
FINAL NOTICE

To: Yohichi Kumagai

Date of birth: 19 October 1955

Individual Reference: KXY01071

Dated: 8 May 2012

ACTION

1. For the reasons given in this notice, the FSA imposes on Yohichi Kumagai:
 - a. a financial penalty of £119,303, pursuant to section 66 of the Financial Services and Markets Act 2000 ("the Act"), for failure to comply with Statements of Principle 5 and 7 of the FSA's Statements of Principle for Approved Persons during the period between 1 October 2009 to 31 March 2011; and
 - b. an order, pursuant to section 56 of the Act, prohibiting him from performing any significant influence controlled function in relation to any regulated activities carried on by any authorised or exempt persons or exempt professional firm ("the Prohibition Order"), on the grounds that he is not fit and proper to perform such functions. This Order takes effect from 8 May 2012.
2. Mr Kumagai agreed to settle at an early stage of the FSA's investigation, and therefore qualified for a 30% (Stage 1) discount under the FSA's executive

settlement procedures. Were it not for this discount, the FSA would have imposed a penalty of £170,433.

SUMMARY OF REASONS

3. The FSA has taken the action set out above as a result of the conduct of Mr Kumagai in his performance of the CF1 director function and the CF3 chief executive function at MSIEu, where he was executive Chairman and Managing Director throughout the Relevant Period.
4. This case concerns a serious failure by Mr Kumagai to ensure MSIEu's corporate governance and control arrangements were fit for purpose, which resulted in MSIEu being poorly organised and managed across its business as a whole, following a decision to expand and diversify into a new business area by writing business for European clients through three branches in Europe.
5. The failings occurred despite the FSA clearly indicating that the change in business strategy would require careful and focused oversight from the Board. Following an ARROW visit undertaken before Mr Kumagai joined MSIEu, the FSA Supervision Team wrote to Mr Kumagai setting out that oversight of the new and expanded business would be reliant on good systems and controls, adequate pricing and reserving. A key factor in achieving this was identified as the implementation of a new underwriting and general ledger system. It also highlighted the importance of the Board being supplied with management information of good quality and quantity to enable effective apportionment and oversight.
6. Mr Kumagai was responsible for the appointment of senior staff at MSIEu. During the Relevant Period Mr Kumagai failed to take reasonable steps to ensure that the corporate governance at MSIEu and the mix of skills and experience of the directors and senior management changed sufficiently quickly to reflect the developments of the business. In addition, he allowed personnel to operate in senior positions with limited experience of non-JIA business and UK regulatory obligations. As a result, Board effectiveness was weak and it failed to operate at the level needed for the size and complexity of MSIEu's developing operations.
7. Mr Kumagai was aware that the control and oversight of the non-JIA business was inadequate, but devoted insufficient resources to developing this area. Mr Kumagai was concerned to achieve increased profitability through the expansion of the business. He failed to take prompt and effective action to put in place the corporate governance and systems and controls needed to comply with UK regulatory requirements.

8. Late in the Relevant Period, Mr Kumagai took some steps to address the failings in MSIEu's corporate governance. The FSA considers that he should have recognised the need to address these issues when he first became aware of them. In the event, the steps taken were insufficient to address the weaknesses in the systems and controls of which he was aware.
9. Mr Kumagai breached Statement of Principle 5 by failing to take reasonable steps to ensure the business of MSIEu was organised so that it could be controlled effectively. In particular he:
 - a. Failed to ensure that the management structure and the composition of the Board changed sufficiently quickly to reflect the increase of the non-JIA business; and
 - b. Failed to take reasonable steps to ensure that key functions were adequately resourced and that suitable individuals were responsible for all aspects of MSIEu's business, with an appropriate segregation of functions and duties.
10. Mr Kumagai breached Statement of Principle 7 by failing to take reasonable steps to ensure the business of MSIEu for which he was responsible in his controlled function complied with the relevant requirements and standards of the regulatory system. In particular he:
 - a. Failed to ensure MSIEu's corporate governance was reviewed effectively, despite the need for this review being brought repeatedly to his attention;
 - b. Permitted the continued expansion of the non-JIA business without reasonably assessing or implementing the controls and oversight required to support that expansion. In doing so he gave inadequate consideration to the FSA's message that the new strategy would require careful and focused oversight from the Board and good systems and controls;
 - c. Failed to ensure that the PAS underwriting and claims IT system was implemented effectively and in a timely manner, and that other information systems operated effectively, with the result that senior management was not provided with information of sufficient quality to effectively control the business; and
 - d. Failed to take reasonable steps to ensure that MSIEu managed its capital adequately, including holding sufficient capital to meet its ICG.
11. The FSA regards these failings as serious. Mr Kumagai's failure to address the weaknesses at MSIEu in a timely manner posed risks to policy holders. Action has been required to mitigate the risk to policy holders, although in this case the risk

was significantly reduced by MSIEu's relationship with its parent company. Additionally, the breaches arose despite specific communications sent to Mr Kumagai as CF3 by the FSA that identified the need for careful and focused oversight from the Board following a decision by MSIEu to expand into new business areas, and various internal reports from staff of issues regarding corporate governance.

12. The FSA considers that a substantial financial penalty is required to demonstrate that senior managers holding significant influence functions must take responsibility for ensuring that firms comply with regulatory requirements and are organised so that they can be controlled effectively, with effective corporate governance arrangements and effective systems and controls to manage the changing risks of their business.
13. The FSA considers that the serious failings identified in this notice demonstrate that Mr Kumagai lacks competence and capability to perform significant influence functions. The FSA therefore considers that he is not fit and proper to perform such functions and that it is appropriate to impose the Prohibition Order on him.
14. The FSA also recognises that:
 - (1) Mr Kumagai co-operated fully with the Review by an independent third party into failings at the Firm.
 - (2) Mr Kumagai recognised at an early stage that the steps he took during the Relevant Period were insufficient and voluntarily resigned from his position which assisted the Firm to take substantial steps in addressing the issues identified by the Review.
 - (3) Mr Kumagai has co-operated fully with the FSA investigation.
 - (4) Mr Kumagai has had a long and successful career with the Parent Company in Japan and there are no previous disciplinary findings recorded against him.

DEFINITIONS

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

"ARROW" means the framework the FSA uses to make risk-based regulation operational. ARROW stands for the Advanced, Risk-Responsive Operating Framework.

"the Act" means the Financial Services and Markets Act 2000

"the Board" means the Board of Directors of MSIEu

"CUO" means Chief Underwriting Officer

"EDM" means the weekly Executive Directors Meeting of MSIEu "the FSA" means the Financial Services Authority

"the Group" means the MS&AD Insurance Group

"GENPRU" means the part of the FSA's Handbook entitled "General Prudential sourcebook"

"Head Office" means MSIEu's principal place of business in London, where its central management and control functions were based

"the Holding Company" means MSIG Holdings (Europe) Ltd, a company incorporated in the UK

"ICA" means Individual Capital Assessment, which is an ongoing assessment by a firm of its capital resources undertaken as part of an assessment of the adequacy of the firm's overall financial resources

"ICG" means Individual Capital Guidance, which defines the amount and quality of capital that the FSA thinks that a firm should hold at all times based on an evaluation of the firm's ICA. ICG may be substantially greater than the firm's minimum regulatory capital requirement.

"Independent NED" means Independent Non-Executive Director
"JIA" means Japanese Interest Abroad

"MSIEu" means Mitsui Sumitomo Insurance Company (Europe) Ltd, a company incorporated in the UK

"the Parent Company" means Mitsui Sumitomo Insurance Company Ltd (Japan), a company incorporated in Japan

"PAS" means MSIEu's Pan-European Policy Administration System, an underwriting and claims IT system

"the Relevant Period" means 1 October 2009 to 31 March 2011 (inclusive)

"the Review" means a review by an independent third party commissioned by the Holding Company into MSIEu's corporate governance.

"RMP" means Risk Mitigation Programme

"Three Lines of Defence" means MSIEu's internal control framework involving operational processes (the first line), compliance and risk management (the second line), and internal audit (the third line)

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber)

FACTS AND MATTERS

15. MSIEu is an insurance company regulated by the FSA, carrying out predominately wholesale insurance business including commercial property and liability insurance. Based on its nature, scale and complexity, MSIEu itself is categorised and supervised by the FSA as a Medium Low (ML) impact.
16. MSIEu is 100% owned by the Holding Company which is in turn owned by the Parent Company. The Parent Company first established a representative office in London in 1924. It is now part of the Japanese MS&AD Group, which is one of the world's largest non-life insurance groups.
17. Historically, the focus of MSIEu was to service the business needs of the Group's Japanese domiciled clients in Europe and the Middle East. This was known as JIA business.
18. Up until 2007 MSIEu did not write any non-JIA business, i.e. any business for non-Japanese clients. In 2007, before Mr Kumagai joined MSIEu, a decision was taken to expand into non-JIA business, focusing heavily on the market in Germany and France. MSIEu enjoyed rapid growth in this area, which led MSIEu's gross written premiums to nearly double between 2007 and 2010 so that by year end 2010, approximately half of MSIEu's gross written premium was in non-JIA business. MSIEu's Head Office was in London but it had three branch offices in Europe.
19. In April 2009, Mr Kumagai was seconded to MSIEu from the Parent Company and was appointed as executive Chairman and Managing Director of MSIEu. Mr Kumagai held the director (CF1) and chief executive (CF3) controlled functions throughout the Relevant Period. He joined at a critical stage, as MSIEu expanded its non-JIA business. Mr Kumagai chaired the Board and also sat on the EDM, a weekly meeting between all directors to consider management issues.
20. A number of other new directors were appointed at the same time as Mr Kumagai to replace previous post-holders. These appointments, including Mr Kumagai's, occurred as part of a rotational staffing strategy employed by the Parent Company which involved employees of the Parent Company being seconded to MSIEu for a period of time (typically three years). Employees were appointed from elsewhere within the Parent Company, and typically had little or no European

experience prior to their appointment.

21. On 1 June 2009 the FSA Supervision team provided the Board of Directors with a Risk Assessment/ Capital Adequacy Review Letter and RMP, marked for the attention of Mr Kumagai, resulting from an earlier ARROW visit to MSIEu. This stated that:

"We also are aware of your intention to grow the business by expansion into the local [i.e. non-JIA] market due to the saturation of the Japanese market. This change in strategy will require careful and focused oversight from the Board to maintain its success..."

...the oversight of the new and expanded European and Middle East operations is reliant on good systems and controls, adequate pricing and reserving. A key factor is the new underwriting and general ledger system (PAS) being implemented during 2008/2009. It is important that the Board is supplied with management information on the new business venture that is of the quality and quantity to enable it to discharge its apportionment and oversight role effectively..."

22. The letter also commented upon MSIEu's governance and culture particularly in relation to a need to appoint an Independent NED with experience within the European market, stating that:

"Whilst historically the governance and regulatory culture of the firm is good, we were concerned that currently on your firm's Board there are no independent non-executive directors to give a robust challengeAlso as the firm diversifies into an increased local portfolio without the independent expertise in this area of the business, there may not be effective oversight of the risks involved..."

23. On 26 June 2009, in response to the FSA's letter, Mr Kumagai wrote to the FSA responding to a number of items on the FSA's RMP and providing the findings of an internal audit report as was required by the RMP. The letter identified various steps that MSIEu would take to address issues including:

- a. an update on implementation of PAS which stated that its installation was imminent; and
- b. recruiting high calibre independent non-executive representation onto the Board.

24. In late 2009, to address the FSA's concern regarding the experience of the Board described in paragraph 22 above, MSIEu appointed an Independent NED with relevant and appropriate experience.

25. The internal audit report recommendations included:

- a. a review of the effectiveness of the Board and executive committees, with

the results to be incorporated into the future running of those bodies; and

- b. ensuring that the role of MSIEu's Operations Department was clearly communicated and that branch offices developed procedures to operate autonomously.
26. During September 2010, after a further visit raised concerns, the FSA requested details of how MSIEu intended to strengthen its reserves, an overview of the controls and oversight of the European branches, and to arrange a visit to the German branch. The letter and a response to the request were discussed during a number of EDMs in which Mr Kumagai was present.
27. In March and April 2011, two meetings were held between FSA Supervision and MSIEu in which MSIEu reported that it held insufficient capital to meet its ICG.
28. In April 2011, after the second meeting between MSIEu and the FSA, the Holding Company commissioned an independent third party to carry out a review of MSIEu's corporate governance. The Review was split into two phases, Phase One (completed 3 May 2011) and Phase Two (19 July 2011).
29. Phase One included a high level review of the oversight and governance and systems and controls within the UK operation and the German branch. It also considered the facts around the capital shortfall against ICG.
30. Phase Two included an in-depth review of the corporate governance arrangements and systems and controls at MSIEu including for the two largest branches in Germany and France.

The Review — Phase One

31. The Phase One report was received on 5 May 2011. Its key findings were that the corporate governance structure, and the make up of the senior management team of MSIEu had not changed to reflect the developments in its business, and that the board was weak and did not have the appropriate resources to effectively oversee and control non-JIA business. It also found that MSIEu had failed to meet its ICG.

The Review — Phase Two

32. On 19 July 2011 the FSA received Phase Two of the Review. This raised significant concerns about fundamental aspects of MSIEu's corporate governance, oversight of its branch operations, and systems and controls. It identified:
- a. issues with the corporate structure, corporate governance, resourcing and the Three Lines of Defence model used by MSIEu;

- b. significant weaknesses in MSIEu's information systems, reserving and aggregate exposure management; and
 - c. insufficient effective control, support and oversight of the European branch offices, in particular the German branch.
33. These issues, and MSIEu's failure to hold adequate capital to meet its ICG, are considered in turn below.

Corporate structure, corporate governance, resourcing and the Three Lines of Defence

34. The Review identified concerns as to MSIEu's corporate structure, with numerous European branches and high central costs. It highlighted governance concerns relating to a lack of Board effectiveness, due to a lack of appropriate skill and experience, a lack of corporate behaviour on the Board, and difficult decisions being deferred several times. The Review also identified that inadequate staff resources and staff changes created gaps in MSIEu's First and Second Lines of Defence.
35. The high central costs led to a concern during the Relevant Period to cut these costs so as to improve profitability. This was a factor in the decision in early 2010 to merge MSIEu's back office functions with those of another Group company within the UK.
36. Within the confines of the Parent Company's rotational staffing policy referred to in paragraph 20 above, Mr Kumagai had responsibility for the appointment of senior staff at MSIEu, including nominations to the Board. This policy allowed Mr Kumagai, with other members of the Board, to determine what position incoming staff would hold, and to make any additional external appointments where these were required.
37. Mr Kumagai was aware that as a result of the policy a number of individuals with limited recent experience of non-JIA business were placed into senior positions within MSIEu. They had restricted experience and were unfamiliar with the business and the UK regulatory environment. Mr Kumagai was aware that incoming staff being seconded from the Parent Company might lack the appropriate skills and experience. He took steps to address this in response to the FSA's "Dear CEO" letter relating to SIF holder competence which he received in October 2009. These included conducting an interview with incoming staff to determine whether their skills and experience were appropriate to their proposed role, and limiting those roles where it was necessary to do so due to concerns this procedure identified. Despite this, there remained a lack of skills

and experience of the UK regulatory system and non-JIA business across the Board as a whole.

38. The corporate governance issues are apparent from a review of the minutes of Board meetings and EDMs, all of which were attended by Mr Kumagai (with the exception of the EDM of 4 October 2010):
- a. In September 2009, Compliance reported to the EDM on a review of Board and Committee performance which identified that the various executive committees through which MSIEu was controlled were not operating effectively. Mr Kumagai asked the chairmen of the respective committees to address the shortcomings identified in the review but put no checks in place to ensure that this happened and was effective.
 - b. In late 2009, MSIEu appointed an Independent NED with relevant and appropriate experience in non-JIA business. In March 2010, the Independent NED identified to Mr Kumagai a number of weaknesses in MSIEu including its understanding of European markets, leadership and corporate governance. He suggested a corporate governance model for MSIEu to adopt, but Mr Kumagai's actions in response to his analysis and suggestions were insufficient and not swift enough.
 - c. The need for changes to MSIEu's corporate governance was also raised at EDMs from March 2010 onwards, by MSIEu's Internal Audit and others, but no action was taken until late 2010. By letter of 8 October 2010, Mr Kumagai confirmed to the FSA on behalf of MSIEu that it would *"undertake a review of its corporate governance and report to the Board with observations and recommendations."* This review was repeatedly discussed at the EDM during October and November 2010, but no agreement was reached as to how or by whom it should be conducted.
 - d. At a Board Meeting on 25 November 2010, the Independent NED observed that almost nothing had been achieved in relation to the corporate governance review and asked what the plan was for the following year. The Independent NED further observed that the Board *"did not have a CEO, CFO or an individual in charge of operations. It was not clear who was running the company and who was in charge"*.
 - e. On 27 January 2011, the Board approved as a concept a proposed organisational restructuring of MSIEu. This included the proposed appointment of the Independent NED as Chairman, Mr Kumagai's job title being changed to Chief Executive Officer and a single director being given direct responsibility for the European branches.
39. Mr Kumagai had begun discussing this revised corporate structure with the Holding Company, MSIEu's Corporate Planning Department and others in October 2010. Mr Kumagai sought only limited input from the Independent NED. On 24

March 2011, the Board approved the revised corporate structure, subject to a full legal review being undertaken. On 1 April 2011, the new corporate structure was announced to the staff.

40. At the next Board meeting, on 20 April 2011, it was agreed that no further steps should be taken to implement the new corporate structure until the ongoing corporate governance review, the legal review and a visit by the FSA in MSIEu's Cologne branch had been completed. In fact, the planned restructure was not implemented, being superseded by a remediation programme which has resulted in significant change to MSIEu's structure, management and governance.
41. MSIEu had a lack of resources in key Head Office functions. Mr Kumagai, who was responsible for the appointment of senior staff at MSIEu, allowed vacancies to remain or key posts to be filled on an interim basis including:
 - a. MSIEU did not have a CUO. At an EDM on 5 May 2009, which Mr Kumagai attended, the appointment of a CUO was discussed as being intended to *"give the expertise to oversee and support the non-JIA business and that this would enable the firm to demonstrate that it can control its overseas business which had been a concern to the FSA"* An individual identified as a suitable candidate to act as CUO was vetoed by the German branch. Mr Kumagai took no further steps during the Relevant Period to identify and appoint a suitable CUO;
 - b. On 25 March 2010, a meeting of the Board which Mr Kumagai attended confirmed the appointment of a senior executive officer to oversee the branch operations. As Mr Kumagai was aware, the individual appointed was selected as part of the rotational management strategy and had only limited experience of non-JIA business. Consequently he should have been aware that this did not make up for the absence of an appropriately experienced CUO;
 - c. Key appointments were made by the Board on an interim basis from March 2010 onwards, and no effective steps were taken for the remainder of the Relevant Period to appoint permanent post-holders;
 - d. From April 2010, Mr Kumagai allowed an appointment to be made to a certain key post without considering whether the resulting span of responsibility was too wide for the post-holder to perform his responsibilities adequately; and
 - e. Mr Kumagai was aware that key functions in the Second Line of Defence were under resourced, and therefore unable to fulfil their

function. Thus MSIEu sought to achieve oversight of the German branch's underwriting through reviews by third-party reviewers including reinsurers performing reviews for the reinsurers' own purposes, rather than any reviews and testing by MSIEu's Second Line of Defence.

42. The Three Lines of Defence system used by MSIEu to manage and control the organisation was compromised, in that, as a result of appointments made by the Board, responsibility for functions within different Lines of Defence were not always allocated to different individuals.

Information systems, reserving and aggregate exposure management

43. During the Relevant Period MSIEu sought to implement PAS, an underwriting and claims IT system, to standardise business processes across all branches and hence to enhance the control environment. Mr Kumagai was aware that implementation of this system was identified in June 2009 as a key factor in providing management with adequate data to oversee and control the growing branch business. Without such a system MSIEu was unable to efficiently generate financial data that was required to control the business.
44. Although MSIEu reported to the FSA in June 2009 that implementation was imminent, this had not been completed across all of the branches by the end of the Relevant Period. There were fundamental difficulties with implementation of the system, and, as a result, significant weaknesses arising from the lack of an effective system by which the business could be monitored by management.
45. These difficulties were apparent to Mr Kumagai, as reflected in the minutes of Board meetings and EDMs at which he was present:
 - a. At a Board Meeting on 30 July 2009, timing of the PAS implementation was discussed and the pressures on the budget noted. Mr Kumagai expressed a *"strong expectation that all directors, managers and staff would implement PAS in accordance with the timescales"*;
 - b. At an EDM on 24 August 2009 it was reported that good progress appeared to have been made with the implementation of PAS in London and the system was about ready to be launched for a live run in Germany;

- c. At an EDM on 26 November 2009, it was noted that the German branch was finding the implementation of PAS to be very cumbersome;
 - d. On 21 December 2009 PAS was described as being used successfully in the UK branch and *"expected to go live in the German branch in January [2010] and the issues raised by [the] German colleagues should not prevent this"*;
 - e. At an EDM on 5 July 2010 it was noted that PAS had still not been fully implemented at this stage;
 - f. A visit by the CFO to the German branch on 27 July 2010, identified a number of issues with PAS there, in particular a reticence by members of staff regarding its implementation, inefficient cash matching and slow response times. This report was sent to Mr Kumagai in August 2010 but the steps he took to ensure the issues it raised were addressed proved ineffective;
 - g. On 29 July 2010, the Board was informed that PAS was now expected to be completed in *"at least mid to late 2011"*;
 - h. At a Board Meeting on 24 September 2010 a number of complaints were raised about PAS and, in particular, its implementation in the German branch. The Independent NED queried who was taking ownership of this issue which had been repeatedly reported to the Board but he did not see any progress and needed an answer as to how the system was working; and
 - i. At the Board Meeting on 27 January 2011, it was observed by the Independent NED that the implementation of PAS was a major issue and he was concerned that *"no matter how many times the issues were mentioned at a Board meeting, nothing appeared to happen. It needed to be solved"*. Details were provided to the Independent NED about the steps being taken to address the issue including that there was oversight at the EDM which understood exactly what was going on and that the mistakes had been identified and processes developed to overcome them. It was, however, recognised that the same issues came to the Board every meeting and that a plan to deal with them should be communicated to the Board and employees.
46. Despite being aware of these difficulties, Mr Kumagai took insufficient steps to ensure that adequate resources were devoted to the implementation of the PAS system, as difficulties with the system increased. In particular, he did not take sufficient steps to ensure that those to whom he had delegated responsibility for implementation of the PAS system had sufficient time and adequate IT skills and experience to perform their role. Moreover, he did not take sufficient steps to

ensure that the issues identified above were being dealt with promptly and effectively by those responsible for the implementation of PAS and that the project was being given the priority it required.

47. The difficulties with PAS led to numerous manual work-arounds being put in place within the branches to input data into the various information systems. This created concerns as to the quality of data being provided to MSIEu's senior management, Finance Department and auditors, which were brought to Mr Kumagai's attention.
48. The difficulties with PAS contributed to and exacerbated deficiencies in the reserving process, by which MSIEu calculated the amount of reserves that it should hold so as to be able to meet all future claims arising from policies currently in force and written in the past. This process was run within the central Finance Department with limited senior management involvement. There was no Reserving Committee, integrated reserving methodology or sufficient resources to operate an adequate level of control. These difficulties were exacerbated by MSIEu's difficulties in obtaining data of sufficient quality to support the process as a result of the difficulties with PAS.

Management and oversight of the branch operations

49. The Review identified concerns with MSIEu's control and oversight of its branch operations. Mr Kumagai's failure to appoint a CUO and the corporate governance and systems issues described above, which persisted throughout the Relevant Period, significantly undermined Mr Kumagai and senior management's ability to monitor and control its branch operations.
50. MSIEu identified non-JIA business as representing better potential for growth due to the relative saturation of the JIA market. However, Mr Kumagai failed to adequately resource oversight and control of the expansion of the non-JIA business.
51. On 27 July 2010, the CFO visited the German branch to carry out a review of financial reporting and controls. This reported significant concerns about financial record keeping and control in the German branch, which were exacerbated by a number of other issues including difficulties with the implementation of PAS. This report was provided to Mr Kumagai. However, he did not take sufficient steps to ensure that these concerns were effectively addressed.
52. Capital requirement management by MSIEu gave no capital assignment to the branches. As a result, the German branch gave little regard to the capital implications from development in its business. Further, the German branch was consistently allowed to exceed planned gross written premiums for the branch, as it expanded at a greater rate than anticipated. This meant that MSIEu was not

able to monitor its capital requirement but rather had to manage its capital on a retrospective basis. From the meetings described at paragraph 55 below, Mr Kumagai was aware that MSIEu was unable to manage its capital effectively in the business being written in the branches.

Capital shortfall against ICG

53. From December 2010 to the end of the Relevant Period (three months), MSIEu failed to hold sufficient capital to meet its ICG. Concerns over the adequacy of MSIEu's capital position were raised with Mr Kumagai throughout the Relevant Period, but the steps taken by Mr Kumagai were inadequate to address them.
54. The FSA expects firms to meet ICG at all times and interprets ICG as its view, at a point in time, of the adequate amount of capital that a firm must hold, based on that firm's risk profile. Should a firm's capital fall below its ICG, the FSA would take a view as to whether that constituted a breach of the threshold condition of maintaining adequate financial resources or of GENPRU 1.2.26R.
55. Mr Kumagai was present at numerous senior management discussions in relation to this issue, which included the following:
 - a. On 1 September 2009, the EDM was informed that MSIEu's regulatory capital of £43.1m had fallen below its risk appetite buffer of 10% above ICG (being £43.8m), although it was still above the ICG of £39.8m.
 - b. On 19 October 2009, the EDM noted that the ICG was "*up to £41.8m which is only a£1 .3m below our regulatory capital position*".
 - c. At an EDM on 8 February 2010, it was agreed that MSIEu would not have the necessary regulatory capital in the next two years. There were discussions about the target of providing a return on equity to the Holding Company of 10.5%. The majority of the members of the EDM were reluctant to seek a capital injection from the Parent Company without first having generated additional profits from the business.
 - d. At the Board Meeting on 25 March 2010, the Board observed that additional regulatory capital would be needed in the future as the business expanded. The intended way to deal with the position was to "*maximise profitability and strengthen the infrastructure to gain efficiencies*".
 - e. By 25 October 2010, the EDM was aware that the projected shortfall

against ICG was nearly £2m. Some members of the EDM remained reluctant to inform the FSA of the position at that stage. Instead, it was decided to discuss the position with the Holding Company before informing the FSA.

- f. An Extraordinary Board Meeting was held on 8 November 2010 to discuss the shortfall against ICG. The Board recognised that the shortfall could increase to £5m by 31 December 2010. It was confirmed that the Holding Company was willing to provide additional funds but that this was dependent upon first being provided with a sustainable business plan.
- g. Mr Kumagai stated at interview that he made efforts to formulate a business plan that would enable the business to meet the target return on equity but was unable to do so and as a result this delayed the provision of a finalised plan.
- h. By letter of 12 November 2010, Mr Kumagai informed the FSA that it projected a capital shortfall of approximately £2 million against its ICG as at 31 December 2010.
- i. By 31 December 2010 MSIEu had fallen short of its ICG by approximately £1.8 million.
- j. At an EDM on 31 January 2011, it was noted that discussions with the Holding Company about the capital injection had not started and were to be put back to March 2011. However, it was submitted that this did not fit with the need to submit the ICA to the FSA by the end of February 2011 and that a timeline for the provision of capital from the Holding Company needed to be agreed before then. The Holding Company *"wanted a business plan to ensure that there was a plan in place to make profit otherwise the risk that MSIEu wrote might need to be reduced."* At this stage, this required business plan had not been provided to the Holding Company.
- k. An Extraordinary Meeting of the directors of MSIEu was held on 17 February 2011 to discuss the ICA which had increased from the £37.6m reported in November 2010 to £48.6m. It was agreed that MSIEU would inform the FSA of the position at a meeting on 30 March 2011 that had already been arranged to discuss Solvency II.
- l. On 30 March 2011, Mr Kumagai and other directors of MSIEu informed its FSA Supervision team that it had fallen short of its ICG and projected that the shortfall would reach approximately £7.7 million.
- m. MSIEu submitted a plan to recapitalise to the FSA on 15 April 2011.

- n. On 28 April 2011, MSIEu received a capital injection of £14m from the Parent Company to address the capital shortfall against ICG.

Response to the Review

56. On 11 May 2011, following discussions with the FSA, MSIEu ceased writing new non-JIA business from the German branch. Subsequently, the FSA requested that MSIEu cease writing any new non-JIA business in all of its EU branches. MSIEu agreed to do this voluntarily on 3 June 2011.
57. After the receipt of the Phase One report, Mr Kumagai resigned from his position as CEO of MSIEu on 1 June 2011. A further six members of the board of MSIEu also resigned at this time.

Responses provided by Mr Kumagai at interview

58. During an interview with the FSA enforcement team, Mr Kumagai explained that MSIEu had two core business areas in JIA and the newly started non-JIA. He explained that the JIA business was working well. The non-JIA business was, however, behind in terms of the planned expansion into this area. The main issue for his role was to expand and produce a profit from the non-JIA business. He also at the time recognised a need to improve the control and oversight of the non-JIA business alongside its planned expansion. He explained that this was one of the purposes behind the merger of MSIEu's Head Office functions with those of another Group company, and explained that it led to a loss of key personnel which exacerbated difficulties in the relationships between Head Office and branch staff.
59. Mr Kumagai conceded that progress in the full implementation of PAS had been slow, and hampered by resource constraints of which he was aware.
60. In relation to MSIEu's capital shortfall, Mr Kumagai stated that he had ongoing discussions with the Holding Company while he sought to produce a business plan which would meet the Holding Company's target return on equity. Despite his best efforts, he was unable to produce a business plan that did so, and this led to significant delay.
61. In relation to MSIEu's corporate governance, Mr Kumagai accepted that this was weak.
62. Mr Kumagai did take steps to ensure that the Independent NED was appointed in 2009 and sought to bring about improvements to the corporate governance in late 2010/early 2011, by restructuring the senior management, appointing the Independent NED as Chairman of the Board in his place and by taking on the role

of CEO.

FAILINGS

- 63. The relevant statutory and regulatory provisions are referred to in Annex A.
- 64. As the holder of the CF3 function throughout the Relevant Period, Mr Kumagai had responsibility for the conduct of the whole of the business of MSIEu.
- 65. By reason of the facts and matters set out above, Mr Kumagai breached Statements of Principle 5 and 7.

Statement of Principle 5

- 66. Statement of Principle 5 requires an approved person performing a significant influence function to take reasonable steps to ensure the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.
- 67. As CF3, Mr Kumagai was responsible for ensuring that suitable individuals were responsible for all aspects of MSIEu's business, and that any managerial vacancies which put at risk compliance with the requirements and standards of the regulatory system were suitably filled in a timely manner.
- 68. Throughout his tenure as CF3, Mr Kumagai was required to:
 - a. Take reasonable steps to ensure that the business of MSIEu was organised so that it could be controlled effectively as it expanded, by ensuring that all functions were adequately resourced;
 - b. Take reasonable care to maintain an appropriate apportionment of significant responsibilities among MSIEu's directors and an appropriate segregation of functions; and,
 - c. Take reasonable steps to ensure that any managerial vacancies were filled appropriately.
- 69. Mr Kumagai failed to take reasonable steps to ensure that all aspects of the business of MSIEu were organised so that it could be controlled effectively, in breach of Statement of Principle 5. In particular:

- a. He failed to ensure that the management structure and the composition of the Board changed to reflect the increase of the non-JIA business, although he did ensure that an Independent NED with appropriate experience was appointed. As CEO, Mr Kumagai should have considered the impact of the rotational policy on MSIEu's ability to control itself effectively, including making additional appointments to the Board as necessary to create an appropriate mix of skills and experience. Mr Kumagai was aware that the Parent Company's rotational policy affected the skills and experience of the Board, and took limited but inadequate steps to address this.
- b. He allowed the CUO vacancy to remain unfilled throughout the Relevant Period. As a result, there were not enough people within MSIEu's senior management with detailed knowledge of the non-JIA business being written and thus senior management was unable to appropriately oversee and challenge the non-JIA business.
- c. He failed to take reasonable steps to ensure that those he made responsible for PAS implementation had sufficient time or adequate IT skills and experience. Mr Kumagai was aware of the key importance of PAS to achieving effective oversight of the expanding branch operations and of difficulties with its implementation that worsened throughout the Relevant Period. Despite this he failed to take reasonable steps to consider whether appropriate resources were allocated to this, either at the outset or as difficulties with the system increased.
- d. He also failed to ensure appropriate division of responsibilities between MSIEu's senior management when appointing staff in the course of the Relevant Period, and so demonstrated a lack of understanding of the risks posed by the lack of segregation between the First and Second Lines of Defence to the effective management and control of MSIEu. In making a certain senior management appointment, he also failed to take reasonable steps to ensure that the individual so appointed was not given too wide a span of responsibility.
- e. He failed to take reasonable steps to ensure that managerial vacancies were filled appropriately, by appointing individuals to key positions at Head Office on an interim basis from March 2010, and failing to take effective steps to appoint permanent post-holders for the remainder of the Relevant Period.

70. Statement of Principle 7 requires an approved person performing a significant influence function to take reasonable steps to ensure the business of a firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.
71. As CF3, Mr Kumagai was required to take steps to satisfy himself that MSIEu complied with regulatory requirements and to act promptly to remediate any actual or suspected problems involving potential breaches.
72. In order to discharge his regulatory obligations, Mr Kumagai was required to take reasonable steps to:
- a. Assess the level and nature of the controls required to support MSIEu's expansion of the non-JIA business;
 - b. Satisfy himself that the governance structure was operating effectively to supervise and oversee MSIEu's business, and to the extent that it did not do so, take steps to ensure that appropriate changes were implemented;
 - c. Satisfy himself that MSIEu was managing its capital adequately and that effective plans were in place to deal with projected capital shortfalls against ICG; and
 - d. Satisfy himself that the management information received by the senior management team and auditors was of a nature which permitted them to assess on a continuing basis the extent to which MSIEu was in compliance with regulatory requirements and standards.
73. Mr Kumagai breached Statement of Principle 7 by:
- a. Failing to ensure MSIEu's corporate governance was reviewed, despite the need for this review being brought to his attention from the beginning of the Relevant Period.
 - b. Permitting the continued expansion of the non-JIA business without reasonably assessing or implementing the controls and oversight over the branch business required to support that expansion. In doing so he gave inadequate consideration to the FSA's message that the new strategy would require careful and focused oversight from the Board, and that this would be reliant on good systems and controls. Where issues were raised as to the operation of the branches, for example in the report on the German branch that was provided to him after a visit by Head Office staff, Mr Kumagai failed to take adequate steps to ensure that they were addressed. As a result, the poor controls and oversight of the branch business were not rectified as effectively or swiftly as they should have been.
 - c. Failing to ensure that MSIEu had adequate management information, in particular that PAS was fully implemented effectively and in a timely

manner. Mr Kumagai was aware from the FSA's letter of June 2009 that MSIEu's expansion into the local market would require good systems and controls, and adequate pricing and reserving, and that PAS would be an essential tool to oversee the business written in MSIEu's branches. Despite being aware of the difficulties and delays in the full implementation of PAS across all of the branches, Mr Kumagai failed to take steps to ensure that these issues were being dealt with promptly and effectively by those responsible for the implementation of PAS or that the project took the priority it required. The lack of an effective IT system compromised the quality and integrity of the data being provided to senior management and auditors, in particular the data required to monitor MSIEu's financial position; and

- d. Failing to take reasonable steps to ensure that MSIEu managed its capital adequately, including by holding sufficient capital to meet its ICG. Mr Kumagai failed to understand the seriousness of a shortfall in capital against ICG. He gave inadequate regard to warnings that a capital shortfall against ICG would occur and failed to take prompt action to address the shortfall once it materialised. Mr Kumagai eventually recognised the need for a capital injection and commenced discussions with the Holding Company regarding the new business plan needed to apply for such capital. He was not able to create a business plan that would enable the business to meet the target return on equity and as a result this delayed the provision of a finalised plan.

SANCTION

Financial penalty

74. 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 appropriate outcome in this case, the FSA has had regard to this guidance. The FSA considers that the seriousness of this matter merits the imposition of a financial penalty.
75. DEPP 6.1.2G provides that the principal purpose of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.
76. The FSA introduced a new policy for imposing a financial penalty in March 2010, which requires the FSA to apply a five-step framework to determine the appropriate level of the financial penalty. This policy is set out in Chapter 6 of DEPP. In this case, as the Relevant Period is 1 October 2009 to 31 March 2011, the breach

straddles both the old and new FSA penalty policies. However, as the gravamen of the breach occurred from March 2010 onwards, the FSA has applied the new policy to calculate the appropriate penalty for MSIEu's breach.

77. DEPP 6.5B sets out the details of the five-step framework that applies in respect of financial penalties imposed on individuals in non-market abuse cases.
78. The FSA has no evidence to suggest that Mr Kumagai is unable to pay the financial penalty.

Step 1: disgorgement

79. Pursuant to DEPP 6.5B.1G, at Step 1 the FSA seeks to deprive an individual of the financial benefit derived directly from the breach where it is practicable to quantify this.
80. The FSA has not identified any financial benefit that Mr Kumagai derived directly from the breach. Step 1 is therefore nil.

Step 2: the seriousness of the breach

81. Pursuant to DEPP 6.513.2G, at Step 2 the FSA determines a figure that reflects the seriousness of the breach. That figure is based on a percentage of the individual's relevant income. The individual's relevant income is the gross amount of all benefits received by the individual from the employment in connection with which the breach occurred, and for the period of the breach.
82. The period of the breach was from 1 October 2009 to 31 March 2011. The FSA considers Mr Kumagai's relevant income for this period to be £568,111.41.
83. In deciding on the percentage of the relevant revenue that forms the basis of the step 2 figure, the FSA considers the seriousness of the breach and chooses a percentage between 0% and 40%. 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 individuals there are the following five levels:

Level 1 – 0%

Level 2 – 10%

Level 3 – 20%

Level 4 – 30%

Level 5 – 40%

84. In assessing the seriousness level, the FSA takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly.
85. DEPP 6.5B.2G(11) lists factors that tend to show the breach was reckless, including whether the individual appreciated there was a risk that their actions or inaction could result in a breach and failed adequately to mitigate that risk.
86. The FSA considers that Mr Kumagai was aware that there was a risk that the weaknesses in MSIEu could result in a breach but took inadequate steps to address those weaknesses.
87. The FSA considers that Mr Kumagai's conduct included negligent conduct, in that, in some instances, Mr Kumagai failed to appreciate the relevant risks of his actions or inaction.

88. DEPP 6.5B.2G(13) lists factors likely to be considered 'level 1, 2 or 3 factors'.

Of these, the FSA considers the following factors to be relevant:

- a. Mr Kumagai did not make any profit or avoid any loss as a result of the breach, either directly or indirectly;
 - b. there was no loss to MSIEu's customers, either individually or in general, as a result of Mr Kumagai's breach, and the risks to customers were significantly reduced by MSIEu's relationship with the Parent Company;
 - c. some aspects of the misconduct were committed negligently; and
 - d. there was no actual effect on the orderliness of, or confidence in, the insurance market as a result of the breach.
89. DEPP 6.5B.2G(12) lists factors likely to be considered 'level 4 factors' or 'level 5 factors'. Of these, the FSA considers the following to be relevant:
 - a. Mr Kumagai appreciated there was a risk that the weaknesses in MSIEu could result in a breach but failed adequately to mitigate that risk.
 90. DEPP 6.5B.20(8) lists factors relating to the impact of the breach, and DEPP 6.5B.20(9) lists factors relating to the nature of the breach. These include the factors referred to at paragraphs 84(a) and (b) above and the following additional factors which the FSA considers to be relevant:
 - a. Mr Kumagai held a senior position within MSIEu and, as holder of the

CF3 function, had overall responsibility for the conduct of the whole of the business of MSIEu; and

- b. Mr Kumagai took limited steps to address some of the issues of which he was aware, although in most instances these were taken towards the end of the Relevant Period and were inadequate.
91. The FSA considers that the breaches, which involved significant corporate governance failings and continued for a period of eighteen months, represent a persistent failure by Mr Kumagai to address risks which were brought to his attention by the FSA and by internal reports prepared during the Relevant Period. Allowing MSIEu's non-JIA business to grow without implementing the appropriate controls could have put policy holders at risk, albeit that in this case the risk was significantly reduced by the relationship with the Parent Company. The FSA considers that Mr Kumagai's failure to address doubts about MSIEu's capital adequacy in a more timely manner shows insufficient understanding of the importance of timeliness in dealing with compliance with regulatory requirements, even if he was confident that additional capital could be required at short notice from its Parent Company.
92. Taking all the relevant factors into account, the FSA considers that this is a level 4 breach in terms of seriousness. The Step 2 figure is therefore £170,433.

Step 3: mitigating and aggravating factors

93. Pursuant to DEPP 6.5B.3G, at Step 3 the FSA 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.
94. The FSA has had regard to the following aggravating factors:
- (1) Mr Kumagai, as CEO of MSIEu, received direct communications from the FSA in 2009 identifying the need for careful and focused oversight over MSIEu's growing business through good systems and controls;
 - (2) These issues were also highlighted throughout the Relevant Period by internal reports Mr Kumagai received from his staff;
 - (3) Mr Kumagai received the "Dear CEO" letter sent by the FSA on 12 October 2009, which emphasised the importance the FSA places on the competence of individuals performing significant influence functions at authorised firms; and,
 - (4) In 2010, the FSA published a policy statement (PS 10/15) emphasising that the quality of governance is a major focus for the FSA.

95. The FSA has had regard to the following mitigating factors:
- (1) Mr Kumagai co-operated fully with the Review by an independent third party into failings at the Firm;
 - (2) Mr Kumagai recognised at an early stage that the steps he took during the Relevant Period were insufficient and voluntarily resigned from his position which assisted the Firm to take substantial steps in addressing the issues identified by the Review;
 - (3) Mr Kumagai has co-operated fully with the FSA investigation; and,
 - (4) Mr Kumagai has had a long and successful career with the Parent Company in Japan and there are no previous disciplinary findings recorded against him.
96. Having taken into account the above factors, the FSA considers that the Step 3 figure should remain at £170,433.

Step 4: adjustment for deterrence

97. Pursuant to DEPP 6.5B.40, if the FSA considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the breach, or others, from committing further or similar breaches, then the FSA may increase the penalty.
98. The FSA considers that the Step 3 figure of £170,433 represents a sufficient deterrent to Mr Kumagai and others, and so has not increased the penalty at Step 4.
99. The Step 4 figure is therefore £170,433.

Step 5: settlement discount

100. Pursuant to DEPP 6.5B.5G, if the FSA and the individual 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 FSA and the individual reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
101. The FSA and Mr Kumagai reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure. The Step 5 figure is therefore £119,303.

Penalty

102. The FSA has therefore imposed a total financial penalty of £119,303 on Mr Kumagai for breaching APER 5 and APER 7.

Prohibition

103. The facts and matters described above demonstrate that Mr Kumagai lacks competence and capability to perform a significant influence function, and therefore that he is not fit and proper to perform such a function in relation to any regulated activity carried on by any authorised or exempt persons, or exempt professional firm.
104. As a result, the FSA makes a Prohibition Order in the terms set out above in order to achieve its regulatory objectives.

PROCEDURAL MATTERS

Decision maker

105. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.
106. This Final Notice is given under section 390 of the Act.

Manner and time for payment

107. The financial penalty must be paid in full by Mr Kumagai to the FSA by no later than Tuesday 22 May 2012, 14 days from the date of the Final Notice.

If the financial penalty is not paid

108. If all or any of the financial penalty is outstanding on Wednesday 23 May 2012, the FSA may recover the outstanding amount as a debt owed by Mr Kumagai and due to the FSA.

Publicity

109. 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 the consumers.

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

FSA contacts

111. For more information concerning this matter generally, contact Clare McMullen (direct line: 0207 066052) or Stephen Smith (direct line: 0207 0662142).

Matthew Nunan

Acting Head of Wholesale

Enforcement and Financial Crime Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS, STATUTORY PROVISIONS

- 1) The FSA's statutory objectives, set out in section 2(2) of the Act, are market confidence, financial stability, consumer protection and the reduction of financial crime.
- 2) Section 66 of the Act provides that the FSA may take action against a person if it appears to the FSA that he is guilty of misconduct and the FSA is satisfied that it is appropriate in all the circumstances to take action against him. An approved person is guilty of misconduct if, while an approved person, he has failed to comply with a Statement of Principle issued under section 64 of the Act or has been knowingly concerned in a contravention by the relevant authorised person or a requirement imposed on that authorised person by or under the Act.
- 3) Section 56 of the Act provides that the FSA may make an order prohibiting an individual from performing a specified function, any function falling within a specified description or any function, if it appears to the FSA that that individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person, exempt person or exempt professional person. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated activities.
- 4) During the Relevant Period Yohichi Kumagai was an approved person for the purposes of section 66 of the Act.

REGULATORY PROVISIONS

Statements of Principle and Code of Conduct for Approved Persons

- 5) The Statements of Principle and Code of Conduct for Approved Persons ("APER"), issued under section 64 of the Act, sets out the fundamental obligations of approved persons and also conduct which, in the opinion of the FSA, constitutes a failure to comply with a particular Statement of Principle. It also describes factors which the FSA will take into account in determining whether an approved person's behaviour complies with it.
- 6) APER 3.1.3G states that when establishing compliance with, or a breach of, a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour expected in that function.

- 7) APER 3.1.40 states that an approved person will only be in breach of a Statement of Principle when he is personally culpable. Personal culpability arises where an approved person's conduct was deliberate or where the approved person's standard of conduct was below that which would be reasonable in all circumstances.
- 8) Statement of Principle 5 states that: *"An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively."*
- 9) APER 4.5.2E gives examples of conduct that, in the opinion of the FSA, does not comply with Statement of Principle 5. Such conduct includes:
 - a) Failing to take reasonable steps to ensure that suitable individuals are responsible for those aspects of the business under the control of the individual performing a significant influence function (APER 4.5.8E), including allowing managerial vacancies which put at risk compliance with the requirements and standards of the regulatory system to remain, without arranging suitable cover for the responsibilities (APER 4.5.9E(3)).
- 10) Statement of Principle 7 states that: *"An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system."*
- 11) APER 4.7.2E gives examples of conduct that, in the opinion of the FSA, does not comply with Statement of Principle 7. Such conduct includes:
 - a) Failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the regulatory system in respect of its regulated activities (APER 4.7.3E);
 - b) Failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulatory system in respect of its regulated activities (APER 4.7.4E); and,
 - c) Failing to take reasonable steps to ensure that procedures and systems of control are reviewed and, if appropriate, improved, following the identification of significant breaches (whether suspected or actual) of the relevant requirements and standards of the regulatory system relating to its regulated activities (APER 4.7.7E), including (1) unreasonably failing to implement recommendations for improvements in systems and procedures; and (2) unreasonably failing to implement recommendations for improvements to systems and procedures in a timely manner (APER 4.7.8E).

- 12) APER 4.7.12G provides that an approved person performing a significant influence function need not himself put in place the systems of control in his business (APER 4.7.4E). Whether he does this depends on his role and responsibilities. He should, however, take reasonable steps to ensure that the business for which he is responsible has operating procedures and systems which include well-defined steps for complying with the detail of relevant requirements and standards of the regulatory system and for ensuring that the business is run prudently. The nature and extent of the systems of control that are required will depend upon the relevant requirements and standards of the regulatory system, and the nature, scale and complexity of the business.
- 13) APER 4.7.13G provides that, where the approved person performing a significant influence function becomes aware of actual or suspected problems that involve possible breaches of relevant requirements and standards of the regulatory system falling within his area of responsibility, then he should take reasonable steps to ensure that they are dealt with in a timely and appropriate manner (APER 4.7.7E). This may involve an adequate investigation to find out what systems or procedures may have failed and why. He may need to obtain expert opinion on the adequacy and efficacy of the systems and procedures.
- 14) APER 4.7.14G provides that, where independent reviews of systems and procedures have been undertaken and result in recommendations for improvement, the approved person performing a significant influence function should ensure that, unless there are good reasons not to, any reasonable recommendations are implemented in a timely manner. What is reasonable will depend on the nature of the inadequacy and the cost of the improvement. It will be reasonable for the approved person performing a significant influence function to carry out a cost benefit analysis when assessing whether the recommendations are reasonable.

General Prudential Sourcebook (GENPRU)

- 15) The General Prudential Sourcebook contains rules and guidance in relation to the adequacy of a firm's financial resources.
- 16) GENPRU 1.2.26R provides:

"A firm must at all times maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due."

Fit and Proper Test for Approved Persons

- 17) The part of the FSA Handbook entitled "The Fit and Proper Test for Approved Persons" ("FIT") sets out guidance on how the FSA will assess the fitness and propriety of a person to perform a particular controlled function.
- 18) The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.
- 19) FIT 1.3.1G states that the FSA will have regard to a number of factors when assessing the fitness and propriety of a person and that the most important considerations will be the person's honesty, integrity and reputation, competence and capability and financial soundness.

FSA policy for exercising its power to make a prohibition order

- 18) The FSA's policy in relation to prohibition orders is set out in Chapter 9 of the Enforcement Guide ("EG").
- 19) EG 9.1 states that the FSA's power to make prohibition orders under section 56 of the Act helps it work towards achieving its regulatory objectives. The FSA may exercise this power where it considers that, to achieve any of its regulatory objectives, it is appropriate either to prevent an individual from performing any functions in relation to regulated activities or to restrict the functions which he may perform.