
FINAL NOTICE

To: Instinet Europe Limited

Of: 26th Floor, 25 Canada Square, Canary Wharf, London E14 5LQ

Dated: 8 April 2010

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

1. THE PENALTY

- 1.1. The FSA gave Instinet Europe Limited (the “Firm”) a Decision Notice on 29 March 2010 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA had decided to impose a financial penalty of £1.05 million on the Firm in respect of breaches of rules set out in chapter SUP 17 of the FSA Handbook and Principles 2 and 3 of the FSA’s Principles for Businesses which occurred between April 2007 and June 2009 (“the Relevant Period”).
- 1.2. The Firm has confirmed that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on the Firm in the amount of £1.05 million.
- 1.4. This penalty is discounted by 30% pursuant to Stage 1 of the early settlement discount scheme. Were it not for this discount, the FSA would have imposed a financial penalty of £1.5 million on the Firm.

2. REASONS FOR THE ACTION

Summary

- 2.1. Accurate and complete transaction reporting is essential to enable the FSA to meet its statutory objectives of maintaining market confidence and reducing financial crime. The primary function for which the FSA uses transaction reports is to detect and investigate suspected market abuse, insider trading and market manipulation.
- 2.2. A transaction report is a data set submitted to the FSA that relates to an individual financial market transaction which includes (but is not limited to) details of the product traded, the firm that undertook the trade, the trade counterparty and the trade characteristics such as buy/sell identifier, price and quantity.
- 2.3. In the Relevant Period the Firm breached the following:
 - (1) Chapter 17 of the Supervision Manual, which is part of the FSA Handbook (SUP 17) in that it failed to submit accurate transaction reports in respect of more than 22.1 million transactions;
 - (2) Principle 2 by failing to conduct its business with due skill, care and diligence through failing to respond appropriately to clear indications that there were issues with the effectiveness of the transaction reporting process; and
 - (3) Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, through:
 - (a) failing to take adequate steps in the lead up to the implementation of the Markets in Financial Instruments Directive ("MiFID") to ensure that its transaction reporting processes and procedures would be fully compliant with the MiFID requirements after they came into force; and
 - (b) largely as a result of this pre-MiFID breach, failing from November 2007 to June 2009:
 - (i) to have in place formal procedures and controls in relation to transaction reporting; and
 - (ii) to carry out sufficient monitoring to ensure that breaches of transaction reporting rules were discovered and escalated appropriately.
- 2.4. The FSA considers these breaches to be particularly serious because:

- (1) the Firm's failure to submit accurate transaction reports could have a serious impact on the FSA's ability to detect and investigate suspected market abuse and consequently could impact the FSA's ability to maintain market confidence and reduce financial crime. In addition, its failure has impaired the FSA's ability to provide accurate transaction reporting data to overseas regulators;
 - (2) the inaccurate reporting impacted a large proportion of transactions across all asset classes in which the Firm dealt in the period;
 - (3) where reviews were commenced, they were not completed or escalated to senior management and hence not acted upon; and
 - (4) the breaches occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of MiFID and public statements by the FSA.
- 2.5. Since 2008, the Firm and its current senior management have taken a number of steps which mitigate the seriousness of the breaches. These include:
- (1) committing extensive resources, including engaging external consultants, to carry out a detailed review of its transaction reporting processes, making personnel changes in key roles and implementing a comprehensive remediation programme;
 - (2) establishing a working group to oversee remediation and improvement of standards, controls and processes around transaction reporting issues, including those highlighted in the external consultants' report; and
 - (3) cooperating fully with the FSA in the course of its investigation.

Relevant statutory and regulatory provisions

- 2.6. The FSA is authorised pursuant to section 206 of the Act, if it considers that an authorised person has contravened a requirement imposed on him by or under the Act, to impose on him a penalty in respect of the contravention, of such amount as it considers appropriate.
- 2.7. Maintaining market confidence and the reduction of financial crime are statutory objectives for the FSA under Section 2(2) of the Act.
- 2.8. The transactions which are required to be reported to the FSA are defined in SUP 17.1.4R which states:

"A firm which executes a transaction:

- (1) *in any financial instrument admitted to trading on a regulated market or a prescribed market (whether or not the transaction was carried out on such a market); or*
 - (2) *in any OTC derivative the value of which is derived from, or which is otherwise dependent upon, an equity or debt-related financial instrument which is admitted to trading on a regulated market or on a prescribed market;*
- must report the details of the transaction to the FSA.”*
- 2.9. The time period for making reports is stipulated in SUP 17.2.7R:
- “A firm must report the required details of the transaction to the FSA as quickly as possible and by not later than the close of the working day following the day upon which that transaction took place.”*
- 2.10. SUP 17.4.1EU provides:
- “Reports of transactions ...shall contain the information specified in SUP 17 Annex 1 EU which is relevant to the type of financial instrument in question and which the FSA declares is not already in its possession or is not available to it by other means.”*
- 2.11. SUP 17.4.2R provides:
- “The reports referred to in SUP 17.4.1 ... shall, in particular include details of the names and the numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the firms concerned.”*
- 2.12. Annex 1 to SUP 17 provides lists of fields and mandatory information to be provided as the minimum content of a transaction report.
- 2.13. The FSA’s Principles for Businesses (“the Principles”) are requirements imposed under section 138 of the Act. They represent a general statement of the fundamental obligations of firms under the regulatory system.
- 2.14. Principle 2 states that:
- “A firm must conduct its business with due skill, care and diligence.”*
- 2.15. Principle 3 states that:
- “A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.”*

- 2.16. The FSA's approach to exercising its main enforcement powers is set out in the Decision Procedure & Penalties Manual ("DEPP") and Enforcement Guide ("EG").

Facts and matters relied upon

Background

- 2.17. The Firm has been regulated by the FSA since 1 December 2001, with permissions to arrange deals in investments as well as dealing as principal and agent in trades. It is an agency broker and undertakes riskless principal trading by matching trades for different counterparties, dealing in equities and instruments providing rights over them. It is classified as a MiFID investment firm. In February 2007, during the lead up to MiFID, the Firm underwent a change of control.
- 2.18. SUP 17 requires transaction reports containing mandatory details to be submitted to the FSA by the end of the next business day following the day on which the firm entered into the transaction. At the end of each working day transaction reports received by firms are loaded onto the FSA's transaction monitoring system.
- 2.19. The implementation of MiFID across all European Economic Area ("EEA") member states on 1 November 2007 (effective on 5 November for transaction reporting) introduced changes to the list of products in which transactions have to be reported and standardisation of the list of fields which need to be included in the reports. SUP 17 was amended from 1 November 2007 to reflect these changes. Whilst the changes required to be implemented by firms were significant in respect of their MiFID transaction reporting obligations the mandatory content of the transaction reports for many products remained largely unaffected by MiFID changes.
- 2.20. The FSA has provided regular and detailed information to firms in its "Market Watch" publication on transaction reporting issues. In order to assist firms with transaction reporting generally and with respect to changes introduced by MiFID, the FSA issued a Transaction Reporting User Pack (TRUP) in July 2007.
- 2.21. Statements were made by the FSA in Market Watch in March 2007 and June 2008 (Issues 19 and 28) and TRUP that firms should regularly review the integrity of transaction report data.
- 2.22. Issue 28 of Market Watch in June 2008 stated:

"Firms must report transactions to us accurately to help us monitor for market abuse and maintain market confidence. Accuracy in transaction reports also reduces the number of requests for clarification that we need to make to firms."

Therefore, we encourage all firms to review the integrity of their transaction report data regularly. Our Transaction Monitoring Unit is happy to provide firms a sample of reports we have received so that firms can check those transaction reports against their own records.

...

We will be undertaking regular reviews of the quality and completeness of firms' submissions. We expect firms now to be fully compliant with the transaction reporting requirements set out in SUP 17. Where we identify problems with transaction reporting we will consider the use of our enforcement tools. In doing so, we will take into account the appropriateness of the firm's systems and controls, including its monitoring programme around transaction reporting."

MiFID Implementation

- 2.23. The Firm set up a project team to assist with the implementation of MiFID in April 2007. However, the work done prior to MiFID implementation was insufficient to ensure that the Firm's transaction reporting processes and procedures would be fully compliant with the MiFID requirements. The handover from the MiFID project team to Operations when MiFID came into force was inadequately documented in respect of transaction reporting and as a result there was insufficient detail of the requirements, and no documented procedure around transaction reporting within Operations.
- 2.24. The Firm's subsequent breaches largely resulted from these errors, which took place prior to the appointment, by the Firm's current owner, of new senior management, operations and compliance personnel.

The Firm's internal reviews after MiFID Implementation

- 2.25. In February 2008 the Firm sought data from the FSA in order to check its transaction reports. As a consequence of this request, the FSA highlighted to the Firm discrepancies affecting over 500,000 transactions where pence rather than pounds had been used in the unit price field in reports.
- 2.26. In July 2008 the Firm undertook a compliance monitoring review of its compliance with the rules in SUP 17 in the period January to June 2008. The report produced as part of this review was incomplete in its conclusions and coverage. This review was not escalated to senior management at the time and therefore the shortcomings of the report, together with the issues it did raise, were not addressed.
- 2.27. In November 2008, the Firm undertook another review of its transaction reporting process. However, this review had a limited scope and did not consider the requirements of all relevant FSA rules. The issues highlighted in this review were again not escalated to senior management and it was therefore not acted upon.

- 2.28. In January 2009 the FSA highlighted to the Firm shortcomings around the trade time for London Stock Exchange trades shown on all of those transaction reports submitted since MiFID implementation in November 2007, which affected 9.2 million transactions. The time had been entered using US Eastern time rather than local London time as required by the rules in SUP 17. Following this the FSA asked the Firm to provide the FSA with a detailed explanation of all its processes and controls around transaction reporting. The Firm provided this information and undertook a full review of the adequacy of its transaction reporting procedures and processes. Following the review, the Firm took substantial remedial action to improve the processes and procedures relating to transaction reporting. The Firm also retained external consultants to review and validate the firm's methodology and remediation efforts. This review was completed, escalated to senior management and shared with the FSA in May 2009.
- 2.29. In this review, the Firm identified that a total of 22.1 million transactions had not been reported in accordance with SUP 17 requirements. The errors identified included:
- (1) transactions not reported at all due to the netting of trades into one trade per equity per day affecting 9.5 million transactions;
 - (2) over 1,000 trades which should have been cancelled or amended after having transaction reports made but were not;
 - (3) transaction reports for trades in Global Depository Receipts were not submitted in over 237,000 cases;
 - (4) trades which were booked late and then not reported, impacting 132,000 transactions; and
 - (5) transactions that were not reported due to trades being netted at broker level in 3.1 million cases.

Inadequate controls in relation to transaction reporting

- 2.30. Largely as a result of the inadequate work done prior to the implementation of MiFID, the Firm had no formal procedures and controls in relation to transaction reporting from November 2007 to June 2009, although it started to revise its controls in February 2009. Despite repeated public statements by the FSA in Market Watch and TRUP that firms should regularly review the integrity of transaction reporting data, prior to April 2009 the reviews carried out by the Firm were inadequate and the Firm only sought data from the FSA on one occasion (as referred to in paragraph 2.25 above).

Analysis of Breaches

Breaches of SUP 17

- 2.31. During the time period 5 November 2007 to 11 May 2009 the Firm failed to report or reported incorrectly over 22.1 million reportable transactions for the period, in breach of rules SUP 17.1.4 R and SUP 17.4.1 EU. The breaches included:
- (1) reporting the trading time in US Eastern time rather than London local time impacting 9.2 million transactions;
 - (2) reporting the unit price in the minor (pence) rather than major currency (pounds), and incorrect time (GMT/BST) reports for approximately 565,000 transactions; and
 - (3) the errors highlighted in 2.29 (1) – (5) above.

Breaches of Principle 2

- 2.32. During the Relevant Period the Firm failed to conduct its business with due skill, care and diligence around transaction reporting in breach of Principle 2, in that it failed to respond appropriately to clear indications that there were issues with the effectiveness of the transaction reporting process. The reviews of transaction reporting carried out in July 2008 and November 2008 were not escalated, the former was not completed and the latter was of limited scope. As a result, neither review was acted on effectively.

Breaches of Principle 3

- 2.33. The Firm failed to take reasonable care to organise and control its affairs responsibly and effectively in relation to transaction reporting in breach of Principle 3, in that:
- (1) it failed to take adequate steps in the lead up to the implementation of MiFID to ensure that its transaction reporting processes and procedures would be fully compliant with the requirements that would come in to force post MiFID;
 - (2) largely as a result, from November 2007 until June 2009 there was no formal documented transaction reporting operational procedure in place; nor were there sufficient transaction reporting controls and monitoring to ensure that breaches in transaction reporting rules were discovered and escalated appropriately, despite public warnings from the FSA through Market Watch and TRUP and the availability of transaction reporting data from the Transaction Monitoring Unit at the FSA.

3. SANCTION

- 3.1. The FSA's policy on the imposition of financial penalties and public censures is set out in DEPP and EG. In determining the financial penalty, the FSA has had regard to this guidance. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring 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.
- 3.2. The FSA considers that the seriousness of this matter merits the imposition of a significant financial penalty.
- 3.3 The FSA has had regard to the following factors:
 - (1) the Firm's failure to submit accurate transaction reports could have a serious impact on the FSA's ability to detect and investigate suspected market abuse and consequently could impact the FSA's ability to maintain market confidence and reduce financial crime. In addition, as the FSA will have sent a large number of the Firm's incorrect transaction reports to other competent authorities in compliance with obligations under MiFID, its failure is likely to have impaired the FSA's ability to provide accurate transaction reporting data to overseas regulators;
 - (2) the inaccurate reporting impacted a large proportion of transactions across all asset classes in which the Firm dealt in the period;
 - (3) the Firm's breaches occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of the Markets in Financial Instruments Directive ("MiFID") and public statements by the FSA.
- 3.4 The Firm's breaches largely resulted from errors that took place prior to the appointment, by the Firm's current owner, of new senior management, operations and compliance personnel. The Firm and its current senior management have taken a number of steps which mitigate the seriousness of the breaches. These include:
 - (1) committing extensive resources, including engaging external consultants, to carry out a detailed review of its transaction reporting processes, making personnel changes in key roles and implementing a comprehensive remediation programme;
 - (2) establishing a working group to oversee remediation and improvement of standards, controls and processes around transaction reporting issues, including those highlighted in the external consultants' report; and

(3) cooperating fully with the FSA in the course of its investigation.

4. CONCLUSIONS

4.1. The FSA considers in all the circumstances that the seriousness of the breaches merits a substantial financial penalty. In determining the financial penalty the FSA has considered the need to deter the Firm and other firms from committing similar breaches. The FSA has also had regard to penalties in other similar cases.

4.2. The FSA considers that a financial penalty of £1.5 million is appropriate, discounted to £1.05 million after the applicable Stage 1 discount for early settlement.

5. DECISION MAKERS

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

6. IMPORTANT

6.1. This Final Notice is given to the Firm in accordance with section 390 of the Act.

Manner of and time for Payment

6.2. The financial penalty must be paid in full by the Firm to the FSA by no later than 22 April 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

6.3. If all or any of the financial penalty is outstanding on 23 April 2010, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

Publicity

6.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

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

FSA contacts

- 6.6. For more information concerning this matter generally, the Firm should contact Celyn Armstrong (020 7066 2818) or Dan Enraght-Moony (020 7066 0166) at the FSA.

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Tracey McDermott

Head of Department

FSA Enforcement and Financial Crime Division