Reference number FS/2010/0019

PERFORMANCE OF REGULATED ACTIVITIES – Conduct – Disciplinary powers – Misconduct – Unauthorised trading – Whether managing director carrying on "desk head" role is guilty of misconduct – FSMA 2000 s.66(2)

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
FINANCIAL SERVICES

SACHIN KARPE **Applicant**

- and -

THE FINANCIAL SERVICES AUTHORITY **Authority**

- and -

UBS AG **Interested Party**

TRIBUNAL: SIR STEPHEN OLIVER QC
MAURICE BATES
KEITH PALMER

Sitting in public in London on 12-16 and 19 and 20 December 2011

Michael Blair QC and Tom De Vecchi, counsel, instructed by Addleshaw Goddard, solicitors, for the Applicant

Jonathan Crow QC and Sharif Shivji, counsel, for the Authority

David Mayhew, counsel, and Nikunj Kiri and Stephen Flaherty, solicitors, instructed Herbert Smith LLP, for the Interested Party

DECISION

Introduction

1. Throughout the period from 1 January 2006 to 30 January 2008 ("the Relevant Period"):

   (a) UBS AG ("UBS"), the Interested Party, was a major global financial group headquartered in Zurich. Amongst other businesses, UBS operated an international wealth management business ("UBS WM"), which focused on providing wealth management services to individuals. UBS WM's business in the United Kingdom is conducted through its London branch (the "London Branch").

   (b) Sachin Karpe, the Applicant, worked for UBS WM within the London Branch. He worked within the London International Business which dealt with non-UK resident clients advised in the UK. Mr Karpe was the Desk Head of the Asia II Desk, which provided wealth management services to customers resident in India, or of Indian origin. Until 31 October 2007, Mr Karpe was approved by the Authority to perform the Investment Adviser controlled function (CF21). On 1 November 2007, CF21 was superseded by the Customer controlled function (CF30). Mr Karpe held CF30 until 31 March 2008 when he was dismissed by UBS for gross misconduct.

   (c) Andrew Cumming, Laila Karan and Jaspreet Ahuja were all Client Advisers who worked on the Asia II Desk and reported directly to Mr Karpe throughout the Relevant Period. All three were approved to perform CF21 controlled functions until 31 October 2007 and CF30 functions thereafter.

The Reference

2. By a Decision Notice dated 9 July 2010, the Authority ("the FSA") informed Mr Karpe of its decision to:

   (a) Impose a financial penalty of £1,250,000 pursuant to section 66 of the Financial Services and Markets Act 2000 ("the Act") for breaching Principle 1 of the Authority's Statements of Principle for Approved Persons ("APER");

   (b) Make an Order pursuant to section 56 of the Act, prohibiting Mr Karpe from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm on the grounds that he was not a fit and proper person as his conduct demonstrated a lack of honesty and integrity.

3. By a Reference Notice dated 2 August 2010 ("the Reference"), Mr Karpe referred the Decision Notice to the Upper Tribunal (Tax and Chancery Chamber) Financial Services ("the Tribunal").

4. In summary, Mr Karpe relies upon the following grounds in his reference:

(a) There is no (or no sufficient) basis in law for imposing any penalty;

(b) The financial penalty should be no greater than £450,000 because;

(i) The FSA did not give sufficient weight to UBS' compliance culture in general and in relation to its Indian business in particular. UBS' management structure and style encouraged his behaviour and did not provide adequate guidance and training;

(ii) It is not correct for the FSA to say that losses of USD 42 million are attributable solely to Mr Karpe's conduct; and

(iii) The FSA has not followed its own guidance in respect of the determination of financial penalties and has acted unfairly in imposing a financial penalty which may make Mr Karpe bankrupt.

5. Mr Karpe has not referred the FSA's decision to impose a prohibition order on him to the Tribunal.

Relevant statutory framework and FSA's handbook provisions

6 Section 2(1) of the Act provides that, in discharging its general functions, the Authority must, so far as is reasonably possible, act in a way which is compatible with its regulatory objectives and in a way which the Authority considers most appropriate for the purpose of meeting those objectives.

7 Pursuant to section 2(2) of the Act, the Authority's regulatory objectives include the maintenance of confidence in the financial system, the protection of consumers, and the reduction of financial crime.

Disciplinary Powers

8. The Authority is empowered by Section 66(1) of the Act to take action against a person under this section if (a) it appears to it that he is guilty of misconduct; and (b) the Authority is satisfied that it is appropriate in all the circumstances to take action against him. By Section 66(3) of the Act, the Authority is empowered to impose a financial penalty in such circumstances.

9. Section 66(2) of the Act provides that a person is guilty of misconduct if, while an approved person, he has failed to comply with a statement of principle issued under section 64 or he has been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under the Act.

10. The Authority has issued the Statements of Principle and Code of Practice for Approved Persons pursuant to section 64 of the Act. Statement of Principle 1 states that an approved person must act with integrity in carrying out his controlled functions.

Policy on the imposition of financial penalties

11. Section 69 of the Act requires the Authority to issue a statement of its policy with respect to the imposition of penalties under section 66 and the amount of such penalties. In deciding whether to exercise its power under section 66 in the case of any particular behaviour, the Authority must have regard to the statement of policy in force at the time the misconduct occurred.

12. The Authority's current policy in this regard is contained in Chapter 6 of the Decision Procedure and Penalties manual ("DEPP"). The Authority has also had regard to the guidance published in the Enforcement Manual ("ENF"), and in particular Chapters 11 and 13 which set out the relevant guidance in force when some of the misconduct described below occurred.

Prohibition

13. As is pointed out above, Mr Karpe has not referred the FSA's decision to impose a prohibition notice on him. For completeness (and in case the matter should become relevant) we will shortly summarise the provisions and tests relating to that aspect.

14. By section 56 of the Act, the FSA has the power to prohibit individuals who appear to it not to be fit and proper from carrying out functions in relation to regulated activities. The part of the FSA's Handbook entitled the Fit and Proper Test for Approved Persons ("FIT") sets out guidance on how the Authority will assess the fitness and propriety of a person to perform a particular controlled function.

15. 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.

16. FIT 2.1.1G provides that, in determining a person's honesty, integrity and reputation, the FSA will have regard to factors including, but not limited to, those set out in FIT 2.1.3G, which include:

(5) whether the person has contravened any of the requirements and standards of the regulatory system...

(13) whether, in the past, the person has been candid and truthful in all his dealings with any regulatory body and whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards.

17. The FSA's policy in relation to prohibition orders and withdrawal of approval is set out in Chapter 9 of the Enforcement Guide ("EG").

Mr Karpe's response to the charge of misconduct

18. Mr Karpe did not attend the hearing of his reference. His case, presented to the Tribunal in his absence by Michael Blair QC and Tom de Vecchi, is that the £1,250,000 penalty is too severe and disproportionate. He further contended that the FSA does not in law have the authority to impose a disciplinary penalty on him in relation to most if not all of the conduct alleged of him.

19. Following the presentation of the FSA's evidence at the hearing, the closing submission for Mr Karpe is prefaced by these words referring to the position if the Tribunal were against him on the legal issue:

> "As will have become clear, Mr Karpe does not dispute the entirety of the factual case against him. But it is submitted that, when understood in its proper context, the gravity of the conduct of which he is accused is not as serious as the FSA asserts. This is relevant to the question of penalty pursuant to DEPP 6.5.2G(2) which provides that a relevant factor in the assessment of a financial penalty is "(2) The nature, seriousness and impact of the breach in question"".

Our Decision

20. In the absence of any primary evidence to the contrary from Mr Karpe, we rely on the facts and matters set out in the FSA's Statement of Case. This Decision now sets out the contents of the Statement of Case and, where appropriate, we will summarise the opposing observations relating to those facts and matters and state our own conclusions. We have concluded that the argument advanced for Mr Karpe on the law, that there is no (or no sufficient) basis for imposing any penalty, cannot be sustained. We will deal with this as a separate matter in paragraphs 142 to 162. These follow our findings and conclusions on the "factual" issues.

Background to the FSA's case

21 The Statement of Case explains that the services UBS provides to its international wealth management customers in the UK include, amongst other

things: bank account services; investment advisory services; portfolio management (i.e. the discretionary management of a portfolio of cash and investments in accordance with investment guidelines); the execution of trades on customer instructions; and the safekeeping of documents and assets. International wealth management customers are typically non-UK resident individuals who have substantial assets to invest, and are sophisticated, active and performance-driven investors.

22. During the Relevant Period, the Statement of Case records, the London International Business conducted from the London Branch operated from seven desks, including the Asia II Desk, each of which focused on non-UK resident customers from different geographic areas (the "International Business Desks"). Each desk had its own portfolio of customers and was led and managed by a Desk Head.

23. Each international wealth management customer was allocated to a particular Client Adviser. The Client Advisers had day-to-day contact with customers, executed customer orders, provided advice and made recommendations in relation to investments and other products and services where relevant.

24. Mr Karpe has worked in the financial services industry since 1990. He joined UBS on 1 November 1998 as an Associate Director. Upon joining UBS he acted as a Client Adviser on one of the International Business Desks. In March 2005, he was promoted to become the Desk Head of the Asia II Desk and from 1 March 2007 he also held the position of Managing Director. In January 2008 he managed a team of 25 UBS employees.

25. As an approved person holding the CF21 ('Investment Adviser') and CF30 ('Customer') controlled functions, Mr Karpe was able to, and did, deal with customers, and their property, in the course of the carrying on by UBS AG of its regulated activities.

26. As an approved person, Mr Karpe was required to comply with APER. In addition, Mr Karpe was required to act in accordance with UBS' legal and compliance requirements (including money-laundering requirements, UBS Group and local policies and procedures and the UK Compliance Manual), the UBS Client Adviser Manual and the Employee Handbook.

27. The UBS Desk Head Manual, the Statement of Case notes, set out Mr Karpe's responsibilities and duties as a Desk Head. These included:

    (a) reviewing every new account opened on the Asia II Desk;
    (b) ensuring that all members within his team were aware of and practised UBS' Risk Principles; and
    (c) ensuring that all team members within his team were aware of their obligations under UBS' Anti-Money Laundering Rules.

28. Whilst acting as Desk Head Mr Karpe supervised the Client Advisers on the Asia II Desk who offered a number of services to customers, including:
    (a) advising on investment opportunities, and managing portfolios;
    (b) making recommendations on financial products;
    (c) marketing or distributing marketing material in respect of regulated products; and
    (d) opening UBS accounts for customers and providing account maintenance.

Client Mandates

29. The Statement of Case states that UBS's customers agreed a specific mandate for their accounts (the 'Mandate') establishing the terms by which customers authorised UBS to provide services. Mr Karpe's responsibilities included ensuring that his (and his Client Advisers') customers' investments were undertaken in accordance with the relevant Mandate.

30. The terms of the Mandates were such that UBS' customers could elect for a number of different account services, including:

    (a) a self-directed account whereby the customer would give instructions to execute transactions which may or may not have been based upon investment recommendations; and

    (b) a discretionary service whereby the customer's assets would be managed at UBS' discretion but in line with guidelines provided by the customer.

31. The terms of the Mandates in relation to customers who selected the self-directed service did not provide Mr Karpe with any authority to provide a discretionary service whereby the customer's assets would be managed at UBS' discretion.

32. Further, the terms of the Mandates did not provide Mr Karpe with any authority to arrange loans with other UBS customers, whether or not they were guaranteed by UBS, nor was the arrangement of inter-customer loans among the services offered by UBS to its customers.

33. During the Relevant Period, the London Branch had in place a 'Whistleblowing' policy (set out in the Employee Handbook) which required Mr Karpe to disclose information which related to fraud or other illegal or unethical conduct to the London Branch's senior management if he felt unable to report his concerns to his line manager.

The UBS Investigation

34. The Statement of Case records that on 31 December 2007 a UBS employee reported to UBS's money laundering officer concerns regarding a transaction

involving the transfer of US$5,000 from a customer account to Mr Karpe's personal bank account. As a result of this disclosure, UBS undertook a review of trading activity on the Asia II Desk which included detailed forensic analysis carried out by a third party (the 'UBS Investigation'). The UBS Investigation established that Mr Karpe:

(a) carried out unauthorised foreign exchange ("FX") trading, structured products transactions and precious metals derivatives trading, which resulted in significant losses for 21 customers of the Asia II Desk (the "Affected Customers");

(b) used unauthorised internal transfers to conceal the unauthorised FX losses on certain customer accounts;

(c) used the London Branch's Suspense Account (see paragraph 37(c) below) to route internal transfers between customer accounts, which allowed the concealment of the originating customer's name and account number on the recipient customer's statement (and vice versa);

(d) arranged all of the UBS Guarantee Letters (see paragraph 37(b) below);

(e) arranged for the redemption of shares in an investment structure created for one customer to cover losses on other unconnected Asia II Desk accounts; and

(f) was the individual with primary responsibility for the losses on the Asia II Desk and for the subsequent actions taken to cover up those losses. He also instructed three Client Advisers on the Asia II Desk to assist him in covering up the losses.

35. On 31 March 2008 UBS dismissed Mr Karpe with immediate effect for gross misconduct.

The Misconduct alleged in the Statement of Case

Mr Karpe's breach of Statement of Principle 1 of APER

36. The FSA issued the Decision Notice against Mr Karpe on 9 July 2010. By that notice, the FSA decided that, during the Relevant Period, Mr Karpe demonstrated a lack of honesty and integrity, in breach of Statement of Principle 1 of APER.

37. The Statement of Case records that the FSA found that Mr Karpe's conduct during the Relevant Period fell seriously short of the FSA's prescribed regulatory standards for approved persons. In summary, Mr Karpe:

(a) carried out unauthorised trading (specified in paragraphs 38-40 below) on various customer accounts (the "Unauthorised Trading"), in particular using the account of one customer, "Customer A", which resulted in substantial losses. He also carried out unauthorised transfers between unconnected customer accounts, in particular using Customer A's account, to disguise losses which had arisen as a result of the Unauthorised Trading;

(b) orchestrated the movement of funds from one customer account, in particular from Customer A, to others ("the Recipient Customers") to disguise losses which had arisen as a result of the Unauthorised Trading. Mr Karpe arranged for these movements of funds to be effected through various methods which included using purported loans and transfers between unconnected accounts. Mr Karpe's misconduct encompassed the following;

(i) On a number of occasions between 31 October 2005 and 2 October 2007, he arranged purported loans, and, on at least seven occasions, signed documents (the "UBS 'Guarantee' Letters"), which represented to the customers from whose accounts the funds were transferred (the "Transferor Customers") that the transfer of funds amounted to loans at interest rates well above commercial rates of interest to the Recipient Customers. These documents also purported to represent that the apparent loans (the "Purported Loans") had been arranged in the normal course of UBS' business and further that the Purported Loans were guaranteed by UBS in the event of default by the Recipient Customers.

(ii) He signed the UBS 'Guarantee' Letters, which related to Purported Loans totalling USD 14.5 million, in the knowledge that:

1. The UBS 'Guarantee' Letters had not been authorised by UBS;

2. The UBS 'Guarantee' Letters would not have been approved by UBS had formal authorisation been sought; and

3. The UBS 'Guarantee' Letters represented to the Transferor Customers that the Purported Loans had been formally guaranteed by UBS in the event of default.

(iii) He abused his position of Desk Head by instructing Andrew Cumming to countersign the UBS 'Guarantee' Letters.

(c) At all times Mr Karpe was aware that the UBS suspense account (the 'Suspense Account') was an internal account intended to be used by Operations on a daily basis principally to process intra-day transactions where timing differences existed. He knew that the Suspense Account was not to be used by Client Advisers to effect transactions between customer accounts. Despite this, during the Relevant Period, Mr Karpe used, or instructed others to use, the Suspense Account to route internal transfers between Customer Accounts, which allowed the concealment of the transferor customer's name and account number on the recipient customer's statement (and vice versa).

(d) During August 2007 a customer of the Asia II Desk, Customer B, suffered a loss in connection with an investment made on UBS' advice. Mr Karpe was instructed by senior management at UBS to try to reach an agreement with Customer B on the terms that UBS would only reimburse 50% of the loss. Mr Karpe deliberately misled senior management at UBS into the false understanding that Customer B had agreed to these terms; however, this was not the case as Mr Karpe had already confirmed to Customer B that he would receive a full reimbursement. UBS subsequently paid 50% of the loss to Customer B. Unbeknown to senior management at UBS, and in conjunction with a Client Adviser on the Asia II Desk, Laila Karan, Mr Karpe transferred money from Customer A to Customer B in order to make good the full loss. Customer A was unaware that this transfer had been made from its account.

(e) Mr Karpe arranged the implementation of an investment structure for an Indian resident customer, the Reliance ADA Group ("Reliance ADAG"), via an investment fund incorporated in Mauritius (the "Fund"), for the purpose of breaching Indian law and in clear contravention of UBS' guidelines. Mr Karpe took steps wrongfully to conceal the true nature of the customer's investment, mainly by the deliberate and repeated provision of false and misleading information to UBS Legal and Compliance ("Compliance").

(f) Mr Karpe arranged for six unauthorised redemption payments to be made which transferred funds invested in the Fund by Reliance ADAG to Customer A despite being aware that:

(i) Customer A had never invested in the Fund;

(ii) The money being transferred belonged to Reliance ADAG, not Customer A; and

(iii) Reliance ADAG was unaware of the redemptions and had not authorised them.

These payments were used to conceal losses arising from the Unauthorised Trading.

Unauthorised Trading

38. During the Relevant Period, Mr Karpe, whilst Desk Head of the Asia II Desk, carried out Unauthorised Trading affecting 39 customer accounts (“the Affected Accounts”), which resulted in substantial losses for 21 of those customers ("the Affected Customers").

39. The Unauthorised Trading included:

(a) 321 FX trades placed on the Customer A account between February 2007 and January 2008. The trading comprised 192 trades on the USD sub account with a total value of USD 1.5 billion and 129 trades on GBP sub-account with a total value of GBP 635.4 million;

(b) 2811 FX trades placed between January 2006 and February 2007 spread across the USD, GBP, EUR, JPY and CHF sub-accounts of the Customer C account, with a total value of USD 11.3 billion, £4.3 billion; EUR 1.9 billion; JPY 105 billion and CHF 4.9 billion respectively;

(c) An investment of USD 2 million in a 3 month Libor note in the account of Customer D. The Libor Note was eventually sold at 53.90% resulting in a loss of USD 927,000 and monies were invested in a silver investment which resulted in a loss of USD182,128;

(d) Various FX trades placed on the account of Customer D which resulted in losses of approximately USD 2.1 million;

(e) Various FX trades placed on a sub-account of Customer E which resulted in accumulated losses of approximately USD 800,000;

(f) Various FX trades placed on the account of Customer F between 2004 and 2007 which resulted in losses of approximately USD 3.5 million;

(g) Various FX trades placed on the Customer G account which resulted in losses of approximately USD 9 million;

(h) Various FX trades placed on the Customer H account which resulted in losses of approximately USD 647,000;

(i) Various FX trades and a 3 month Libor note trade placed on the account of Customer I which resulted in losses of approximately USD 2.3 million and USD 246,000 respectively;

(j) Various FX trades placed on the Customer J account which resulted in losses of approximately USD 1.1 million;

(k) Precious metals trades placed on the Customer K account which resulted in losses of approximately USD 431,000; and

(l) FX trades placed on the Customer L account which resulted in losses of approximately USD 870,000.

40. In respect of all of the Unauthorised Trades, including those set out in the previous paragraph, and as Mr Karpe was aware, no instructions or authorisations of any kind were received from the customer. Furthermore, in the case of the Customer C account, the beneficial owner of the account believed that it had been closed in January 2006.

41. UBS carried out a remediation exercise designed to establish whether loss had been caused to the Affected Customers. The outcome of the remediation exercise was that, as a result of Mr Karpe's conduct, UBS paid compensation totalling USD 42.4 million to the Affected Customers in relation to losses incurred from unauthorised activity on their accounts, including the Unauthorised Trading.

42. At all times Mr Karpe was not just aware that this trading had not been authorised by the customers. He also took active steps to conceal the losses.

Observations and conclusions on the Unauthorised Trading

43. By way of introduction, it is not in dispute that 18 of the 21 clients (under the effective control of Mr Karpe and to whom compensation was paid) had self-directed accounts. Nor is it in dispute that under UBS's systems, there was no such procedure as "quasi-discretionary trading" as had been alleged by Mr Karpe in his written Reply. UBS's product offering did not extend to discretionary trading in FX. UBS did offer the option of providing advice and execution-only services for FX, but none of the Affected Customers had selected this option. Further, UBS did not permit speculative spot FX trading in Wealth Management and did not permit any of its Wealth Management desk heads or client advisers to act as a discretionary manager. Mr Karpe admitted in the course of an interview with the FSA that he had not been authorised by any client to conduct discretionary FX trading.

44. Investigations showed that Mr Karpe had in fact undertaken unauthorised trading across 39 client accounts. This had resulted in substantial losses to 21 of those and had prompted compensation payments by UBS in the sum of US$42.4m.

45. Following the discovery of the Unauthorised Trading, Deloitte LLP (accountants) were commissioned to determine the compensation due to Affected Customers. The Deloitte investigation was one of four

investigations. The others were carried out by UBS itself, by KPMG (as a "skilled person" under section 166 of the Act) and by the FSA itself. All four investigations concluded that there had been widespread Unauthorised Trading which had caused losses of many millions of dollars across a large number of client accounts.

46. It was emphasised by Mr Michael Blair QC for Mr Karpe that there had been a large number of FX trades undertaken on the Asia II Desk which was situated in an open-plan office. To know what proportion of these had been unauthorised was, he said, a difficult task and the onus lay with the FSA. It was emphasised that allegations of unauthorised trading imply dishonesty. We were accordingly reminded that we should not make any finding relating to unauthorised trading without being satisfied that the FSA had proved its case to a high standard. The absence of documentation recording client instructions could not, it is said, establish that the trades were unauthorised; this was because (as was confirmed by the evidence of Mr Shaun Challis, the Chief Risk Officer) the systems and controls within UBS allowed trades to be placed with the trading desk without client instructions having to be recorded and produced to the trading desk prior to the trade being executed. It is said that the information supplied by Affected Customers should be rejected as wholly unreliable. None of them had been called to give evidence. Then it is observed that the so-called beneficial owner of Customer A (Mr X) had, when interviewed by the FSA in the presence of the Indian regulator, SEBI, denied that he held the Customer A account. Then it is said that UBS, when determining the amounts of compensation to be paid to Affected Customers, had become suspicious that some of those Affected Customers were taking advantage of the investigation and making claims simply because losses had been suffered on their account.

47. We accept that the trades were executed at the trading desk without the client's written authority. We base no conclusions on Mr X's denial that he was beneficial owner of Customer A. We, in common with the FSA conclude as a fact that no instructions had been given by Mr X as regards the many Customer A transactions. We acknowledge that some UBS customers could have jumped on the "remediation" bandwagon, particularly as Deloitte had, we understand, proceeded on the assumption that all individual transactions were presumed to be unauthorised unless documentation could be found to show otherwise; but that has to be matched with the conclusion from the four investigations that there had been substantial unauthorised trading causing large losses to many clients' accounts.

48. We further accept that Mr Karpe took many authorised trade instructions. But that does not displace the fact that the Unauthorised Transactions identified above (e.g. the Customer A and Customer C transactions) were of huge volume both numerically and in amount. Mr Karpe's involvement in the Unauthorised Transactions was in our view a serious breach of APER Principle 1.

Movement of funds between customer accounts to disguise losses

49. We now revert. The FSA say in the Statement of Case that during the Relevant Period Mr Karpe orchestrated the movement of funds from one customer account to another to disguise losses which had arisen as a result of the Unauthorised Trading by

(a) establishing loans between customer accounts without the knowledge of the Recipient Customers (i.e. the Purported Loans); and

(b) making unauthorised transfers between customer accounts, both of which are discussed in detail below.

Purported Loans

50. In order to conceal losses on the Affected Customers' accounts, Mr Karpe arranged for seven purported loans totalling USD14.5 million to be made by other UBS customers. Mr Karpe represented to the Transferor Customers that they were entering into a legitimate agreement with another UBS customer; however, the Recipient Customers were unaware of the transactions.

51. In order to encourage the Transferor Customers to provide these loans, Mr Karpe informed them that:

(a) the loans would be at rates of interest that were approximately double the rate on offer from UBS or other lenders at the time; and

(b) the loans would be guaranteed by UBS.

52. During the Relevant Period, Mr Karpe signed at least seven UBS 'Guarantee' Letters on UBS headed note paper. The UBS 'Guarantee' Letters were designed to, and did, represent to the Transferor Customers that UBS had approved the Purported Loans and authorised a guarantee that UBS would repay the transferred sums in the event of default. In fact, senior management at UBS were not aware of the Guarantee Letters.

53. The Purported Loans were as follows:

(a) On 31 October 2005, a loan of USD 5 million was made for the duration of 12 months from Customer M to Customer C. The interest rate was said to have been 8%. This loan was rolled over repeatedly during the Relevant Period at increased interest rates from 9.5 to 9.625%. The Customer C account was closed in February 2007, and the liability to repay the loan was transferred to the Customer A account. The loan was not repaid;

(b) On 3 March 2006, a loan of USD 3 million was made for the duration of 6 months from Customer M to Customer C. The interest rate was said to have been 9%. This loan was repeatedly rolled over and was also transferred to Customer A. USD 2 million of the loan capital was repaid from the Customer A account;

(c) On 22 September 2006, a loan of USD 3 million was made for the duration of 6 months from Customer M to Customer C. The interest rate was said to have been 8.75% at the outset. This loan was repaid in full using monies from the Customer A account on 19 November 2007 (see paragraph 135(b) below);

(d) In respect of the three loans from Customer M to Customer C (and later transferred to Customer A) interest was paid by Customer C to Customer M of USD 540,556 and interest was paid by Customer A to Customer M of USD 1,042,518;

(e) On 20 February 2006, a loan of USD 1.5 million was made for the duration of 12 months from Customer N to Customer C. On 19 April 2007, Customer N sought repayment of the loan which should have matured on 19 February 2007. On 21 April 2007, Mr Karpe informed Customer N that he had rolled over the loan for three months. Mr Karpe had not been given instructions from Customer N to do so. On 24 May 2007, the loan was repaid by Customer A. Customer A also paid USD 152,373 to Customer N on that date in respect of interest on the loan;

(f) On 15 November 2005, a loan of USD 1 million was made for the duration of one year from Customer O to Customer C. On 15 November 2006, the loan was rolled over for 12 months and interest of USD 85,000 was paid from Customer C to Customer O. On 19 November 2007, the loan was repaid by Customer A including interest of USD 95,000 (see paragraph 136(b));

(g) On 25 January 2007, a loan of USD 1 million (said to be at 10% interest) was made for the duration of 6 months from Customer O to Customer C. This loan was not repaid, and no interest was paid (although Customer O received compensation from UBS for both the capital and unpaid interest).

54. Interest payments totalling at least USD 1.91 million were made in respect of the Purported Loans. Of this total, USD 1.29 million was actually paid by the Customer A account, which had not received the Purported Loans, was unaware of the interest payments, and had no connection to the Customer C account.

55. The Purported Loan arrangements fell outside the scope of services offered by UBS to its customers.

56. Mr Karpe abused his position of Desk Head by instructing a Client Adviser, Andrew Cumming, to countersign the UBS 'Guarantee' Letters.

57. As a result of Mr Karpe's conduct, UBS paid compensation to Customer M (USD 7 million capital and USD 394,000 unpaid interest) and Customer O (USD 1 million capital and USD 64,000 unpaid interest) in respect of the Purported Loans.

58. Mr Karpe signed the Guarantee Letters in the knowledge that:

(a) the Recipient Customers had not agreed to borrow the money or to pay interest thereon and were not aware of the transactions;

(b) senior management at UBS were not aware of the Purported Loans;

(c) the Purported Loans had not been arranged in the ordinary course of UBS's business;

(d) the Purported Loans had not been authorised by the relevant individuals at UBS;

(e) the Purported Loans would not have been approved by UBS had formal authorisation been sought;

(f) senior management at UBS had not agreed to guarantee the Purported Loans and the representation to the Transferor Customers that they had been properly authorised was false; and

(g) the Purported Loans were at higher rates of interest than generally available at the time.

59. At all times, the FSA say in the Statement of Case, Mr Karpe intended that the Purported Loans should assist in the concealment of the losses to customers which had arisen from the Unauthorised Trading.

Unauthorised transfers between unconnected accounts

60. Between 4 December 2006 and 21 January 2008, 67 transfers were carried out between Customer A and the accounts of other UBS customers, including occasions when transfers were routed via the Suspense Account. The aggregate value of the transfers between the various accounts was USD 29,507,690 and £5,141,220. All of these transfers were unauthorised.

61. Various unauthorised transfers were made on a number of other UBS accounts.

62. During the Relevant Period Mr Karpe carried out unauthorised transfers on UBS customer accounts in the knowledge that both the remitting and recipient customers were unaware of the transfers.

63. At all times Mr Karpe intended that the unauthorised transfers should assist in the concealment of the losses to customers which had arisen from the Unauthorised Trading.

Conclusions on unauthorised "loans" and unauthorised transfers

64. The facts of the "loans" and the "guarantees" are not in dispute. Mr Karpe's case is that the loans were all agreed as between his clients and that the guarantees had not been intended to have any legal effect. Moreover, it is said for him, he had made no attempt to conceal these transactions from UBS.

65. The FSA's response is that there were no written records of any instructions from any borrowers. The evidence the FSA had obtained from the beneficial owner of Customer M was that he knew neither whom he was "lending" to nor who the beneficial owners of Customer C and Customer A actually were. Nor was there any evidence that Mr Karpe was taking instructions from lenders. The FSA comments that this had been an area where Mr Karpe's account had changed over time. He had initially admitted that the loans had come about as part of the attempt to solve the problems of losses on the unauthorised FX trading. His case had now changed because he was contending that the loans had been agreed between clients.

66. Referring to the guarantees, the FSA says that the evidence shows that the lenders clearly understood them to be legally binding. A number of letters and messages were relied upon that showed the lenders to be chasing guarantees and in one circumstance, had threatened to enforce a guarantee.

67. We note that none of the loan documentation or documentation relating to the guarantees were contained on either iCRM (UBS's client relationship management tool used by client advisers for recording telephone or e-mail client investment instructions) or on On Demand (UBS's imaging, filing and archiving system for hard copy documents for client advisers to record investment instructions). According to the evidence of Caroline Kuhnert (Head of London International Business) hard copies of the relevant documentation had in fact been stored in Mr Karpe's cupboard. The FSA relies on the fact that Mr Karpe had abused his position as desk head by instructing Mr Cumming, one of the client advisers, to sign the guarantees. (Mr Cumming had been candid in the course of his interviews that he had signed the guarantee letters in the face of specific threats from Mr Karpe.)

68. We agree with the conclusion of the FSA that the sham loans and bogus guarantees are examples and evidence of Mr Karpe's systematic dishonesty in trying to cover his tracks.

69. Regarding the unauthorised transfers between client accounts, we observe that the facts of those transfers are not disputed. Mr Karpe's case is that all such transfers were done on client instructions or with client consent and that many of them had been carried out to give effect to business transactions between

clients. The activity, it was alleged for Mr Karpe, had been known to other client advisers and had been processed by the back office.

70. In response to that, the FSA points out that there were no contemporary written instructions from any clients and that, as such, the transactions plainly violated UBS policy. The FSA makes the point that in the period from 1 January 2006 until 30 January 2007 a total of 173 transfers had been made to and from Customer C after the beneficial owner had thought that account was closed. Moreover, as a sample exercise, an investigation team had obtained all records of communications between June 2007 and January 2008 between the Asia II Desk and the beneficial owner of the Customer A account, including telephone records and notes placed on UBS's internal systems recording contact with customers. Between December 2006 and 21 January 2008, 67 transfers had been carried out between Customer A and the accounts of other UBS customers, including via the Suspense Account (see below). The investigation team had only been able to identify customer communications relating to one particular sub-account.

71. In the light of those factors, the FSA contends that the fact that the transactions may have been processed by the back office did not excuse Mr Karpe's conduct. Further, the FSA says, the fact that Mr Karpe's unauthorised activity had not been identified by a control function at UBS in no way undermines the fundamental point that he had been acting without client instructions.

72. The evidence presented to us in support of the FSA's case has not been displaced by anything to the contrary. It demonstrates a clear breach of APER Principle 1 on Mr Karpe's part.

Use of the Suspense Account to disguise the audit trail of transfers between customer accounts

73. The Suspense Account is an internal account, which was intended to be used by Operations on a daily basis principally to process intra-day transactions where timing differences existed (i.e. it was an account to which unknown transactions were posted prior to their allocation to the correct account once it had been identified). At the end of the day the account would normally show a nil balance as the total debits would match the total credits.

74. The Statement of Case records that Mr Karpe used the Suspense Account to route internal transfers between customer accounts (the "Suspense Transfers"), which allowed the concealment of the originating client's name and account number on the recipient client's statement (and vice versa).

75. The Suspense Transfers were, so the Statement of Case records, effected at Mr Karpe's instruction by Client Advisers who reported to him, principally by Ms Karan. The Suspense Transfers included the following:

(a) On 15 March 2007, USD 1 million was transferred from Customer A to the Suspense Account and from the Suspense Account to Customer B's account;

(b) On 16 March 2007, £350,000 was transferred from Customer A to the Suspense Account and from the Suspense Account to Customer B's account;

(c) On 15 June 2007, USD 1 million was transferred from Customer M to the Suspense Account and from the Suspense Account to Customer A. This was the creation of a Purported Loan;

(d) On 15 June 2007, USD 24,597.22 was transferred from Customer A to the Suspense Account and from the Suspense Account to Customer M. This was the payment of interest on a Purported Loan;

(e) On 26 June 2007, USD 1,217,400 was transferred from Customer A to the Suspense Account and from the Suspense Account to Customer B account; and

(f) On 16 November 2007, an amount in USD (not specified in the Statement of Case) was transferred from Customer A to the Suspense Account and from the Suspense Account to the Customer P account.

76. In addition, further transfers were carried out between Customer A and the Suspense Account on 16, 21 and 22 February 2007, and 15 March 2007.

77. During the Relevant Period, the Statement of Case records, Mr Karpe effected the Suspense Transfers in the knowledge that:

(a) the Suspense Transfers had not been authorised by UBS;

(b) the Suspense Transfers would not have been approved by UBS had formal authorisation been sought.

78. At all times (the Statement of Case records) Mr Karpe intended that the Suspense Transfers would be used:

(a) in the concealment of losses to customers which had arisen from the Unauthorised Trading; and

(b) to deliberately conceal the audit trail of transfers between customer accounts.

Conclusions on the Suspense Account issue

79. Mr Karpe does not, we understand, dispute the actual use made of the Suspense Account as having been to route money from one client account to another such that the originating client's name and account number were concealed from the recipient client's statement. Use of a Suspense Account in that way was, Mr Challis (Chief Risk Officer) said in evidence, "inappropriate

and should not have been allowed to occur by Operations" whose team "had ownership of the Suspense Account".

80. In his defence it was asserted for Mr Karpe that the use of the Suspense Account in the way he had used it may have been unusual but it had not been against any published UBS policy. It was pointed out that there were no controls or restrictions in place and that UBS own "Compliance" Team had never picked it up.

81. In the absence of any supporting evidence from Mr Karpe, we conclude that he was using the Suspense Account for an improper purpose. Had it been the case that the transfers would be made between clients and at their instructions, we can see no reason why it would have been necessary to use the Suspense Account in order to preserve anonymity or confidentiality; and if UBS had been aware of the transfer in question there would have been no need to obscure the identity of the clients on UBS's own system. We infer that Mr Karpe had been using the Suspense Account deliberately and to conceal what would otherwise have been improper transactions. We accept that there were weaknesses in compliance systems within Operations: indeed, as KPMG's Skilled Person's Report observed, there were no controls in place to prevent such transfers. Nonetheless we accept Mr Challis's evidence that only the Asia II Desk had been using the Suspense Account in that way. Our conclusion therefore is that Mr Karpe had been exploiting the weaknesses in the UBS control systems. But that is no defence to the charge that his misuse of the Suspense Account had been for an improper purpose.

Misleading senior management regarding compensation paid to Customer B

82. In late 2006, Customer B requested that UBS lend him USD 5 million so that he could make an investment. Instead, UBS sold certain assets held by Customer B in order to raise the USD 5 million for the investment. UBS detected the error on 14 May 2007. Customer B suffered loss as a result of UBS' actions because the investments that had been sold outperformed the cost he would have incurred to borrow USD 5 million from UBS. Customer B requested full reimbursement of the losses, which totalled USD 194,426.

83. During 2007, Mr Karpe was instructed by certain individual senior managers at UBS ("Senior Management") to try to secure an agreement with Customer B whereby UBS would only reimburse 50% of the loss. On 3 August 2007, Mr Karpe informed Senior Management that Customer B had reluctantly agreed to accept 50% compensation. However, this was not the case as, on 24 July 2007, Mr Karpe had confirmed to Customer B that he would receive a full reimbursement of USD 194,426.

84. In September 2007, in accordance with their understanding of the settlement Mr Karpe had supposedly concluded, Senior Management approved the transfer of USD 97,213 to Customer B, the sum being 50% of his total loss. Unbeknown to Senior Management at UBS, on 28 September 2007, Mr Karpe

arranged for an additional transfer of USD 97,213 to be made from Customer A to Customer B, thereby fully compensating Customer B.

85. The case for the FSA in the Statement of Case is that Mr Karpe arranged for the additional transfer of USD 97,213 to be made from Customer A to Customer B in the knowledge that:

(a) Customer A had not authorised the transfer of USD 97,213 from its account;

(b) neither Senior Management nor anyone else at UBS had authorised the second transfer of USD 97,213 to Customer B (i.e. they had not authorised for Customer B to be paid 100% compensation);

(c) he had misled Senior Management into the false understanding that he had secured a settlement with Customer B to "only reimburse him" USD 97,213 when in fact he had already agreed to reimburse him USD 194,426.

86. The case for Mr Karpe is that his conduct should not be viewed in isolation and that he had taken the steps he did under pressure and to resolve a dispute which had been caused in a different UBS office and he had done so in what he had considered to have been the best interests of his colleague Laila Karan whose career was potentially threatened by the episode. His explanation to the FSA had been he had used "desk profits" made from the sale of excess shares that had been "accidentally purchased" for another client in order to fund the balance of the compensation.

Conclusions on the Customer B Compensation issue

87. We agree with the FSA that this matter demonstrates Mr Karpe's dishonesty and is clear evidence of his lack of integrity. Mr Karpe lied to senior management of UBS. He does not appear to have been under pressure to achieve a settlement. There is nothing to show that Ms Karan had been at risk of any serious criticism. There was no evidence to support the suggestion that Mr Karpe had used "desk profits" to pay the other 50%. The record shows that the money came from Customer A at Mr Karpe's express direction. This is evidence of dishonesty on the part of Mr Karpe which he has attempted to conceal by putting forward a different explanation after the event.

Involvement with Reliance ADAG and the Fund

88. Mr Karpe:

(a) directed the implementation of an investment structure to enable an Indian resident customer to breach Indian law in clear contravention of UBS's internal compliance rules ;

(b) wrongfully took steps to conceal the true nature of the customer's investment, including by the deliberate and repeated provision of false and/or misleading information to Compliance and

(c) effected unauthorised redemption payments from the Fund knowing, *inter alia*, that the redemptions were not properly authorised by the customer and that they breached UBS's internal compliance rules.

The investment structure

89. The customer in question was the Reliance ADAG Group ("Reliance ADAG"), a large group of Indian companies headed by Anil Ambani, a wealthy Indian individual. Reliance ADAG gave all of its instructions regarding investment decisions directly to Mr Karpe, who relayed the instructions to Jaspreet Ahuja a senior Client Adviser on the Asia II Desk.

90. Mr Ahuja had initially arranged for the Fund to be set up in Mauritius in February 2006 for another of the Desk's customers using a fund manager called Groupe Opportunité ("Opportunité" / the "Fund Manager") based in France with whom he had had prior dealings.

91. The Fund was established as a Protected Cell Company: i.e. a single legal entity comprising a series of self-contained cells. This structure allowed an investor to invest in a particular cell, the assets and liabilities of which were ring fenced from the rest of the company.

92. On or around August 2006, Reliance ADAG informed Mr Karpe that it wanted to invest in Reliance Communications Limited ("RCOM"), an Indian company within its own group. In order to facilitate this investment, Mr Karpe instructed Mr Ahuja to arrange for the Fund to create or activate a cell, ("Cell E") in the Fund for investment by Reliance ADAG. Mr Karpe envisaged that Cell E would then invest in RCOM securities through a vehicle known as a Foreign Institutional Investor ("FII").

93. Under an instrument of Indian law called the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations 1995 (as amended) (the "Indian Regulations"), an Indian person or company (whether resident or non-resident in India) is not permitted to invest in Indian securities through an FII vehicle except in particular circumstances (which are not relevant here). Such vehicles are designed so that non-Indian investors may make investments in Indian securities. Mr Karpe understood that Reliance ADAG would be prohibited by the Indian Regulations from investing in RCOM securities via an FII. He proposed to use the Cell E investment structure to conceal the fact that this investment was in fact being made by Reliance ADAG. In order to achieve this objective he proposed to conceal the fact that Reliance ADAG was the ultimate beneficial owner of Cell E.

94. Further, UBS's internal compliance rules provided that Compliance approval should be obtained prior to entering into cross-border business so as to ensure compliance with local law and regulation.

95. Mr Karpe understood that:

(a) Compliance approval was required if the proposed investment structure was to proceed;

(b) Compliance would examine the identity of the ultimate beneficial owner of the investment structure when considering whether to give its approval;

(c) Compliance would not give its approval if it knew that the ultimate beneficial owner was Reliance ADAG, which was an Indian investor.

96. Mr Karpe understood that in order to obtain Compliance approval he would have to conceal the fact that Reliance ADAG was the ultimate beneficial owner of Cell E.

97. Mr Karpe instructed Mr Ahuja to arrange an investment structure which would conceal the fact that the investment was being made by Reliance ADAG. He understood and intended that this would:

(a) assist Reliance ADAG in breaching the Indian regulations, and

(b) breach UBS's internal compliance rules.

98. Following the instructions of Mr Karpe, Mr Ahuja arranged for three companies within Reliance ADAG (Reliance Energy Limited, Reliance Natural Resources Limited and Reliance Energy Global Pte Limited, together the "Reliance Investors") to invest over USD 250 million in Cell E, which, in turn, invested in RCOM securities as described below, through FII vehicles. The Reliance Investors were the beneficial owners of Cell E.

99. As Mr Karpe knew, the structure was arranged so that it would appear that it was the Fund Manager who was directing Cell E's investments. In fact, the Fund Manager's role was merely to execute the instructions of Reliance ADAG or the Reliance Investors that had been passed to the Fund Manager via Mr Ahuja. In accordance with those instructions, Cell E invested in RCOM securities through FII vehicles.

100. As a result of Mr Karpe's provision of false information to Compliance, and his complicity in the provision of false information by Mr Ahuja:

(a) The Reliance Investors invested over USD 250 million in Cell E;
(b) Cell E used these monies to acquire RCOM shares and derivatives via FII vehicles; and

(c) The Fund opened an account with UBS Zurich for Cell E. RCOM shares and derivatives (and other assets) were held on this account. At certain times, the value of these assets exceeded USD 400 million.

Mr Karpe's concealment of the true nature of Reliance ADAG's investment

101. The Statement of Case makes the point that Mr Karpe knew that the use of Cell E of the Fund was not the first attempt to use an investment structure for Reliance ADAG for the purpose of breaching Indian law. The first, unsuccessful, attempt was a proposed investment for Mr Ambani and/or his family to invest in Indian securities using an insurance vehicle. To conceal the true nature of that investment, Mr Ahuja deliberately, and over a prolonged period, provided UBS' Legal and Compliance Department in Zurich ("Compliance Zurich") with false and/or misleading information. Mr Karpe was copied into all of the correspondence but did not correct the false information provided by Mr Ahuja. Mr Karpe also made misleading statements regarding the ownership of the proposed investment directly to Compliance in Zurich.

102. Mr Karpe subsequently instructed Mr Ahuja to implement the investment structure for Reliance ADAG using Cell E. Mr Ahuja took the following deliberate steps, of which Mr Karpe was, according to the Statement of Case, aware and in some of which he participated directly, to conceal the true nature of that investment:

(a) In December 2006 Mr Ahuja arranged for Reliance ADAG to invest in Cell E indirectly (via the purchase of structured notes by the Reliance Investors) rather than directly (by the purchase of shares in Cell E) to conceal the link between the customer and its investment;

(b) in December 2006 and January 2007 Mr Ahuja repeatedly provided UBS Singapore's account opening team and UBS' Legal and Compliance Department in Singapore ("Compliance Singapore") with false and/or misleading information in relation to the Fund;

(c) in January 2007 at Mr Karpe's instruction Mr Ahuja and other Asia II Desk staff routed payments from one of the Reliance Investors to Cell E through the account of an unconnected customer in breach of UBS compliance rules. At Mr Karpe's direction they created internal documents setting out false reasons for the transfers; and

(d) in September and October 2007, in order to open an account for Cell E at UBS Zurich, Mr Ahuja signed account opening documentation containing false and/or misleading information.

Proposed investment using an insurance vehicle

103. In January 2006, and again in June 2006, in the process of unsuccessfully seeking approval of a proposed investment structure using an insurance vehicle for Mr Ambani and/or his family to invest in Indian securities, Mr Ahuja deliberately provided false and/or misleading information to Compliance Zurich to conceal the identity of the prospective beneficial owner of the investment. Mr Karpe was copied into all of the correspondence but did not correct the false information provided by Mr Ahuja. Mr Karpe also made misleading statements directly to Compliance Zurich.

104. Mr Karpe was, so the Statement of Case claims, aware that:

(a) the approval of Compliance Zurich was required if the proposed investment structure was to proceed;

(b) Compliance Zurich would examine the identity of the ultimate beneficial owner of the proposed investment structure when considering whether to give its approval;

(c) Compliance Zurich would not give its approval if the ultimate beneficial owner was an Indian investor.

105. In an email exchange between Mr Ahuja and Compliance Zurich dated 31 January 2006, Mr Ahuja initially represented that a subsidiary of a global insurance group would be the beneficial owner of the proposed investment.

106. In a further email exchange dated 10 February 2006, Mr Ahuja represented to Compliance Zurich that the ultimate beneficial owner was not an Indian entity.

107. Mr Karpe was copied into all of the correspondence but did not correct the false information provided by Mr Ahuja.

108. These representations were untrue and the Statement of Case contends that Mr Karpe knew them to be untrue. Mr Karpe's intention was to mislead Compliance Zurich into believing that the investment was being arranged on behalf of a non-Indian investor.

109. In a further email exchange dated 8 and 9 June 2006, Mr Ahuja represented to Compliance Zurich that the beneficial owner of the proposed investment was a French national closely associated with an asset management company. Mr Karpe was copied into the correspondence but did not correct the false information provided by Mr Ahuja .

110. In a further email exchange on 9 June 2006, Mr Karpe represented to Compliance Zurich that the client was a French national and a fund.

111. The representations that the investor was a French national and a fund were untrue and, the Statement of Case alleges, Mr Karpe knew them to be untrue. The French national to whom Mr Karpe was referring was, the husband of the

Chief Executive of Opportunité. The fund to which Mr Karpe was referring was Opportunité. Mr Karpe knew that neither the husband of the Chief Executive nor Opportunité would have any beneficial interest in the proposed investment. The reference to be drawn from those events (so the Statement of Case contends) is that Mr Karpe's intention had been to mislead Compliance Zurich into believing that the investment was being arranged on behalf of a non-Indian investor. As Mr Karpe was aware, the beneficial owners of the proposed investments would be the Reliance Investors, and/or Mr Ambani and his family.

Investment through Cell E

112. As Mr Karpe knew, Mr Ahuja arranged for the Reliance Investors to invest indirectly in Cell E (rather than directly purchasing shares in Cell E) by subscribing to structured notes (the "Notes") issued by third party banks (the "Note Issuers") which referred to underlying shares in Cell E. The Notes conveyed all of the risk and reward of the shares in Cell E to the Reliance Investors. However, according to the Statement of Case, the strict legal ownership of those shares remained with the Note Issuers.

113. Between 4 December 2006 and 9 October 2007, the Reliance Investors invested over USD 250 million in Cell E in this way.

114. The Notes were, the Statement of Case contends, intended by Mr Karpe to disguise the link between Reliance ADAG or the Reliance Investors and Cell E.

The provision of false and/or misleading information to the UBS Singapore account opening team and Compliance Singapore

115. The Statement of Case contends that Mr Ahuja unsuccessfully attempted in December 2006 to open an account with UBS Singapore to hold Cell E assets relating to a proposed derivatives transaction (the "Singapore Account"). When he was doing this, and as Mr Karpe was aware, Mr Ahuja deliberately provided the account opening team at UBS Singapore and Compliance Singapore with false and/or misleading information in order to conceal the identity of the beneficial owner of Cell E.

116. Mr Karpe, so the Statement of Case contends, was aware that:

(a) the approval of Compliance Singapore was required if the Singapore Account was to be opened and the proposed derivatives transaction was to proceed;

(b) Compliance Singapore would, in the context of the proposed derivatives transaction, examine the identity of the ultimate beneficial owner of the Singapore Account when considering whether to give its approval; and

(c) Compliance Singapore would not give its approval if the ultimate beneficial owner investing in the derivatives transaction was an Indian investor.

117. In a series of emails between 19 December 2006 and 3 January 2007, Mr Ahuja represented to Compliance Singapore that two French nationals were the beneficial owners of Cell E.

118. On 20 December 2006, Mr Ahuja completed and signed two Client Profile and Acceptance Checklists as part of UBS' account opening documentation. These documents represented that the Chief Executive of Opportunité and her husband were the beneficial owners of Cell E.

119. Mr Karpe was copied into the email correspondence and Mr Karpe also signed the Client Profile and Acceptance Checklists, although he did not date his signatures. Mr Karpe deliberately did not correct the false information provided by Mr Ahuja.

120. These representations were untrue, so the Statement of Case alleges, and Mr Karpe knew them to be untrue. Mr Karpe supported Mr Ahuja in maintaining these representations even when challenged forcefully by Compliance Singapore as to their veracity. Mr Karpe's intention was to mislead Compliance Singapore into granting approval for the proposed new account.

Use of the Customer Q account to conceal the link between Reliance ADAG and the Fund

121. In January 2007, USD 68 million was transferred from Reliance Natural Resources Limited ("RNRL"), one of the Reliance Investors, to Cell E's account with a third party bank. The Statement of Case alleges that, in order to conceal the link between RNRL and Cell E, Mr Karpe caused the payment to be routed via the account of another UBS WM customer, Customer Q, which was not connected to Reliance ADAG in any way, and was unaware of the transactions made through its account.

122. Mr Karpe caused two payments totalling USD 68 million to be made from RNRL to Customer Q, and from Customer Q to Cell E:

(a) On 3 January 2007, USD 18 million was transferred from RNRL to Customer Q, and the same amount was transferred from Customer Q to Cell E; and

(b) On 11 January 2007, USD 50 million was transferred from RNRL to Customer Q, and the same amount was transferred from Customer Q to Cell E.

123. In respect of the payment on 3 January 2007 of USD 18 million from RNRL to Customer Q and from Customer Q to Cell E, Mr Karpe caused the following to occur:

(a) On 3 January 2007, Mr Ahuja signed a payment instruction, transferring USD 18 million from RNRL to Customer Q;

(b) On 3 January 2007, Mr Ahuja created a telephone note which falsely recorded that Mr Karpe had been instructed in a meeting in India with RNRL to transfer USD 18 million to Customer Q to fund a joint bid being made for a company by RNRL and Customer Q;

(c) On 3 January 2007, a client adviser assistant on the Asia II Desk, falsely recorded that the beneficial owner of the Customer Q account had instructed an Asia II Desk client Adviser, to transfer USD 18 million to the Fund's account with another bank in Mauritius and that Mr Karpe had called the owner of the Customer Q account to confirm the instructions.

124. In respect of the payment on 11 January 2007 of USD 50 million from RNRL to Customer Q and from Customer Q to Cell E, Mr Karpe caused the following to occur:

(a) On 11 January 2007, Mr Ahuja completed a Payment Due Diligence form for the payment of USD 50 million. Mr Ahuja falsely recorded on the form that he had received instructions to make the payment from Mr Karpe who had in turn received the instructions from the client (i.e. RNRL);

(b) On 11 January 2007, Mr Ahuja signed a Payment Instructions form for the transfer of USD 50 million from RNRL to Customer Q;

(c) On 11 January 2007, Mr Ahuja created a telephone note which falsely recorded a purported instruction from RNRL to Mr Karpe to transfer a further USD 50 million from RNRL to Customer Q to assist in an acquisition that RNRL was attempting to make; and

(d) On 11 January 2007, another client adviser working on the Asia II Desk, wrote on the payment instruction form for the transfer of USD 50 million from Customer Q to Cell E that Mr Karpe had confirmed the instructions with the client and that the amount was "*OK to pay*".

125. The Statement of Case concludes on this topic with the following points. Mr Karpe instructed Mr Ahuja and other staff on the Asia II Desk to effect these payments and to falsely record the purported instruction from RNRL. He did so in order to disguise from Compliance the fact that RNRL was making payments into Cell E, and also to disguise the true identity of the beneficial owner of Cell E from external regulatory scrutiny. Mr Karpe knew that the

money was in fact being transferred to Cell E to fund the purchase of RCOM securities, which he understood to be a breach of the Indian regulations.

The provision of false and/or misleading information to Compliance Zurich

126. In September 2007 Mr Karpe and Mr Ahuja applied to open an account for Cell E at UBS Zurich to hold Cell E assets. Mr Karpe was (it is alleged) aware that:

(a) the approval of Compliance Zurich was required if the Zurich Account was to be opened;

(b) Compliance Zurich would examine the identity of the ultimate beneficial owner of the proposed account when considering whether to give its approval; and

(c) Compliance Zurich would not give its approval if the ultimate beneficial owner was an Indian investor.

127. Around September and October 2007 Mr Karpe signed the following documentation:

(a) UBS's Due Diligence Form for Sensitive Clients (exact date of signature unknown), which represented that the beneficial owners of the Fund were eight institutional investors (i.e. the Note Issuers); and

(b) UBS' Verification of the Beneficial Owner's Identity form, which again listed the Note Issuers as the beneficial owners of the Fund. Mr Karpe signed this document on an unknown date between 12 September 2007 and 1 October 2007.

128. It is alleged that Mr Karpe knew that these representations were false, and that Reliance ADAG was the beneficial owner of Cell E. Moreover, as Mr Karpe knew, these institutional investors were no more than the issuers of the structured notes through which the Reliance Investors had invested in Cell E. This structure had, it is alleged, been used to conceal the link between Reliance ADAG and Cell E.

Conclusion on the Allegations

129. For Mr Karpe it is contended that he had not been involved in setting up the Fund, and his involvement in setting up Cell E in that fund had been peripheral, as his knowledge and understanding of such structures had been limited. The reality, he contends, is that the Fund and Cell E within the Fund had been principally set up, implemented and coordinated by Mr Ahuja. To the extent that he had been involved, Mr Karpe's case runs, he had not known that the structure breached Indian law. What was more, the use of FII structures for Indian resident investors was commonplace within UBS and that

was well known to senior management. In particular, far from it being deliberately concealed from Compliance, senior management within UBS (including Mr Kurt Kumschick) knew of the Fund's existence and moreover knew the identity of the individual behind Cell E.

130. For the FSA we were taken through emails relating to the setting up of the Fund. These satisfy us that Mr Karpe and Mr Ahuja had made several unsuccessful attempts to set up an investment structure to allow a major client, Mr Ambani and his family companies (the Reliance Group) to invest in Indian securities in breach of the FII regulations. Both Mr Karpe and Mr Ahuja had, we are satisfied, appreciated that it would be necessary to mislead Compliance as to the identity of the beneficial owner of such investments if Compliance approval were to be obtained for this transaction. During the Relevant Period, Mr Ahuja had been client adviser on the Reliance account and Mr Karpe had been the main point of contact. Mr Karpe and Mr Ahuja had had to resort to an indirect investment under which the Reliance Investors had invested USD 250m in the Cell E structure which had been used to acquire, among other things, Indian equities and synthetic equities swaps. Our attention was drawn to a number of emails. There had been an approach to Compliance in Zurich in January 2006, copied to Mr Karpe, in which Mr Ahuja had informed Mr Kumschick that he had been working with Mr Karpe on a structure/solution for the mega client whom he had met in December 2005 to facilitate their investing in Indian equities. There had been an approach to Zurich in June 2006, again copied to Mr Karpe, in which Mr Ahuja had revived his conversation with Compliance in Zurich. In that email message, an attempt had been made to mislead Compliance as to the true identity of the beneficial owner. In fact Mr Karpe must, we think, have known that the ultimate beneficial owner had been Mr Ambani family/Reliance. Then there had been an approach to Compliance in Singapore in December 2006. This message from Mr Ahuja had attempted to open an account for the investment fund set up in Mauritius. The correspondence relating to this had been all conducted in email and copied to Mr Karpe. We note also that in September 2007, Mr Karpe and Mr Ahuja had applied to open an account for the Fund at UBS Zurich.

131. The information from the email messages, summarised above, satisfies us that Mr Karpe had been aware of the setting up of the Fund and Cell E. They show that Mr Ahuja had in effect been Mr Karpe's subordinate in the operation and that Reliance had been Mr Karpe's contact. We infer that Mr Karpe must have known that Indian nationals could not invest in Indian securities through FIIs having regard to the length of his time serving as a client adviser for Indian clients. Moreover, irrespective of what Mr Kumschick may have known or approved, Mr Karpe must have known that he needed approval from Compliance and, in order to get it, he had, we think, been prepared to mislead Compliance repeatedly.

132. Mr Karpe has not provided any evidence to rebut the inferences that the FSA have, in their Statement of Case, sought to sustain. Consequently our

conclusion on the point is that Mr Karpe deliberately concealed what he had been doing from Compliance. He must have known that what he was doing was wrong having regard to the further fact that he had disguised the investment by Reliance in Cell E, not only by making the investment through structured notes, but also by routing the money through the other (unconnected) client account, known as Customer Q. In this connection we refer to the two payments from Reliance that had been routed through Customer Q, namely USD 18m on 3 January 2007 and USD 50m on 11 January 2007.

Unauthorised redemption payments from Cell E to Customer A

133. Between September 2007 and January 2008, Mr Karpe instructed Mr Ahuja to arrange for three redemption requests to be made to Cell E, which resulted in six payments totalling USD 8 million to be made from Cell E to the Customer A account. There was (it is pointed out in the Statement of Case) no connection between Cell E or its beneficial owner, Reliance ADAG, and the Customer A account; Customer A did not invest in Cell E. Reliance ADAG was not aware of the payments that were made to Customer A.

134. Between 24 September and 23 October 2007 four payments of USD 1 million were made from Cell E to Customer A.

135. The total of USD 4 million was principally used to:

(a) Pay the additional compensation of USD 97,213 to Customer B (see paragraph 84 above); and

(b) repay Purported Loans between Customer M and Customer C totalling USD 3.5 million (including approximately USD 500,000 interest).

136. On 15 November 2007, a payment of USD 2 million was made from Cell E to Customer A. The money was principally used to:

(a) Make a payment of USD 1 million to Customer P's account clearing a loss on that account in order to allow it to be closed; and

(b) repay Purported Loans between Customer C and Customer O totalling USD 1.095 million including interest (see paragraph 53(f) above).

137. On 11 January 2008, a payment of USD 2 million was made from Cell E to Customer A.

138. Mr Karpe orchestrated the redemptions from Cell E to Customer A despite knowing that:

(a) Reliance ADAG and the Reliance Investors were unaware of the redemptions and had not authorised them;

(b) The redemption payments were not made to Reliance ADAG or the Reliance Investors as they should have been, but were instead transferred to the account of an unconnected customer, Customer A, and were then used to conceal losses from unauthorised trading conducted by Mr Karpe.

Conclusion on unauthorised redemption payments

139. We agree with the FSA. The unauthorised redemptions provide an example of Mr Karpe appropriating funds from one account (Cell E) to cover up losses in another completely unconnected account (Customer A). That the funds moved in the manner explained in the Statement of Case is not in dispute.

140. We refer in this connection to an email trail of messages between Mr Karpe and Mr Ahuja in late 2007. These show Mr Karpe expressing concern that by creating a document trail that evidences a redemption from Cell E, one of the financial institutions involved in the structure might discover that the USD 8m drawn from Reliance's investment did not in fact go to Reliance. That of itself indicates Mr Karpe knew that what he was doing was wrong. This issue shows a further breach on Mr Karpe's part of Principle 1.

Breach of APER Statement of Principle 1

141. The findings and conclusions set out above satisfy us that Mr Karpe's conduct demonstrates that he acted without integrity in carrying out his controlled functions in breach of APER Principle 1. The Authority may impose a penalty of such amount as it considers appropriate pursuant to section 66(3) of the Act, in that, in the course of carrying out his controlled functions at UBS, Mr Karpe:

(a) carried out Unauthorised Trading on various customer accounts which resulted in substantial losses;

(b) facilitated the movement of funds between accounts by various means to disguise losses which had arisen as a result of his Unauthorised Trading;

(c) misused the Suspense Account to facilitate the disguising of losses;

(d) misled senior management at UBS regarding settlement discussions that he had been given the responsibility to conduct;

(e) directed the implementation of an investment structure for a customer, via the Fund, for the purpose of enabling that customer to breach Indian law; and

(f) arranged for the redemption of shares from the Fund to an unconnected customer despite being aware that the redemption was not properly authorised for the purpose of disguising losses.

In reaching that conclusion we mention that we are, for the reasons that now follow, against Mr Karpe on the legal arguments that there is no basis in law for imposing any penalty.

Mr Karpe's argument on the law

142. The case for Mr Karpe is that, as regards the penalty for misconduct, the FSA does not have the statutory power to impose one: or at least that the power is considerably limited. This is because most if not all of the matters to which the misconduct is said to relate fell outside the scope of Mr Karpe's controlled function and his conduct is therefore outside the FSA's disciplinary reach.

143. The primary argument runs on these lines:

(i) For a person to be guilty of misconduct he must, while an approved person, have failed to comply with a Statement of Principle: see section 66(2).

(ii) The Statement of Principle which Mr Karpe is said to have breached is Principle 1, i.e. a failure to "act with integrity in carrying out his controlled function": APER 2.1.2.

(iii) The Controlled Function applicable to Mr Karpe (with effect from 1 November 2007) was CF30 being a "customer function". This is stated in SUP 10.10.7AR as being the function of "advising on investments" and "performing other functions related to this such as dealing and arranging".

(iv) SUP 10.10.7A is limited precisely to advising on investments and performing other functions related to this, such as dealing or arranging. It cannot cover routine managerial functions and "back office" functions; those are not within the ambit of controlled functions at all.

144. With regard to pre-November 2007 activities the controlled function applicable to Mr Karpe was CF21 (Investment Advisers). This is stated in SUP 10.10.7 (as it read until 31 October 2007) to be the function of "advising on investments" and "performing functions within the customer trading function in connection with advising on investments" (i.e. "dealing and arranging deals in investments with or for … customers" (see SUP 10.10.16R)).

The FSA's response to the primary argument

145. The purpose of SUP 10.10.7 (and SUP 10.10.7A) is, say the FSA, to identify in precise terms the core functions that are controlled. The critical words in Statement of Principle 1 of APER, however, are directed at the performance or carrying out of those controlled functions which involves an approved person doing more than simply undertaking the core functions themselves. That approach is reinforced by SUP 10.10.4R (which has remained in being throughout the Relevant Period). This sets out the scope of performing or carrying out a customer function. The phrase "carrying out" is, we note, used in APER interchangeably with the term "performance". For present purposes we regard the two words as having the same effect. SUP10.10.4R provides that a "customer function … will involve the person performing it in dealing with clients, or dealing with property of clients, of a firm in a manner substantially connected with the carrying on of a regulated activity of the firm". The argument for Mr Karpe, as observed for the FSA, gives this rule no substantive effect at all. The FSA further contend that their approach to the construction and application of Principle 1 is not only preferable as a matter of interpretation: it is preferable as a matter of common sense.

Discussion

146. The case for Sachin Karpe, that much of the misconduct falls outside the scope of his controlled function and is therefore outside the FSA's disciplinary reach, raises an important issue which we now examine.

147. The actual question for us is whether, as the FSA alleges, Mr Karpe is guilty of misconduct. To make good its case the FSA has to satisfy us that Mr Karpe, to use the words of section 66(2), "while an approved person … has failed to comply with a Statement of Principle". Statement of Principle 1 to which the present charge relates, states that – "An approved person must act with integrity in carrying out his controlled function". Mr Karpe's controlled function is essentially that of advising clients on investments and dealing or arranging deals in investments with or for clients. Thus the FSA has to satisfy us that Mr Karpe failed to act with integrity in carrying out his controlled function of advising on investments and arranging deals for clients. We therefore have to determine what acts and activities the controlled function necessarily requires for its proper performance and whether Mr Karpe has failed to act as so required.

148. To start with the controlled function, section 59 of the Act contains the primary legislation governing approval. In principle UBS, being an authorised person, is required by subsection (1) to ensure that no person, such as Mr Karpe, performs a controlled function in relation to the carrying on of its regulated activity unless the FSA has approved the performance by him of the controlled function. Subsection (4) empowers the FSA to specify a description of function subject to the constraints in subsections (6) and (7) (relevant to the present situation where the person in question, Mr Karpe, is

not exercising a significant influence function) that the function will involve him in dealing with customers of the authorised person (i.e. UBS) or property of such customers "in a manner substantially connected with the carrying on of" its regulated activity.

149. The FSA rules made under section 59(3) created the function. The ambit of the "customer function" is set out in the Supervision Handbook at rule SUP 10.10. They have already summarised the CF21 and CF30 functions.

150. The controlled function for which Mr Karpe's approval was granted was advising on investments and arranging deals in investments of UBS's customers in a manner substantially connected with the carrying on by UBS of its regulated activity. That is the core activity. It must, as we have already observed, include the performing of activities necessarily required for the carrying out of the core elements. There is no dispute that Mr Karpe undertook to carry out, and did perform or carry out, CF30 and CF21 functions.

151. Turning to the Statement of Principle provisions in APER, Mr Karpe as an approved person is required to act with integrity in carrying out the controlled function of advising on investments and arranging deals for clients. The question is whether in carrying out the activities complained of (e.g. unauthorised trading, arranging or purporting to arrange unauthorised loans and guarantees and settling a dispute between UBS and a dissatisfied customer by paying him out of clients' funds) Mr Karpe has failed to act with integrity in performing or carrying out a controlled function.

152. All depends on what meaning is to be given to the expression in Statement of Principle 1 "in carrying out his controlled function". It is, we recognise, capable of bearing two meanings. The first is – "in carrying out" those functions that fall precisely within the terms of the relevant prescription of controlled function, i.e. advising clients on investments and dealing or arranging deals and investments with or for clients. The second is – in carrying out activities that are necessary and incidental to the role of an investment adviser.

153. The first construction, preferred by Mr Karpe, leads (it is argued for him) to the exclusion from CF21 and CF30 of:

(i) The majority of the alleged unauthorised trading involving FX spot trading. This is because, it is argued for Mr Karpe, FX is not an investment.

(ii) Resolving problems resulting from losses on FX whether by use of Suspense Account or by lending (or purporting to do so) because, it is said, those are on any basis outside the scope of approval of a UBS employee.

(iii) Signing letters of guarantee and arranging lending. These, it is said, involve no investment activity.

(iv) Settling the dispute with Customer B.
(v) Designing and running vehicles created for Indian investors.

Moreover, it is said, the first construction reflects the reality of Mr Karpe's position as a "desk head". As the team manager he is distanced from the actual provision of advice and from the actions involved in dealing or arranging deals. The desk head role is covered, if at all, by the Statements of Principle which relate to approved persons performing a significant influence function. Mr Karpe is not one. Further the role of establishing new products was not, as Mr Bernhard Buchs (the Global Head of Risk and Compliance for UBS WM during the Relevant Period) explained, within the responsibilities of client advisers or desk heads in connection with their controlled function.

154. The second construction, as relied on by the FSA, is set out in paragraph 155 above.

Conclusions on primary issue as to whether Mr Karpe's actions were in breach of SUP 10.10.7 and 7A

155. We prefer the FSA's construction. We are concerned here with the question whether Mr Karpe has failed to act with integrity in "carrying out his controlled function" such that he is guilty of misconduct under section 66(2) FSMA. The controlled function in SUP 10.10.7 and 7A is defined, so far as is relevant to the present situation, by reference to the performance of functions in connection with and in relation to investments. That defines the core function. But, in determining whether in performing the core function a person has "carried out" his controlled function, for the purposes of Principle 1, the analysis of what has or has not been performed must inevitably go wider. Take, for example, the case of an adviser who has to provide the client with account statements and trade confirmations. The provision of such documents in itself does not fall within the strict meaning of "advising on investments": but it does fall within the scope of performing or carrying out that function. The provision of such material is required by the function.

156. SUP 10.10.7R is a rule and it reflects the wording of the primary legislation and through SUP 10.10.4 it incorporates the conditions set out in section 59(6) and (7) of the Act. It recognises in terms that the relevant function has to be performed and that the nature will be in a manner substantially connected with the "carrying on" of the firm's regulated activity. So understood, the duty of integrity under Statement of Principle 1 must be taken to apply to those activities that are necessary and incidental to the role of investment adviser. That interpretation is consistent with the words of APER 1.1.2G which explains that the "Statements of Principle apply only to the extent that a person is performing a controlled function for which approval has been sought and granted"; and those words show how the Statements of Principle are concerned with conduct that takes place in performing or carrying out a controlled function as much as with the controlled function itself.

157. Moreover, in this connection we mention that the preferred interpretation is consistent with the "Code of Practice" used by the FSA to assist with identifying breaches of the Statements of Principle. Section 64(2) of the Act directs that, where the FSA issues any statement of principle, it must also issue "a code of practice for the purpose of helping to determine whether or not a person's conduct complies with the statement of principle". The FSA's code appears in APER. As empowered by section 64(3) of the Act, the code sets out "descriptions of conduct which, in the FSA's opinion, do not comply with the relevant Statements of Principle" and "certain factors which, in the opinion of the FSA, are to be taken into account in determining whether an approved person's conduct complies with a particular Statement of Principle" (APER3.1.1G).

158. The Code of Practice sets out a non-exhaustive list of conduct which constitutes a breach of APER Principle 1. The conduct listed in the Code of Practice covers a wide range of things that may happen in the course of performing a controlled function. The relevant conduct for present purposes includes:

- Misleading (or attempting to mislead) by act or omission a client or his firm or the FSA (APER 4.1.3E).
- Falsifying documents (APER 4.1.4(1)E).
- Providing false or inaccurate documents or information to the client, firm or the FSA (APER 4.1.4(9)-(11)).
- Failing to inform without reasonable cause, a customer, the firm or the FSA of the fact that their understanding of a material issue is incorrect despite being aware of their misunderstanding (APER 4.1.6E).
- Failing to disclose the existence of falsified documents (APER 4.1.7E) and deliberately preparing inaccurate or inappropriate records or returns in connection with the controlled function (APER 4.1.8E).
- Preparing inaccurate trading confirmation, contract notes or other records of transactions or holding of securities for a customer, whether or not the customer is aware of these inaccuracies or has requested such records (APER 4.1.9E).
- Misappropriating a client's assets (APER 4.1.11E), wrongly using one client's funds to cover trading losses on another client's account or on firm accounts (APER 4.1.11E) and using a client's funds for purposes other than those for which they were provided (APER 4.1.11E).

159. Regarding those matters listed in the Code of Practice, it is argued for Mr Karpe that reliance should not be placed by the FSA on them. They are merely assertions of the FSA's opinion as to the scope of Principle 1. We disagree. We see the text of the Code of Practice as essential to the construction of the Statements of Principle themselves. We note that under section 64(2) FSMA that the FSA is required to issue a Code of Practice when it issues any Statement of Principle. Here, the Code of Practice, in common with the Statements of Principle, was created pursuant to the power in section

64 and in furtherance of the general function of the FSA as prescribed in section 2(4). The particular items of conduct in the Code of Practice in APER 4.1 (set out above) are designed to cover, non-exhaustively, a range of actions that will be necessary and incidental to the performance of a CF21 and CF30 controlled function. The Statements of Principle and the Code of Practice must therefore be read as a whole. As so read, they support the construction of Principle 1 advanced by the FSA.

160. Turning now to the specifics, the controlled function for which Mr Karpe was approved was advising on investments and dealing and arranging deals in investments, being in all cases a function that was to involve him in dealing with customers of UBS and with their property in a manner substantially connected with the carrying on of its regulatory activity.

161. That Mr Karpe did perform the core elements of the CF21/CF30 functions is not in dispute. UBS's regulatory activity was providing investment services to clients: and in conducting this activity it imposed on those of its staff employed as client advisers the requirement that they were approved. A description of the relevant business of UBS is found in the FSA KPMG's Skilled Person's Report which identified the relationship between UBS and its clients as follows:

> "**trading/managing/dealing –** This stage covers the on-going and day-to-day activity on the client account. This can cover trading activity covering a variety of products such as equities, bonds, structured products, alternative investments and derivatives, the provision of credit facilities, processing of payments to external counterparties and physical withdrawals of cash from the account. This stage of the client life cycle will be characterised by on-going interaction between the client and the Client Adviser.
>
> **administration** – This supports the relationship with the client and the activity on the client's account. It covers a variety of activities including client reporting (valuation statements, transaction reports etc), the use of retained mail facilities, the application of fees to the client's account and transfer of assets both internal and external between client accounts and to external parties. These activities are generally carried out by specialist support teams rather than the Client Adviser.
>
> **annual client reviews –** The Bank needs to regularly review its relationship with each client, and review the activity on each client account annually to ensure that their knowledge of the client is up-to-date and the activity on the account is in accordance with this knowledge."

The clients of UBS who were affected by Mr Karpe's conduct were using their accounts for the investment of their personal wealth. In particular they were,

as appears from the "Client Opening Forms" put in evidence and from the list of investment products in the "remediation" statements prepared following the Deloitte enquiry, using the services of UBS to buy and hold for their accounts a wide variety of investment products covering derivatives, structured products and bonds as well as equities.

162. It seems to us that all the activities that Mr Karpe performed in dealing with clients and dealing with property of clients were performed in a manner substantially connected with UBS's regulated activity. Mr Karpe failed therefore to act with integrity in carrying out his controlled function.

Penalty

163. The case for Mr Karpe is that the penalty of £1,250,000 is excessive. He seeks to mitigate this. The reasons that follow are similar to those put forward as his defence to the particular charges made against him.

164. First, it is argued for Mr Karpe, the FSA has not established the extent to which the trades for which Mr Karpe was responsible were unauthorised. The FSA cannot rely on the absence of documentation recording client instructions because, as regards trades put to the trading desk, UBS's systems and controls allowed these to be carried out without client instructions having to be recorded at that particular point. Not all the clients had, it was observed, provided reliable accounts of their trading relationships with UBS. Moreover the Deloitte remediation exercise proceeded on the presumption that all the trades were unauthorised unless documentation could be produced to demonstrate the contrary. For those, among other reasons, the "losses" to the clients resulting from unauthorised transactions and transfers of cash should be regarded as considerably less than the USD 42m paid by UBS as compensation to the affected clients.

165. The second point taken from Mr Karpe related to the shortcomings in the internal systems and controls of UBS. These, it was argued, had contributed to the losses caused to the Affected Customers. The use of the Suspense Account by Mr Karpe was unusual rather than improper and the "Operations" team that "owned" the Suspense Account (to use Mr Challis's term) knew of its use by him and did not question that use.

166. Third, it was argued for Mr Karpe, the FII structure had been set up by Mr Ahuja and there was no documentation in evidence that showed that Mr Karpe had communicated with the relevant entities within the structure. It was suggested that senior management within UBS, being senior to both Mr Karpe and Mr Ahuja, had actually given the directions relating to the setting up and implementation of the FII structure; and in any event the FII regulations were difficult to understand and constantly evolving. Moreover FII structures were in relatively widespread use within UBS; for example there had been 14 "cells" of the Fund and only one had been the subject of the present allegation of misconduct.

167. We are satisfied that Mr Karpe was responsible for unauthorised transactions and transfers between clients of a substantial aggregate amount. We cannot be any more certain than were Deloitte when compiling the "remediation" statements as to the actual loss to particular clients. But the scale of the unauthorised operations attributable to Mr Karpe is large enough and continued over a long enough period to justify a substantial penalty.

168. We accept that the compliance and compliance monitoring failings on the part of UBS may have created an environment within which staff of UBS could get away with wrongdoing. But that does not excuse the wrongdoing.

169. So far as the setting up and implementation of the FII structure is concerned, we see Mr Karpe's involvement as that of deliberately misleading UBS's compliance in order to accommodate a major client of his. He, with a long and successful experience of handling accounts on behalf of resident and non-resident Indian clients, lied to Compliance about the true identity of the relevant beneficial owner and that had been his initiative. Whatever the views of a manager based in Singapore (and senior to Mr Karpe) might have been about whether he would sanction an investment structure for Reliance (different to that which was ultimately implemented), that would not however have excused Mr Karpe from deliberately misleading UBS's Compliance.

170. We find no grounds for mitigation in those circumstances. In support of Mr Karpe, however, it had been further emphasised that he had been acting in the best interests of his clients, e.g. to replenish their losses. That, we observe, may have been true of some clients, but others lost out heavily as is evident from the accounts given above about the Customer C and the Customer A investments.

171. In our opinion the fine imposed in the Decision Notice of £1.25m is appropriate to the circumstances. In reaching this conclusion we have taken into account the scale of the losses that resulted from Mr Karpe's carrying out of unauthorised transactions and transfers between clients over many years. We think that Mr Karpe induced others serving on his desk to participate in what was an obviously dishonest course of conduct. He has not cooperated with the FSA. We recognise that this is not a case for fixing the penalty at an amount designed to produce "disgorgement" of ill-gotten gains. Nonetheless Mr Karpe has admitted to benefitting indirectly in the sum of £30,000 (after tax). And we infer that the whole motivation was to benefit him indirectly and in the long term by obtaining new clients through his apparent prestige, increasing funds under management and thereby advancing his career and increasing his bonuses.

Should it be relevant to take account of any verifiable hardship that Mr Karpe can show that he will suffer?

172. In common with the FSA we are not satisfied that the evidence of means supplied by Mr Karpe is complete. Mr Karpe has not come to give evidence. He could have and has chosen not to. For what it is worth however we mention his account in a (fourth) affidavit that he now works as a consultant for a boutique investment company (Altamount) from which he receives a monthly fee of £3,184 (i.e. 250,000 rupees). He says he also receives 150,000 rupees as consultancy fees from a business called HLA which provides guidance on business strategy, marketing and hiring; but in a more recent affidavit, Mr Karpe says the HLA fee has not been paid for five months and that Altamount is currently facing a grim deterioration and that Mr Karpe's consultancy fee for four months of 2011 has not been paid. However, Mr Karpe and his wife's RBS bank statement for July-September 2011 shows a total expenditure of £63,678. On that basis, expenditure has exceeded disclosed quarterly income by some £53,000. That suggests, it was pointed out for the FSA, that Mr Karpe is either living beyond his means or is not being open about his assets and sources of income. In that connection we note that we have been given no details about three other bank accounts admitted to be (or have been) Mr Karpe's. It is not disputed that £2,000 in cash was drawn at St Johns Wood in July 2011 from the joint account Mr Karpe held with his wife. In an earlier statement he referred to an art collection worth £500,000 to £1m. In his most recent affidavit he says that it is currently worth £100,000.

173. Because of those inconsistencies and apparently incomplete disclosures of means we are unable to accept that there is verifiable evidence showing hardship to Mr Karpe if he were to be penalised in the amount of £1.25m.

Direction

174. We direct the FSA to impose a financial penalty of £1.25 million.

Note concerning anonymisation

175. At the start of the hearing of this reference, and following submissions from the press, this Tribunal issued a direction restricting the reporting of the names of "actual or prospective clients of UBS or any related party of such". We have anonymised references to UBS clients (using the term Customer A, Customer B etc) save as regards those clients and clients' companies that have already been identified through articles in the press.

SIR STEPHEN OLIVER QC
JUDGE OF THE UPPER TRIBUNAL
RELEASE DATE: 15 May 2012