not seek to ensure that the Trader's book was actively managed by someone in either London or Toronto during the Trader's absence. This had two main consequences. First, prices in the Trader's book were not updated when the Trader was on holiday, contravening both the Firm's Fair Value Accounting and Market Risk Policy. Secondly, there was no proper oversight of the profit and loss statements for the Trader's book which were submitted during the Trader's absence. These were being signed off by one of the junior traders who did not have a proper understanding of the numbers being reported.
- 4.22. This lack of effective systems and controls for supervision meant that the Firm failed to pick up both that the Trader was mismarking his positions and that the price of his positions was not being updated on a daily basis when he was on holiday. Effective supervision would have identified the mismarking of positions and the posting of fictitious trades.

Additional failings

- 4.23. Although the failings set out above were the principal ways in which the Firm facilitated the Trader's mismarking of positions and entering of fictitious trades, there were two further inadequacies in the Firm's systems and controls which, although

less serious than the above, also contributed to the Trader's misconduct going undiscovered for such an extended period of time. These were as follows:

Failures regarding operational statistics for the Trader's business

- 4.24. Front office management did not receive operational statistics on deal cancellations, corrections or late trades or details as to whether these were attributable to trader error, client activity or operational error. Had this information been received, it would have served as an additional tool to highlight to management the increase in the volume of trade breaks which occurred when the Trader began posting fictitious trades after 26 February 2007.

Lack of standardised broker reconciliation processes

- 4.25. The Firm failed to establish a broker reconciliation process which was standardised across all business lines. Had a consistent reconciliation process across business lines been in place, the loss incurred through the Trader's misconduct would not have gone undetected for such an extended period.

5. FACTORS RELEVANT TO DETERMINING THE ACTION

- 5.1. The FSA has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches, helping to deter other persons from committing contraventions and demonstrating generally the benefit of compliant behaviour.
- 5.2. The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual ("DEPP"), which forms part of the FSA Handbook. Section 6.2 of DEPP sets out some factors that may be of particular relevance in determining the appropriate level of financial penalty. These have been taken into account by the FSA in determining the appropriate level of penalty in this case. Section 6.2 of DEPP provides that the listed criteria are not exhaustive and all relevant factors will be taken into consideration. In deciding on the action, the FSA has taken the following into consideration.

The nature, seriousness and impact of the suspected breach

- 5.3. The FSA views the matters set out above as serious. In particular, the fact that the Trader was able consistently to mismark his positions over a period extending to almost two years reveals serious and systemic weaknesses of the systems and internal controls relating to the Firm's Fixed Income business. Moreover, such a grave lack of systems and controls meant that the Firm rendered itself vulnerable to be used for a purpose connected with financial crime.
- 5.4. In addition, the techniques employed by the Trader for disguising his losses were unsophisticated: had the Firm taken reasonable care to ensure that proper systems and controls were in place for the supervision of trading, the mismarking of positions and entering of fictitious trades would have been readily discoverable.
- 5.5. Conversely, the FSA has taken into account the fact that there was no loss suffered by clients or other third parties, and it was the Firm itself which bore the loss of CAD \$8.8MM.

The conduct of the Firm after the breach

- 5.6. The FSA has taken into account that the Firm brought the Trader's conduct to the attention of the FSA as soon as practicable after learning of it and immediately commissioned an internal audit investigation into the matter, in order to identify the control breakdowns which led to the loss and the reasons why it went undiscovered for an extended period of time.
- 5.7. In addition, the FSA has taken into consideration the fact that the management of the Firm has responded to the failings identified in the Internal Audit Report by proposing/implementing the following remedial steps:
- i Review of the existing trade break escalation procedures to determine if they are appropriate. The review and a detailed action plan for any new policy was completed by 31 October 2007.
 - ii In response to the Trader's conduct, all London office employees have attended fraud/irregularities training sessions held by compliance. These sessions will continue to be conducted on a regular basis. In Toronto, sessions are being

developed which will include training on reconciliation standards, escalation processes and fraud scenarios.

- iii In April 2007, the Firm established an International Fixed Income ("IFI") Steering Committee, with representation from Global Business Systems, London management and the front and back offices. This meets regularly to discuss IFI related issues and review and monitor progress with respect to an IFI Improvement Plan.
- iv In January 2007 a senior operations person was appointed to liaise between local front office and back office in Toronto. Management intends that this person will ensure that trade escalation procedures are followed in accordance with the policy.
- v Since the end of March 2007, the valuations attributed to the business previously traded by the Trader are independently verified by the Middle Office at London Market close.
- vi Management will take steps to improve supervision of staff involved with the business previously traded by the Trader, including the updating of job descriptions. Job descriptions will be appended to annual performance reviews, and management will hold a series of sessions to ensure that each supervisor understands his obligations. The Firm will ensure that management reporting requirements are documented and implemented.
- vii Where a local employee's P&L does not roll up into the local supervisor's trading books, management will look to implement procedures for better regular dialogue between functional and local supervisors. This will include a requirement that all P&L, risk reports and escalation of operational issues reports are provided to the local supervisor.
- viii Management are assessing the feasibility of fully implementing an electronic trading system for the business traded by the Trader and are reviewing statistics for the business.

- ix A new holiday policy has been drafted, and was communicated to all staff in London before 31 August 2007. The new policy will allow front office employees to provide consultation during their holiday if required but specifically prohibits active trading and management of client accounts whilst out of the office. Managers will be held accountable for the enforcement of the policy for the employees they supervise. Operations will work with managers to establish tools to enable them to monitor any trading from out of the office during this 5 day holiday period.
- x In May 2007, the broker reconciliation process was standardised across all business lines.

5.8. The FSA has taken into consideration the above factors relating to the nature, seriousness and impact of the breach and the conduct of the Firm after the breach in deciding that the appropriate level of the penalty is £490,000. This amount takes into account that TD Bank has received the maximum level of discount afforded under the FSA's Discount Scheme, being 30%, reflecting the fact that TD Bank has agreed to settle at the earliest possible time.

6. DECISION MAKER

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

7. IMPORTANT

7.1. This Final Notice is given to TD Bank in accordance with section 390 of the Act. The following statutory rights and obligations are important.

Manner of and time for payment

7.2. The financial penalty must be paid in full by TD Bank to the FSA by no later than 30 November 2007, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.3. If all or any of the financial penalty is outstanding on 1 December 2007, the FSA may recover the outstanding amount as a debt owed by TD Bank and due to the FSA.

Publicity

7.4. 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 these 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 TD Bank or prejudicial to the interests of consumers.

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

FSA contacts

7.6. For more information concerning this matter generally, you should contact Ken O'Donnell (direct line: 020 7066 1374/fax: 020 7066 1375) or Anna Hynes (direct line: 020 7066 9464/fax: 020 7066 9465).

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James Symington
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FSA Enforcement Division