Chapter 6

Penalties

6.5B The five steps for penalties imposed on individuals in non-market abuse cases

6

Step 1 - disgorgement

6.5B.1 G The *FCA* will seek to deprive an individual of the financial benefit derived directly from the *breach* (which may include the profit made or loss avoided) where it is practicable to quantify this. The *FCA* will ordinarily also charge interest on the benefit. Where the success of a firm's entire business model is dependent on breaching *FCA rules* or other requirements of the *regulatory system* and the individual's *breach* is at the core of the firm's *regulated activities*, the *FCA* will seek to deprive the individual of all the financial benefit he has derived from such activities.

[**Note:** For the purposes of DEPP 6.5B, "firm" has the special meaning given to it in DEPP 6.5.1 G.]

Step 2 - the seriousness of the breach

6.5B.2 G

(1) The *FCA* will determine a figure which will be based on a percentage of an individual's "relevant income". "Relevant income" will be the gross amount of all benefits received by the individual from the employment in connection with which the *breach* occurred (the "relevant employment"), and for the period of the *breach*. In determining an individual's relevant income, "benefits" includes, but is not limited to, salary, bonus, pension contributions, *share* options and *share* schemes; and "employment" includes, but is not limited to, employment as an adviser, *director*, partner or contractor.

(2) Where the *breach* lasted less than 12 *months*, or was a one-off event, the relevant income will be that earned by the individual in the 12 *months* preceding the end of the *breach*. Where the individual was in the relevant employment for less than 12 months, his relevant income will be calculated on a pro rata basis to the equivalent of 12 *months'* relevant income.

(3) This approach reflects the *FCA*'s view that an individual receives remuneration commensurate with his responsibilities, and so it is reasonable to base the amount of penalty for failure to discharge his duties properly on his remuneration. The *FCA* also believes that the extent of the financial benefit earned by an individual is relevant in terms of the size of the financial penalty necessary to act as a credible deterrent. The *FCA*recognises that in some cases an individual may be approved for only a small part of the work he carries out on a day-to-day basis. However, in these circumstances the *FCA* still considers it

appropriate to base the relevant income figure on all of the benefit that an individual gains from the relevant employment, even if their employment is not totally related to a *controlled function*.

(4) Having determined the relevant income the *FCA* will then decide on the percentage of that income which will form the basis of the penalty. In making this determination the *FCA*will consider the seriousness of the *breach* and choose a percentage between 0% and 40%.

(5) This range is divided into five fixed levels which reflect, 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:

(a) level 1 - 0%;

(b) level 2 - 10%;

(c) level 3 - 20%;

(d) level 4 - 30%; and

(e) level 5 - 40%.

(6) The *FCA* will assess the seriousness of a *breach* to determine which level is most appropriate to the case.

(7) In deciding which level is most appropriate to a case against an individual, the *FCA* will take into account various factors which will usually fall into the following four categories:

(a) factors relating to the impact of the *breach*;

(b) factors relating to the nature of the *breach*;

(c) factors tending to show whether the *breach* was deliberate; and

(d) factors tending to show whether the *breach* was reckless.

(8) Factors relating to the impact of a *breach* committed by an individual include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the *breach*, either directly or indirectly;

(b) the loss or risk of loss, as a whole, caused to *consumers*, investors or other market users in general;

(c) the loss or risk of loss caused to individual *consumers*, investors or other market users;

(d) whether the *breach* had an effect on particularly vulnerable people, whether intentionally or otherwise;

(e) the inconvenience or distress caused to *consumers*; and

(f) whether the *breach* had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

(9) Factors relating to the nature of a *breach* by an individual include:

(a) the nature of the *rules*, requirements or provisions breached;

(b) the frequency of the *breach*;

(c) the nature and extent of any *financial crime* facilitated, occasioned or otherwise attributable to the *breach*;

(d) the scope for any potential *financial crime* to be facilitated, occasioned or otherwise occur as a result of the *breach*;

(e) whether the individual failed to act with integrity;

(f) whether the individual abused a position of trust;

(g) whether the individual committed a breach of any professional code of conduct;

(h) whether the individual caused or encouraged other individuals to commit *breaches*;

(i) whether the individual held a prominent position within the industry;

(j) whether the individual is an experienced industry professional;

(k) whether the individual held a senior position with the firm;

(l) the extent of the responsibility of the individual for the product or business areas affected by the *breach*, and for the particular matter that was the subject of the *breach*;

(m) whether the individual acted under duress;

(n) whether the individual took any steps to comply with *FCA rules*, and the adequacy of those steps;

(o) in the context of contraventions of Part VI of the *Act*, the extent to which the *behaviour* which constitutes the contravention departs from current market practice;

(p) in relation to a contravention of section 63A of the *Act*, whether the individual's only misconduct was to perform a *controlled function* without approval;

(q) in relation to a contravention of section 63A of the *Act*, whether the individual performed *controlled functions* without approval and, while doing so, committed misconduct in respect of which, if the individual had been an *approved person*, the *FCA* would have been empowered to take action pursuant to section 66 of the *Act*; and

(r) in relation to a contravention of section 63A of the *Act*, the extent to which the individual could reasonably be expected to have known that they were performing a *controlled function* without approval. The circumstances in which the *FCA* would expect to be satisfied that a *person* could reasonably be expected to have known that they were performing a *controlled function* without approval include:

   (i) the *person* had previously performed a similar role at the same or another *firm* for which he had been approved;

   (ii) the *person*'s *firm* or another *firm* had previously applied for approval for the *person* to perform the same or a similar *controlled function*;

   (iii) the *person*'s seniority or experience was such that he could reasonably be expected to have known that he was performing a *controlled function* without approval; and

(iv) the *person*'s firm had clearly apportioned responsibilities so the *person*'s role, and the responsibilities associated with it, were clear.

(v) the *person's* approval was subject to a condition or was granted for a limited period, and they failed to act in accordance with that condition or time limitation.

(10) Factors tending to show the *breach* was deliberate include:

(a) the *breach* was intentional, in that the individual intended or foresaw that the likely or actual consequences of his actions or inaction would result in a *breach*;

(b) the individual intended to benefit financially from the *breach*, either directly or indirectly;

(c) the individual knew that his actions were not in accordance with his firm's internal procedures;

(d) the individual sought to conceal his misconduct;

(e) the individual committed the *breach* in such a way as to avoid or reduce the risk that the *breach* would be discovered;

(f) the individual was influenced to commit the *breach* by the belief that it would be difficult to detect;

(g) the individual knowingly took decisions relating to the *breach* beyond his field of competence; and

(h) the individual's actions were repeated.

(11) Factors tending to show the *breach* was reckless include:

(a) the individual appreciated there was a risk that his actions or inaction could result in a *breach* and failed adequately to mitigate that risk; and

(b) the individual was aware there was a risk that his actions or inaction could result in a *breach* but failed to check if he was acting in accordance with internal procedures.

(12) In following this approach factors which are likely to be considered 'level 4 factors' or 'level 5 factors' include:

(a) the *breach* caused a significant loss or risk of loss to individual *consumers*, investors or other market users;

(b) financial crime was facilitated, occasioned or otherwise attributable to the *breach*;

(c) the *breach* created a significant risk that *financial crime* would be facilitated, occasioned or otherwise occur;

(d) the individual failed to act with integrity;

(e) the individual abused a position of trust;

(f) the individual held a prominent position within the industry; and

(g) the *breach* was committed deliberately or recklessly.

(13) Factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

(a) little, or no, profits were made or losses avoided as a result of the *breach*, either directly or indirectly;

(b) there was no or little loss or risk of loss to *consumers*, investors or other market users individually and in general;

(c) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the *breach*;

(d) the *breach* was committed negligently or inadvertently; and

(e) in relation to a contravention of section 63A of the *Act*, the individual's only misconduct was to perform a *controlled function* without approval.

Step 3 - mitigating and aggravating factors

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6.5B.3 G

(1) The *FCA* 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*. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

(2) The following list of factors may have the effect of aggravating or mitigating the *breach*:

(a) the conduct of the individual in bringing (or failing to bring) quickly, effectively and completely the *breach* to the *FCA*'s attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the individual showed during the investigation of the *breach* by the *FCA*, or any other regulatory authority allowed to share information with the *FCA*;

(c) whether the individual took any steps to stop the *breach*, and when these steps were taken;

(d) any remedial steps taken since the *breach* was identified, including whether these were taken on the individual's own initiative or that of the *FCA* or another regulatory authority;

(e) whether the individual has arranged his resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;

(f) whether the individual had previously been told about the *FCA*'sconcerns in relation to the issue, either by means of a private warning or in supervisory correspondence;

(g) whether the individual had previously undertaken not to perform a particular act or engage in particular behaviour;

(h) whether the individual has complied with any requirements or rulings of another regulatory authority relating to the *breach*;

(i) the previous disciplinary record and general compliance history of the individual;

(j) action taken against the individual by other domestic or international regulatory authorities that is relevant to the *breach* in question;

(k) whether *FCA guidance* or other published materials had already raised relevant concerns, and the nature and accessibility of such materials;

(l) whether the *FCA* publicly called for an improvement in standards in relation to the behaviour constituting the *breach* or similar behaviour before or during the occurrence of the *breach*;

(m) whether the individual agreed to undertake training subsequent to the *breach*; and

(n) in relation to a contravention of section 63A of the *Act*, whether the *person*'s firm or another firm has previously withdrawn an application for the *person* to perform the same or a similar *controlled function* or has had such an application rejected by the *FCA*.

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Step 4 - adjustment for deterrence

6.5B.4 G

(1) If the *FCA* 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 *FCA* may increase the penalty. Circumstances where the *FCA* may do this include:

(a) where the *FCA* considers the absolute value of the penalty too small in relation to the *breach* to meet its objective of credible deterrence;

(b) where previous *FCA* action in respect of similar *breaches* has failed to improve industry standards. This may include similar *breaches* relating to different products (for example, action for mis-selling or claims handling failures in respect of ‘x’ product may be relevant to a case for mis-selling or claims handling failures in respect of ‘y’ product);

(c) where the *FCA* considers it is likely that similar *breaches* will be committed by the individual or by other individuals in the future;

(d) where the *FCA* considers that the likelihood of the detection of such a *breach* is low; and

(e) where a penalty based on an individual’s income may not act as a deterrent, for example, if an individual has a small or zero income but owns assets of high value.

Step 5 - settlement discount

6.5B.5 G

The *FCA* and the individual on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, ■ DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the *FCA* and the individual concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.