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# Revocation of Carnegie Investment Bank AB's permit

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DECISION

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# Revocation of Carnegie Investment Bank AB's permit

**The Financial Supervisory Authority's decision**
**(to be announced today at 3pm)**

1. The Financial Supervisory Authority revokes, with the support of ch. 15 Section 1, second paragraph of the Act (2004:297) on banking and financing operations, the license for Carnegie Investment Bank AB (516406-0138) to conduct banking operations.

2. The Financial Supervisory Authority revokes, with the support of ch. 25 § 1 of the law (2007:528) the securities market, Carnegie Investment Bank AB's (516406-0138) all permits to conduct securities business. The permits refer to
   a) receipt and forwarding of orders in respect of one or more financial instruments according to ch. 2 1 § 1 of the Securities Market Act,
   b) execution of orders regarding financial instruments on behalf of customers according to ch. 2 1 § 2 of the Securities Market Act,
   c) trading in financial instruments for own account according to ch. 2 1 § 3 of the Securities Market Act,
   d) discretionary portfolio management regarding financial instruments according to ch. 2 1 § 4 of the Securities Market Act,
   e) investment advice to customers regarding financial instruments according to ch. 2 1 § 5 of the Securities Market Act,
   f) providing guarantees regarding financial instruments and placement of financial instruments with a firm commitment according to ch. 2 1 § 6 of the Securities Market Act, and
   g) placement of financial instruments without firm commitment according to ch. 2 1 § 7 of the Securities Market Act.

3. The Financial Supervisory Authority orders that Carnegie Investment Bank AB's (516406-0138) permission to be registered as manager of fund units according to ch. 4. Section 12 of the Act (2004:46) on investment funds expires in connection with the revocation decision in point 2.

4. The decisions in points 1-3 shall apply immediately.

5. Carnegie Investment Bank AB (515406-0138) must, no later than six (6) months after the date of the decision, inform the Financial Supervisory Authority that the activity requiring a permit has been discontinued. The information must be confirmed by the company's auditor.

6. The Financial Supervisory Authority decides with the support of ch. 15 § 4 first paragraph of the Act on Banking and Financing Operations and ch. 25 Section 6, first paragraph, of the Act on the securities market, that the liquidation of the business must take place in accordance with the conditions specified in**Appendix 1**. Carnegie Investment Bank AB must submit, no later than one month after the date of the decision, a specification of how the liquidation will be handled.

The decision can be appealed to the county court, see**appendix 2**.

# Summary

### The earlier warning and FI's supervision

Carnegie Investment Bank AB (Carnegie or the bank) was given a warning by the Financial Supervisory Authority's (FI) decision on 30 September 2007. The basis for the decision was, among other things, that Carnegie had broken down in its internal governance and control, which in turn meant that the bank lacked the ability to manage the risks inherent in the business. FI found grounds for revoking the bank's permit, but judged that the bank's action plan, in combination with the board and CEO being replaced, made it possible to stop at a warning.

Carnegie has worked on implementing its action plan and FI has followed the work in its supervision. A final assessment was planned for the end of 2008. In parallel with this follow-up, FI has also had reason to follow the bank's credit exposure to an individual customer. FI received information in July 2008 that the exposure, due to the deterioration of the collateral for the credit, had become too large. However, according to reports from the bank, the exposure returned to permitted values. In another supervisory matter concerning the bank's subsidiary, Carnegie Fond AB (556527-9642) (the fund company), FI discovered in its supervision that the fund company, contrary to express legal prohibition, outsourced the management of its funds to the bank. During 2008, FI thus had several ongoing cases regarding Carnegie.

## Recent events

During September-October 2008, the situation on the financial market worsened. At the same time, FI received information that Carnegie was beginning to have difficulties in obtaining liquidity to fulfill its commitments. FI again received a notification from the bank that the large exposure to a customer had exceeded permitted limits. Against this background, FI deepened its review and carried out on-site visits to the bank. The situation became critical and the bank then applied for special liquidity support from the Riksbank. This meant focusing on the bank's ability to fulfill its obligations. The observations made in the ongoing supervision and during site visits are the basis for this decision.

#### Unauthorized high exposure

The investigation shows that Carnegie had an impermissibly large exposure to a single customer. The exposure arose, as this investigation shows, in July 2008. The main reason was that the collateral the bank had for the commitment deteriorated in value, which had the effect that the bank's risk exposure to the customer increased to the same extent. According to the bank, some of the securities were sold, which had the effect of bringing the exposure down to permitted values. However, FI has reason to assume that the intended sale, a futures transaction between the customer and his child, was constructed in a way that meant that the bank's exposure to the customer did not change. However, FI was informed that the bank had fixed the problem. Subsequently, due to price movements, the commitment came to exceed permitted limits on several occasions.

understanding until the bank, through various measures and only after discussion with FI, made a reservation for the commitment of SEK 1 billion on October 23, 2008 at the same time as measures to strengthen the capital base. FI has found reason to criticize the bank's handling of the large exposure and can also state that the bank has also not kept FI informed of the exposure in the manner required by law.

#### Unauthorized fund management

The investigation further shows that Carnegie, partly since the summer of 2007, partly since January 2008 (for various funds) has received the management assignment for the fund company's funds, even though the bank was also the custodian for the funds. This is not permitted and gives reason to question the bank's ability to fulfill its statutory obligations as a custodian. It is also the bank's compliance function that has been responsible for regulatory compliance in the fund company as well, but this function has not paid attention to the obvious conflict of interest that arises when the bank is set to control itself.

#### Deficiencies in internal governance and control

Carnegie has described how the bank worked to remedy the large exposure. There has been preparedness and focus on the problem, but it is FI's view that the bank's management has not exercised adequate internal control to a sufficient extent and, above all, has not followed up on the work carried out. This has meant that necessary, but for the business intervention, measures were not taken until at a late stage and only after FI's views. It cannot be ruled out that this in turn has jeopardized the bank's ability to fulfill its commitments in the long term.

Carnegie has, as FI perceives it, not considered itself to have any responsibility for the fund company instructing the bank to manage the fund company's funds, even though the bank was also a custodian. Instead, the bank has stated that the responsibility lay with the fund company and that the bank was under the impression that FI approved the management assignment. The investigation shows that the bank, whether in the function of the custodian or in the compliance function, has been able to detect or handle both the violation of the rules and the obvious conflict of interest that has arisen. These shortcomings are also circumstances that show that the bank lacked sufficient internal control over its entire operation.

#### Intervention

Carnegie has stated that the bank has taken a series of measures since the decision in 2007, but that all staff have not been in place until recently. Furthermore, the bank has stated that the large exposure derives from a commitment entered into by the previous management and that the people who participated in the outsourcing of the fund management are no longer in the bank. Carnegie has also referred to measures that have been taken in recent weeks with the aim of reducing the risk in the business.

In light of the fact that FI as recently as September 2007 gave Carnegie a warning with a heavy penalty fee, etc. and taking into account the shortcomings that have now been observed, FI makes the assessment that the bank lacks the conditions to run a business that requires a permit.

On 9 November 2008, the bank presented an action plan according to which, among other things, a new issue is planned. However, FI makes the assessment that the plan contains elements of uncertainty that make it difficult to assess whether the plan has the potential to succeed. For this reason, the action plan does not change FI's assessment.

In a letter received by FI today, the National Debt Office has stated that it intends to intervene in the event that FI revokes the permit. FI states that the National Debt Office's plans refer to the situation where FI revokes the bank's authorization and therefore does not affect the bank's current situation and therefore does not change FI's assessment at this stage either.

The banking license must therefore be revoked and the bank put into liquidation. For the same reason, the bank's other operating licenses must be revoked.

In order to provide the conditions for an orderly liquidation that mitigates the impact for the bank's customers as much as possible, FI has decided on a special liquidation plan that gives the bank six months to liquidate its operations. During that period, the bank is allowed to operate operations subject to a permit, with certain restrictions, and remains under FI's supervision.

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**The Financial Supervisory Authority's assessment**

**1 Introduction**

The Financial Supervisory Authority (FI) has, in its supervision of Carnegie Investment Bank AB, 516406-0138, (Carnegie or the bank) made observations that give reason to intervene against the bank. This assessment is made against the background of the warning that FI notified Carnegie in September 2007.

By decision of the Riksbank on 26 October 2008 and 27 October 2008 respectively, the bank has been granted special liquidity support of SEK 5 billion. On October 31, 2008, the bank had used SEK 2.4 billion of this. Additional measures are needed for the bank to be able to maintain good liquidity.

During the summer of 2008, an impermissibly large exposure occurred in the business. A commitment to an individual customer exceeded the statutory limit of a maximum of 25 percent of the capital base. According to information from the bank, however, the bank succeeded in reducing the exposure to permitted values. However, the exposure once again exceeded the limit on further occasions. The reason for this was mainly that the securities that the bank held as collateral fell in value, which had the effect of increasing the net exposure (the part of the credit that was not covered by collateral). FI can thus state that the bank repeatedly had impermissibly large exposures and did not manage the risk this entailed more permanently. First by the bank, following FI's remarks, took measures on 23 and 24 October 2008, the bank's capital base was strengthened and the exposure down to permitted values. The bank then made provisions for credit losses, claimed the profit for the first three quarters and implemented group contributions.

FI has also been able to ascertain in its supervision that the bank, which is the custodian for a number of funds within the group, has received the assignment to manage these funds. The fund legislation does not allow this because the custodian has a control responsibility towards the fund company, which includes, among other things, ensuring that the fund company adheres to the regulations in its management. The law thus prohibits an obvious conflict of interest. No written agreements regarding this assignment seem to have been drawn up, despite requirements in both legislation and the bank's internal regulations. This, in turn, has meant that FI did not become aware of the said assignment agreement, which also meant that FI was unable to act against the agreements.

These observations mean that FI has reason to question the bank's ability to manage the risks associated with the business and whether the bank has a sufficient understanding of the rules to run business subject to a permit. These shortcomings are particularly sensitive in a situation where the bank needs support from the Riksbank to meet its obligations. Against the background of observed shortcomings, it is FI's assessment that the bank does not have functioning internal governance and control and that the bank lacks the ability to conduct operations in a way that does not jeopardize the bank's ability to fulfill its obligations.

**2. The bank's liquidity situation**

The bank's operations must be financed, either through equity, deposits from the public, credits from other banks and institutions or in some other way. This financing can have short as well as long durations and is decisive for whether the bank in turn can fulfill its obligations as they arise. The financial crisis which during the late summer and autumn also affected Swedish conditions has meant that many financial companies have found it more difficult to refinance their operations. This has mainly been due to the fact that the market players have not had sufficient trust in each other. The Riksbank has the option of providing special support to banks that temporarily find themselves having difficulty finding financing. However, this assumes that the bank in question is solid.

Against the backdrop of the financial crisis, Carnegie has found it increasingly difficult to refinance itself and has therefore turned to the Riksbank. By decision of the Riksbank on 26 October 2008 and 27 October 2008 respectively, the bank has been granted special liquidity support of SEK 5 billion. On October 31, 2008, the bank had used SEK 2.4 billion of this.

The Riksbank's support means that Carnegie has the opportunity to fulfill its commitments, but the support must at some point end and be replaced by normal forms of financing. In this context, it is difficult to assess how long Carnegie's liquidity needs can be covered by the existing loan. According to the bank's own forecasts, a larger part of the liquidity support may have been used within the next two weeks, but the bank's ability to fulfill its obligations in a month's time is probably not threatened.

However, the situation is serious and needs special monitoring. It is important that FI makes a continuous assessment of the bank's ability to fulfill its obligations. In this context, it is therefore important to assess the bank's ability to obtain additional capital contributions and more normal financing solutions.

**3. Unauthorized large exposures**

The investigation shows that on July 7, 2008, the bank had a gross exposure to a customer of approximately SEK 3.2 billion, which can be compared to the fact that the bank group (the bank with subsidiaries) had a capital base of just over SEK 1.5 billion. In September 2007, the bank had decided, by board resolution, to increase the credit limit for the Customer from SEK 3.65 billion to SEK 4.25 billion.

There are no regulations on the gross exposure that a bank may take to an individual customer. Instead, the focus is on what net exposure there is, i.e. in principle, to what extent the credit lacks sufficient financial collateral (over-leveraging). There are also no legal provisions that regulate that the collateral must be diversified. The investigation shows that

the bank has had various assets as collateral for the commitment, see appendix 5, but that the collateral mainly consisted of shares in a listed company.

Of the provisions in ch. 7 Section 3 of the Act (2006:1371) on capital adequacy and large exposures (the Capital Adequacy Act) states that a bank may not have a net exposure that exceeds 25 percent of the capital base. In Carnegie's case, the capital base amounted to approx. SEK 1,520 million (at group level) (on September 30, 2008 before measures taken), which means that Carnegie was not allowed at any time to allow the net exposure to a customer to exceed SEK 380 million.

The investigation shows, which the bank has also justified, that the bank had unauthorized large exposures to the customer, the first of which occurred on July 7, 2008. The table below shows how the commitment to the customer has developed from and including July 7, 2008 to 23 October 2008, when the bank took measures to more permanently reduce the exposure to permitted values. The table reports the effect of a futures transaction between the customer and his child, even if it is FI's opinion that this agreement does not affect the large exposure.

*Table: Large exposure to the customer*

| **Date** | **Gross exposure ring** | **Exposure** | **25 percent** | **Comments** |
|---|---|---|---|---|
| 2008-07-07 | 3,227 | 610 | 380 | |
| 2008-07-09 | 3,227 | 336 | 380 | Futures trading as a ligt bank decreased the exposure down to 336 |
| 2008-07-15 | 3 157 | 435 | 380 | |
| 2008-07-17 | | permitted level | 380 | according to the bank |
| 2008-09-12 | 2,828 | 511 | 380 | |
| 2008-09-24 | | permitted level | 380 | according to the bank |
| 2008-09-30 | 2,442 | 399 | 380 | |
| 2008-10-06 | 2,450 | 447 | 380 | |
| 2008-10-14 | | 930 | 380 | put option |
| 2008-10-16 | 2,451 | 1,069 | 380 | |
| 2008-10-20 | 2,451 | 1,342 | 380 | |
| 2008-10-23 | | 1,266as was brought down to 266 | 380 as after measures taken girder is 346.5 | Strengthened capital base then with the year's accrued profit and group contribution etc |

It follows from the investigation that on four different occasions during the summer and autumn of 2008 the bank had impermissibly large exposures to the customer, on July 7, 2008, July 15, 2008, September 12, 2008 and September 30, 2008. On the latter occasion, the bank allowed the exposure to grow from SEK 399 million to a maximum of SEK 1,342 million over a period of over three weeks. As

at most, the unauthorized exposure amounted to 88 percent of the capital base, i.e. 3.5 times permissible values.

It happens that banks in their lending for various reasons exceed the limit of what is considered a permissible exposure. Most often, this is due to the fact that several commitments must be added together for various reasons, or that the capital base decreases and that the relationship between exposure and capital base therefore changes, but it can also be due to an active decision to act or refrain from acting on the part of the bank. FI takes a serious view of banks not being able to stay within permitted limits, but in normal cases FI allows the bank to reduce exposure within a certain specified period.

In this case, the large exposure has arisen since the financial collateral for the credits has deteriorated significantly due to a drop in the price of the listed share which was mainly the basis for the commitment. It has also meant that the situation has improved as the share in question has increased in value. Carnegie has also had some of the shares sold in order to reduce exposure. If it is not unusual for banks to exceed permitted values, it is more unusual for the same exposure to recur again and again as in this case.

In its supervision, FI tries to ensure that banks where an impermissible exposure has arisen take measures to return the bank's risk-taking to the statutory limit values. In its supervision, FI has received information about the large exposures to the Customer, let alone not on every occasion and with some delay. However, FI has received information that the bank, by realizing parts of the collateral, has gained control over the exposure.

However, what FI has discovered during an in-depth review is that the exposure was reduced to permissible values through a futures transaction on July 8-9, 2008. The customer then made a futures transaction with his children. As FI perceives Carnegie's statement, this futures transaction was added at Carnegie's initiative with the aim of enabling the realization of pledged shares without hindrance of the trading ban that affects insiders. However, it turned out that the customer had also entered into an agreement with his children which gave the children the right to sell the shares back to the customer (put option). The children subsequently exercised this option and sold back the shares as of October 13, 2008. According to the bank's statement, it has also been shown that the customer has assumed payment responsibility for the children's obligations towards the bank, such as for own debt (so-called proprietary guarantee). The guarantee commitment was entered into in 2004 and is general in nature, but thus includes, as far as FI can understand, the payment responsibility the children had due to the futures deal. This was also the reason, according to the bank, why the bank allowed the children to use the put option unknown to the bank; it was better for the customer to have access to their securities than for the bank to have to go through the guarantee undertaking. Against this background, it is questionable whether the bank did the right thing when it reduced the exposure to the customer due to the futures contract. The customer was still responsible for payment. Carnegie also chose to add up the customer's and the children's commitment in its own risk management, which indicates that the bank also made the assessment that the children did not have the ability to fulfill the term agreement.

between the customer and the children was signed by the customer on behalf of the children with the support of a general power of attorney for the customer to dispose of the children's deposit at Carnegie. FI was not aware of these circumstances. If the futures transaction between the customer and the children is excluded, the effect is that the impermissibly large exposure that arose on July 7, 2008 was not reduced as of July 9, 2008 as predicted, but remained, possibly until August 31, 2008, or even longer. In addition, FI was led to believe that the bank had succeeded in fixing the problem. The bank has denied knowledge of the put option, and has explained its action, to allow the children to sell the shares back to their father on October 13, 2008, with the customer still obliged to fulfill his guarantee. FI does not dispute this explanation,

When assessing whether an impermissibly large exposure should be sanctioned, the measures taken by the bank are of great importance. FI can state that the commitment that is now in question was not just any commitment. The gross exposure taken against the customer exceeded the capital base. The collateral consisted predominantly of shares (or futures) in one (1) listed company and otherwise of securities on deposit and collateral in the customer's company. The stock in the listed company was subject to large price movements. During the summer and autumn of 2008, it also began to become more and more clear that Sweden was not spared from the financial crisis that was going on in the USA and in Europe. However, the commitment to the customer had been the subject of internal discussions even in the bank's board for a long time.

The bank has stated that it closely followed the commitment and considered various measures, including the possibility of selling the customer's company. However, the measures that were actually taken were the mentioned futures contract and successive, but relatively limited, sales of securities. It was only in connection with the bank again informing FI of an excessive exposure on October 14, 2008 and FI's subsequent site visit and discussions with the bank, that Carnegie chose on October 23, 2008 to make a loss provision of SEK 1 billion and measures that included production of the year's accrued profit as well as a group contribution and a sister contribution. In this way, the large exposure was more permanently reduced to SEK 266 million.

FI makes the assessment that the bank was not able to take sufficient measures but allowed the net exposure to the Customer to exceed permitted limit values during recurring periods and by as much as 3.5 times permitted values. In its handling, the bank has accepted that a futures contract affected the large exposure despite the ongoing guarantee commitment and put option and despite the fact that the bank in its own internal risk control counted the exposures. This has given the impression that the bank has taken sufficient measures. These shortcomings in the handling give rise to serious criticism from FI.

**4. Shortcomings in the responsibility as depository etc**

The investigation shows that the bank undertook to be a custodian for the funds managed by the bank's subsidiary, (the fund company). Furthermore, it has been established that the bank, on behalf of the fund company, took care of the fund company's compliance function, i.e. the function responsible for regulatory compliance in the fund company.

In ch. 4 Section 6 of the Investment Funds Act (2004:46) prohibits fund companies from instructing a bank to manage the funds for which the bank is the custodian. The legislature has chosen to prevent an unacceptable conflict of interest through a ban. As a custodian, the bank has a legal responsibility to check that the management of the funds takes place in accordance with the fund legislation and the fund regulations. In that situation, the bank cannot of course control itself as trustee. In this context, it does not matter if the bank has divided the operations into different organizational units or if there are so-called Chinese walls.

In its opinion, Carnegie has whitewashed the circumstances and that the bank was aware of this prohibition, but has stated that the responsibility for this lies with the fund company and that the bank had the view that FI approved the trustee assignment that the bank had.

From the investigation, and also the bank's statement, it appears that the assignment that existed between the fund company and the bank regarding advice (or as Carnegie has chosen to call it: advisory management), came to be changed to refer to management of the funds. According to Carnegie's own information, this change probably took place during the summer of 2007 when the fund company's responsible manager left his position. It is, however, undisputed that the fund company, by decision in November 2007 and in January 2008, outsourced the management of another fund to the bank.

FI can thus state that, against the provisions of the fund legislation, the bank has received several management tasks from the fund company, even as recently as January 2008. The responsibility for this rests, as the bank stated, primarily on the fund company. However, the bank has been responsible for the fund company's compliance function and does not seem to have paid attention to the legal provision or the obvious conflict of interest that results from the custodian and management being within the bank. What is more serious is that the bank, in its capacity as a custodian, has not paid attention to this situation. As a custodian, the bank has a responsibility according to fund legislation to check that the fund company's decisions regarding management are compatible with the law and fund regulations.

The responsibility for submitting assignment agreements to FI rests, as stated by the bank, on the fund company. However, FI still wants to point out that the agreements that the bank refers to and which regulate the changed mission are not management agreements. The bank has referred to "Management agreements", but the agreements in question are labeled as "Portfolio advisory agreements" and do not relate to management. FI has sole

did not have the opportunity to act on the fact that the bank in reality and against express prohibition took care of the management of the funds.

There is a crucial difference between providing advice and performing management. In the first-mentioned case, there is one or more people in the fund company who must make the decisive decisions, while the management assignment states that the bank decides independently and independently of the fund company how the funds will invest their funds. FI finds it surprising that the bank has not perceived this difference. Nor can FI assess how the bank was led to believe that FI approved this. The information FI had was that which was provided in connection with the fund company being reauthorized, namely that the bank would provide advice to the fund company. It is clear, however, that the bank did not at any time conduct its own investigation or contact FI on the matter.

Instead, it appears obvious that the bank was unable to detect this rule violation, either in the compliance function or in the depository role. FI cannot therefore avoid directing serious criticism at the bank in this regard.

**5. Inadequate internal governance and control and regulatory compliance**

The observations made in connection with FI's investigation give reason to question the bank's internal management and control. The bank has a difficult liquidity situation which forced the bank to turn to the Riksbank for support. Admittedly, it is an exceptional situation on the market, with a stock market downturn, a lack of trust between financial players and general concern. Even if a bank cannot predict all events, it is nevertheless important that the bank has a risk management system that enables satisfactory management of all risks in the business. In it lies a preparedness even for exceptional events. The financial crisis has also been going on for some time, which should have given the bank the opportunity to take measures to reduce the risks in the business to a manageable level.

The fact that the bank has a single commitment with a large gross exposure and with a complicated and partially illiquid collateral should in itself entail a special control of the commitment. It is noteworthy that the bank has not taken care to have a more differentiated collateral portfolio and applied more conservative loan-to-value values, especially in light of the fact that the listed shares were difficult to trade due to the customer's ownership stake. It has been investigated that the board received reports on how the commitment to the customer developed and that the bank's risk and credit committee continuously monitored the commitment, but it seems to have failed in the follow-up of the measures deemed necessary. FI therefore assesses that the bank has had insufficient risk control in these areas.

FI's observations regarding the bank's handling of the above-mentioned large exposure give reason to question whether the bank had satisfactory internal governance and control. The commitment has time and again exceeded the permitted values and it must have been obvious to the management that the measures taken were not sufficient

to minimize the risks. Despite this, the bank has only chosen after a dialogue with FI to make reservations and claim the profit for the first three quarters of 2008. There is also reason to question the bank's actions in initiating a futures contract between the customer and his child and to consider this contract in the assessment of whether the exposure was unauthorized or not. FI questions the appropriateness of the measure, which also meant that it appeared that the bank had no impermissibly large exposure, despite the bank's internal tallying of the engagements in its risk management.

The bank's measures must be placed in relation to the purpose of the rules regarding large exposures. The rationale behind limiting the exposure a bank may take is to prevent single engagements from causing a risk of default. There are thus no business opportunities for a bank to take greater risks. Although the commitment towards the customer was "inherited" by the previous management, the current management has taken conscious decisions which have resulted in the bank, instead of reducing an excessive credit risk, continuing to take market risks by allowing the value of the securities, for the most part shares in a listed company, which were used as collateral for the commitment, had an impact on the size of the exposure. The bank has thereby exposed itself to an unacceptable risk which later also proved to have a strong impact on the bank's financial capacity.

That the bank circumvented or attempted to circumvent the rules on large exposures in ch. 7 the capital adequacy act through the construction where the exposure was transferred to the customer's children, despite a guarantee commitment, FI believes is due to the bank's lack of understanding of risk and rules as well as insufficient internal governance and control.

FI has not been able to see that the bank's capital adequacy ratio has fallen below 1, but the bank has, through the risks taken, shown an increasingly lower ratio, which has resulted in a reduced ability to face further losses in the business. In addition, they were forced to provide a group contribution to strengthen the capital base in connection with the loss being reserved on 23 October 2008.

The bank has also shown deficiencies in regulatory compliance by, in violation of a clear and clear legal rule, still placing the management of funds in the bank, despite the fact that the bank is also a custodian. This has introduced an unacceptable conflict of interest in a situation where the bank has committed to the fund unit owners to exercise control over the fund company. The bank has also not been able to catch this rule violation within the framework of its internal management and control. The compliance function, which is shared by the bank and the fund company, has not been able to identify the possible conflicts of interest that may arise between a bank and a fund company in the same group.

FI is forced to state that the observations made show deficiencies similar to those that were the subject of FI's intervention only just over a year ago. Against this background, the observed deficiencies are particularly serious.

In summary, FI assesses that the bank does not conduct its operations in accordance with ch. 6. § 1 LBF ie. in such a way that its ability to fulfill its obligations is not compromised.

**6. Intervention**

## *6.1 Applicable regulations*

According to ch. 15 Section 1 of the Act (2004:297) on banking and financing operations (LBF) FI must intervene if a bank has violated its obligations according to said act, other statutes that regulate the bank's operations, the bank's articles of association or internal instructions that have their basis in statutes that regulate the bank's operations. If the violation is serious, the bank's authorization must be revoked or, if sufficient, a warning issued. According to ch. 17 Section 1, paragraph five of the LBF, FI may decide that a decision on revocation shall apply immediately.

According to ch. 25 § 1 of the Act (2007:528) on the securities market, FI must intervene if a securities institution has violated its obligations under this Act, other statutes that regulate the company's operations, the company's articles of association, statutes or regulations or internal instructions that have their basis in a statute that regulates the company's Operation. If the violation is serious, the securities institution's license must be revoked or, if sufficient, a warning issued. According to ch. 26 Section 1, fourth paragraph of the Securities Market Act allows FI to decide that a decision on revocation shall apply immediately.

According to ch. 12 Section 1, second paragraph of the Capital Adequacy Act stipulates that if an institution violates the aforementioned law or regulations issued pursuant to the law, the provisions on intervention in the laws that regulate the institution's operations also apply.

In ch. 2 Section 6 of the Act (2005:405) on insurance mediation (LFF) states the conditions for a license for a legal person. The first point states that the legal person must not be in bankruptcy or liquidation. According to ch. 8 Section 1 of the LFF Act, FI must intervene if an insurance intermediary has disregarded its obligations under this Act or regulations issued pursuant to the Act. If the violation is serious, the insurance intermediary's license must be revoked. According to ch. 8 Section 2, fourth point LFF, FI must revoke an insurance intermediary's permit if the insurance intermediary no longer meets the conditions for a permit. According to ch. 10 Section 1, fourth paragraph LFF, FI may decide that a decision on revocation shall apply immediately.

## *6.2 Carnegie's opinion on a possible intervention*

It is the seriousness of the violation that should be decisive for whether it should lead to revocation or a warning. It appears from the preparatory work for the laws in the financial area that such an interventionist measure as revoking a license should be applied restrictively and not take place without strong reasons. Circumstances that may make a warning appear to be sufficient may be that the institution cannot be feared to repeat the violation and that the prognosis is therefore good.

From FI's previous rulings on interventions, it can be deduced that FI, on the occasions when the institutions in question have taken sufficient measures to deal with the noticed violations, has decided to intervene against the institutions with a warning instead of revocation of permission. Furthermore, circumstances such as the fact that there is reason to believe that the institute will in the future have adequate internal governance and control have given reason for the penalty to be limited to a warning.

The bank is fully aware of the existence of the issues highlighted and has insight into their seriousness. In addition to largely implementing the 2007 action program, the bank has taken a number of measures to address these issues as soon as possible.

The bank has taken measures to ensure the bank's funding in the short and medium term and initiated a supplementary program of measures. The company's board and management have been replaced and a process is underway to find a new owner and/or new ownership capital for the company. It must be particularly emphasized that the board and management, with the help of external consultants, work actively and intensively to liquidate the bank's large commitment to an individual customer.

### *6.3 Additional information about changes in the business*

On 9 November 2008, Carnegie submitted a supplementary opinion with an updated liquidity forecast attached. In the opinion, the bank asserts partly shortcomings in FI's handling, partly makes further arguments regarding the choice of sanction. The letter also refers to the plans to carry out a new issue, etc. The bank claims, among other things, that the bank was given far too little time to respond to FI's information and that the bank only received a memorandum on 7 November 2008 that FI's supervisory department has established.

Later during the day on November 9, 2008, the bank submitted additional information about the new issue and other measures that are intended to be taken.

FI has today received a letter from the National Debt Office. The letter shows that the National Debt Office has entered into an agreement with the bank which gives the National Debt Office the opportunity to grant a subsidized loan to the bank. A pledge agreement is linked to the loan agreement, which includes, among other things, the bank's parent company's shares in the bank. According to the agreement, the deposit can be claimed. Through the agreement, the National Debt Office has the opportunity to step in if the Riksbank cancels its loan, for example because FI has revoked the bank's permission.

The National Debt Office has further informed FI that the National Debt Office intends to claim the pledge if FI revokes the bank's permission. The state will then become the owner of the bank and should be considered a bona fide owner. For this reason, the bank should be able to regain the permits as soon as the National Debt Office takes over the shares.

The bank was given a warning as recently as September 2007. The criticism directed at the bank mainly concerned the internal management and control. This is also the subject of the current case. In addition, FI has identified violations with regard to large exposures and receiving management in the capacity of custodian.

In light of the action plan that the bank presented in September 2007, FI chose to issue a warning to the bank instead of revoking the bank's permit. FI thus assessed that the bank had a good forecast for its operations. The bank has taken action in accordance with its plan. FI, which followed up the work on an ongoing basis, intended to make a final assessment at the end of 2008.

FI can state that the bank focused on previously noted shortcomings, but at the same time has again broken down in various areas. FI cannot assess whether the bank's work to remedy previous shortcomings has affected the ability to handle similar challenges within other operations in the bank.

FI has found that the bank has once again failed in several respects and that the bank's internal governance and control has not been able to catch these shortcomings. The current board was appointed at the end of 2007 and should have had the opportunity to settle into the business. It is also clear that the board had at least the big exposure on its agenda.

The current violations are serious and in themselves constitute grounds for intervention. In light of the warning that the bank was given in September 2007, there is no scope for FI to make a new assessment that the bank has a good forecast for its operations.

The action plan that Carnegie presented on November 9, 2008 assumes that the general meeting decides on a directed issue, which requires a qualified majority. It is unclear how many of the existing shareholders support the action plan and therefore it is difficult to form an opinion about the conditions for a new share issue to be decided. Furthermore, it is unclear whether the action plan means that the loan taken out from the Riksbank will be able to be repaid within the time that the Riksbank deems necessary. FI thus notes that the action plan announced contains a number of uncertainties and that it is therefore not currently sufficient to make a good forecast.

FI also notes that the National Debt Office intends to intervene in the event that the bank's authorization is revoked. This in itself therefore does not constitute grounds for now announcing another sanction.

FI therefore finds, after an overall assessment, that the bank's license should be revoked. For the same reason and taking into account the need for an orderly liquidation, the revocation shall apply immediately. It is important that the liquidation takes place in a way that mitigates the effects for the bank's customers, and therefore the liquidation should take place over six months in the manner specified in Appendix 1.

FI will apply to the district court for liquidation of the bank in accordance with ch. 10. §§ 31 and 33 LBF. In such a case, the district court must put the bank into liquidation. A decision on liquidation means that the bank no longer meets the conditions for permission for either securities trading or insurance mediation. When the district court has made a decision on the liquidation of the bank, FI will thereby revoke the authorization regarding insurance mediation. Revocation of the permit is mandatory in this case.

The shortcomings that are blamed on the bank are also attributable to the securities business. Against this background and when the bank is to be liquidated, these permits must also be revoked. The revocation shall apply immediately in this part as well.

The bank is also authorized to be registered as a manager of fund units according to ch. 4. Section 12 of the Act on Investment Funds. Such a license presupposes that the bank also has a license to conduct securities business. Since the bank's permission to operate such activities is now revoked, there are no conditions for the bank to retain the permission to be registered as a manager of fund units. This permit therefore expires.

## The case

### 7. Background

#### *7.1 About Carnegie*

The bank has permission to conduct banking operations in accordance with LBF.

The bank also has permission in accordance with ch. 2. Section 1 of the Act on the securities market to conduct securities trading in accordance with what is stated in point 2 of the decision. The bank is also authorized in accordance with ch. 2 § 1 LFF to practice insurance mediation.

The bank traditionally describes itself as "the leading independent investment bank in the Nordics", with operations in the business areas Securities, Investment banking, Asset management and Private banking. The bank operates in several other countries in Europe and the USA. At the beginning of 2007, the bank acquired the insurance broker Max Mathiessen, which is part of Carnegie's clear investment in Private Banking.

The bank is 100 percent owned by the listed company D. Carnegie & Co AB. In addition to the bank's parent company, the group includes a number of subsidiaries of the bank. A large proportion of these run capital and fund management activities.

For the financial year 2007, the group had total revenues of approximately SEK 4,300 million. According to the annual report for the year 2007, the group had total assets of approximately SEK 45,100 million and equity of approximately SEK 3,000 million.

The average number of employees in the group during 2007 was 1,035. The average number of employees in the bank during the same period was 804.

### *7.2 FI's decision of 27 September 2007*

On 27 September 2007, FI decided to give the bank a warning (dnr 07-6125). The warning was combined with a fine of SEK 50 million.

The basis for the decision was, in short, that the bank had broken down in its internal governance and control, which in turn meant that the bank lacked the ability to manage the risks that existed in the business. Against the background of the action plan that the bank presented, FI considered that the bank had a good forecast for its operations. FI therefore decided not to revoke the bank's permission but instead to stop at a warning.

In this case too, the bank has provided an account of the measures that have been taken. Actions taken and supplementary action programs can be seen from **appendix 3.**

**8. The Financial Supervisory Authority's investigation**

The Finansinspektionen's investigation appears in its entirety from**appendix 4.**Receivables conditions etc. can be seen from**appendix 5.**

## 9. Applicable Regulations

A credit institution's operations must according to ch. 6 Section 1 LBF is run in such a way that the institute's ability to fulfill its obligations is not compromised.

The value of an institution's exposure to a client or group of clients with mutual connections may, according to ch. 7 §§ 3-4 of the Capital Coverage Act, not to exceed 25 percent of the institution's capital base. A group of customers with mutual connections refers to two or more natural or legal persons who, unless otherwise shown, form a whole from a risk point of view because

1. one of them has, directly or indirectly, ownership influence over one or more of the others in the group, or
2. those without standing in such a relationship as referred to in 1 have such mutual connection that any or all of the others may be threatened with payment difficulties if one of them suffers from financial problems.

An institution must continuously report large exposures to FI. If an institute violates any of those in ch. 7 specified limit values, the institute must immediately report this to FI. FI may specify in a decision a certain time within which the exposure must be reduced to the permitted limit values (chapter 10, section 15 of the Capital Adequacy Act).

For each investment fund, according to ch. 3 §§ 1-2 of the Act on Investment Funds, there is a custodian. The custodian must act independently of the fund company and exclusively in the common interests of the unit owners. The custodian must execute the decisions of the fund company that relate to investment

the fund if they do not conflict with the provisions of the Investment Funds Act or the fund regulations. The custodian institution must also receive and store the property included in the fund and ensure that

1. the sale and redemption of fund shares takes place in accordance with the provisions of the Investment Funds Act and the fund regulations,
2. the value of the fund shares is calculated according to the provisions of the Investment Funds Act and the fund regulations,
3. the assets in the fund will be made available to the institute without delay, and
4. the funds in the fund are used in accordance with the provisions of the Investment Funds Act and the fund regulations.

According to ch. 4, a fund company may Sections 4-5 of the Act on Investment Funds assign someone else to perform certain work or certain functions that are part of the fund's operations in order to make the company's operations more efficient. If it includes an assignment for someone to manage the assets in an investment fund on behalf of the fund company, the agreement must contain guidelines for investing the fund assets. The fund company must secure a right to regularly review and, if necessary, change these guidelines.

According to ch. 4, an administrative assignment may Section 6 of the Act on investment funds is not given to the custodian or any other company whose interests may conflict with the interests of the fund company or the unit owners.

A credit institution must identify, measure, manage, report internally and have control over the risks associated with its operations. In this regard, the institute must ensure that it has satisfactory internal control. A credit institution must in particular ensure that its credit risks, market risks, operational risks and other risks taken together do not jeopardize the institution's ability to fulfill its obligations. In order to meet this requirement, it must at least have methods that make it possible to continuously value and maintain a capital which, in terms of amount, type and distribution, is sufficient to cover the nature and level of the risks to which it is or may become exposed. The credit institution must evaluate these methods to ensure that they are comprehensive. (Chapter 6, §§ 2 LBF).

Good risk management can only be achieved if there is satisfactory internal management and control. Responsibility for this rests, according to ch. 6. § 4b LBF, the bank's board.

In ch. 2 Section 6 LFF states the prerequisites for a license for a legal person. The first point states that the legal person must not be in bankruptcy or liquidation.

In FI's general advice (FFFS 2005:1) on governance and control of financial companies, further recommendations are given on internal governance and control. Based on what is relevant in this decision, the councils are divided into councils on governance, internal governance and control, management and control of risks and regulatory compliance.

In terms of governance itself, it is a company's board of directors that has the ultimate responsibility for the company's organization and management of its affairs. Sty-

The board should establish a strategy and objectives for the business that the company conducts. The board should also follow up that these goals are reached. (Chapter 2, § 1 FFFS 2005:1)

Through a good internal control, a company can ensure

- an effective and efficient organization and management of the business,
- reliable financial reporting,
- efficient operation and management of information systems,
- a good ability to identify, measure, monitor and manage one's risks,
- a good ability to comply with laws and regulations, internal rules, as well as good practice or good standards.

(chapter 3, section 1, third paragraph FFFS 2005:1)

The board and the managing director should work to ensure that good internal control characterizes the organization and operation of the company's operations. (Chapter 3 § 2 FFFS 2005:1).

In order to maintain good internal control, the organization should be adapted to the changes in internal and external risks that occur over time. (Chapter 3 § 3 FFFS 2005:1)

The board should follow up the operations on an ongoing basis and ensure that there are controls that ensure that the reporting reasonably reflects the operations. Furthermore, the bank should ensure that information and reporting systems ensure current and relevant information about the bank's operations and risk exposure, etc. (ch. 3. 4 §§ FFFS 2005:1) The institute must, in accordance with ch. 6. § 2 LBF ensure that it has a satisfactory internal control.

The advice shows that there should be a unified function for independent risk control. The function should inform the board, management and otherwise those who need the information. The information should provide a comprehensive and factual picture of the company's risks and contain analyzes of the development of the risks. The function should also propose the changes in control documents and processes that the function's observations about risk management give rise to. The function should have sufficient resources for its tasks. (Chapter 4 § 3 FFFS 2005:1)

There should be a central function for independent control of market risk which is subordinate to the CEO or a member of the executive management who is not responsible for position-taking units and who is assumed to have knowledge of financial instruments and methods for the management and control of market risks. The function should have sufficient resources and knowledge of market risks. The central market risk control function should be responsible for:

- monitor the implementation of guidelines and instructions for market risk throughout the institute,
- report to the board and CEO,
- daily follow-up and actively and preventively control aggregated market risk, including identification and reporting of violations,

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- monitor the effects of reward systems linked to risk-taking in order to thereby assist management in their evaluation. (Chapter 4 § 3 FFFS 2005:1)

In ch. 5 FFFS 2005:1 states how the function for regulatory compliance should be organized and that the board or CEO should determine the function's area of responsibility, tasks and routines for reporting in internal rules.

Compliance means compliance with laws, regulations and internal rules as well as good practice and good standards regarding the activity subject to a permit. The function should continuously inform about the risks that may arise in the business as a result of a lack of regulatory compliance, help identify and assess such risks and assist in the design of internal rules. The function should also inform the board, the managing director and the management in matters of regulatory compliance (ch. 5 FFFS 2005:1).

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Decisions in this case have been made by the Financial Supervisory Authority's board after a presentation by the head of department and chief legal officer Joakim Schaaf. In the final handling of the case, acting director general Erik Saers, head of department Uldis Cerps, deputy head of department Charlotta Carlberg, head of unit Petra Gressirer, head of unit Magnus Löfgren, acting unit manager Martina Jäderlund, lawyers Agneta Blomquist, Ann Ehrngren and Christian von Ahlefeld and inspectors Ingemar Hägg and Agneta Bodin participated.

THE FINANCIAL INSPECTION

Bengt Westerberg

Joakim Schaaf

Attachments:

Appendix 1 .Decommissioning plan
Appendix 2 . Appeal reference
Appendix 3 . Actions taken/list of actions regarding 2007.
Appendix 4 . The investigation
Appendix 5 . Receivables conditions etc. regarding large exposures

Copy for the attention of: The Swedish

Companies Registration Office

Ministry of Finance

The National Debt

Consumers' banking and financial agency

Consumer Agency

The Riksbank

Statistics Sweden

The Swedish Banking Association

Swedish Fund Dealers Association

Upplysningscentralen UC AB VPC

AB

The Association of Fund Companies

Sweden's Aktiespararere

Rahoitustarkastus

The Norwegian Credit Supervisory Authority