
APPENDIX 9: IMRO'S WORK IN RELATION TO BIM AND LBI 1988 TO APRIL 1991

1 Organisation of IMRO

- 1.1 From 27 January 1988 IMRO was a recognised Self-Regulating Organisation under the Financial Services Act 1986 and was responsible for the regulation of investment portfolio management for private and institutional investors, including the "in-house" management of pension funds.
- 1.2 In the period to April 1990 the organisation of IMRO^a was divided into two main sections
- Membership Department^b, which was responsible for determining the fitness and properness of potential IMRO members.
 - Compliance Department^c which was responsible for monitoring the adherence by IMRO members to the rules of the organisation and for dealing with or reporting to the membership department any non-compliance^d.
- 1.3 We received evidence that there was a segregation of responsibilities between the membership and compliance departments prior to April 1990. Mr Robinson told us that he did not agree with that segregation and wanted the Compliance Department to concentrate more on the continuing fitness and properness of IMRO members than monitoring compliance with IMRO rules.
- 1.4 Mr Morgan told us that a reorganisation of IMRO was effected in recognition of the fact that the Membership Department had completed its job of assessing the large number of applications for membership of IMRO that had been made when the Financial Services Act came into effect. It was necessary by 1990 for more visits to members to be undertaken and for resources to be allocated accordingly.
- 1.5 As a result of such views, IMRO was reorganised in April 1990 and new departments were created
- Member Assessment which was responsible for applications for admission and for continuous supervision of IMRO members with the objective of obtaining reasonable assurance that the members continued to be fit and proper.

^a The Chief Executive of IMRO was John Morgan. He had worked for S G Warburg & Co Limited, Williams & Glyn's Bank and N M Rothschild & Sons and had in the period 1978-86 been chief executive of the British Rail Pension Trustee Company.

^b This department was headed by Keith Robinson, a chartered accountant who had trained at CLD and subsequently worked at the Institute of Chartered Accountants of England and Wales and been Secretary to the Council of Lloyd's. He left IMRO to take up a post with another organisation at the end of February 1991.

^c This department was headed by Ronald Smith who had formerly been a partner in Ernst & Whinney.

^d There was a dispute in the evidence we received as to the extent of any reporting of non-compliance to the Membership Department.

- Investor Risk Management which was allocated responsibility for any members where funds were thought to be at risk.

2 Admission of BIM and LBI

2.1 In order that intending members of IMRO might receive interim authorisation pending adjudication of their application for membership the necessary application forms had to be lodged with IMRO by 26 February 1988: BIM and LBI both applied for membership of IMRO on 25 February 1988. We were told by Mr Morgan that around 700 applications (out of a total of some 1200) were made in the few days prior to 27 February 1988 and that, since there was pressure for all applications to be dealt with prior to 29 April 1988, the volume of work faced by IMRO was considerable.

2.2 The admissions procedure was handled in 1988 by the Membership Department. Applications were considered by a team consisting of a case officer^a and a manager, both reporting to the membership director. Their work entailed an examination of the nature and scope of the business and the type of customer proposed by the applicant, the applicant's systems and financial resources, the standing of the applicant's auditors, the record of the applicant to date and the backgrounds and personal histories of its principal officers and controllers. The case officer would then submit his report and a memorandum would be prepared for submission to the membership subcommittee of the board of IMRO which would determine the application for membership, subject to formal approval by the full board.

Admission of BIM

2.3 The documentation submitted by BIM to IMRO for OPS^b membership included the following information:

- The directors of BIM were all employees of PHL save for RM and KM.
- The proposed permitted business included the management of UK and overseas pension funds.
- Of the £688m under management by BIM, only £180m was managed by BIM directly, the major portion of the assets being managed by other IMRO members.
- RM had been the subject of a DTI inquiry in 1971 but that no criminal or civil proceedings had been issued as a result of the Inspectors' report.
- Advice was being obtained from CLD who had been commissioned to write internal audit and compliance manuals.

^a In order to be able to deal with the number of applications, case officers were taken on, often though secondments, from among newly qualified accountants.

^b BIM was an OPS member of IMRO and was, consequently, subject to a lesser degree of regulation than other IMRO members as certain rules (such as those applicable to financial resources, accounting records, financial reporting and audit requirements) were disapplied. The assets of OPS members of IMRO were regarded as being subject to a reduced risk of misuse since it was thought that there was little scope for fraud given the roles performed by the trustees, beneficiaries, actuaries and the Occupational Pensions Board. However, the fact that BIM was an OPS member and that certain rules were disapplied did not make any material difference, save there was perceived to be a reduced risk of misuse of assets.

- BIM was owned by the Maxwell Foundation which had charitable and benevolent objectives and no owners or beneficiaries^a.

2.4 The membership checklist prepared by the BIM case officer on 17 May 1988 contained no mention of the 1971/73 DTI Reports but did refer to "potential question marks over Robert Maxwell". On 1 June 1988 a memorandum was submitted to the membership subcommittee recommending that BIM be admitted to membership: the memorandum

- recorded the Liechtenstein ownership of BIM^b.
- stated that nothing adverse was known about the business record and reputation of BIM.
- stated that nothing adverse was known about the honesty and integrity of the directors and senior staff of BIM.
- stated that the majority of the assets were managed by major stockbrokers and investment houses who were either IMRO or TSA members. One of BIM's major functions was to co-ordinate the investment decisions of the various fund managers. BIM managed £180m of funds directly. The investments were long term, explaining the need for so few staff.

2.5 It was resolved that BIM be admitted to membership of IMRO at a meeting on 1 June 1988 of the membership subcommittee chaired by Mr Smethurst^c. The minutes of the meeting were signed by Mr Corsan at the next meeting, although he had not been present at the meeting on 1 June 1988 and the decision was approved at a meeting of the full board of IMRO held 7 June 1988.

2.6 We were told by Mr Robinson that Mr Corsan^d had told him he had a high opinion of RM and this played a part in his (Mr Robinson's) attitude to the admission of BIM and LBI. Mr Smethurst told us that he recalled saying, when the BIM application came up for consideration, something like that it was "a pity we can't exclude that crook." He told us that, taking into account the fact that no action had been taken against RM on the basis of the 1971/73 DTI Reports and of the fact that LBI had been granted a licence to deal in securities by the DTI (see paragraph 2.9 below), the committee had no evidence to support a refusal to admit BIM; it was appreciated that RM would probably challenge any refusal to admit and IMRO would have to have hard evidence to support its decision. In those circumstances IMRO reluctantly admitted BIM.

^a IMRO did not accept that the Maxwell Foundation did not prepare accounts. It was informed by BIM that accounts were being prepared and would be forwarded as soon as they were completed; there is no record of any such accounts having been sent to IMRO.

^b The ownership of BIM was transferred to the Maxwell Charitable Trust (of which Mr Corsan was one of the trustees) in 1989. IMRO were informed of this in May 1989 after it had happened. BIM should, under IMRO rules, have informed IMRO of this prior to the change of ownership.

^c A former adviser to the Treasury (1969-71) and to the Prime Minister's policy unit (1975-76) and Deputy Chairman of the Monopolies and Mergers Commission. Since 1991 he has been Provost of Worcester College Oxford.

^d He had been senior partner at CLD responsible for relations with RM's companies until his retirement in September 1986 and was a member of IMRO's board.

Admission of LBI

- 2.7 The documentation^a submitted by LBI to IMRO included the following information:
- The management of LBI was to be Mr Larry Trachtenberg and Mr Andrew Smith but the non-executive Chairman and controller was KM^b.
 - LBI had arranged with its auditors, CLD, for the preparation of a comprehensive compliance manual and had requested that CLD monitor compliance procedures on a regular basis.
 - The proposed permitted business included the management of UK and overseas pension funds.
 - LBI had share capital of £150,000 and total shareholders' funds of £854,455.
- 2.8 On 11 March 1988 IMRO sent out vetting requests to SIB, the Stock Exchange, TSA, DTI and other regulatory organisations seeking information about the then directors of LBI: KM, Mr Trachtenberg and Mr Smith^c. Replies received by IMRO revealed nothing of concern.
- 2.9 On 25 April 1988 LBI was granted by the DTI a licence to deal in securities under the Prevention of Fraud (Investments) Act 1958; IMRO was informed of this by Mr Trachtenberg on 28 April 1988^d. As the Membership Department of IMRO had identified LBI as requiring attention prior to admission, the Compliance Department visited LBI on 20 May 1988 and carried out an interim assessment^e. During the course of that visit IMRO recorded the following:
- LBI was owned by KM but it was intended that in June 1988 a holding company, LBH, would be formed with RM holding 75% of the holding company's shares.
 - LBI was regarded by the Maxwells as a private investment but they intended to take no part in the policy or operation of the company.
 - LBI hoped to attract £50-100m from the Maxwell group to manage albeit that the management of Maxwell funds could give rise to conflicts of interest.
 - Liquid capital was inadequate.

The visit was carried out at a time when LBI had no funds under its management; the report on the visit concluded that, subject to the points identified, there would be no serious risk to investors once their funds were received by LBI.

^a Mr Trachtenberg told us that the preparations for IMRO membership and completion of all the relevant documentation were overseen and advised upon by CLD.

^b Mr Trachtenberg told us that he thought that KM had been put forward as Chairman due to concern that RM might not be acceptable to IMRO. In due course, however, that view changed (not least because Lord Donoughue became the executive vice chairman of LBI) and RM became the Chairman.

^c As IMRO was not notified until 10 June 1988 that RM was to be Chairman of LBI (see paragraph 2.10 below) no vetting was carried out of him.

^d We were told by Mr Robinson that little reliance was placed upon this.

^e A "quick & dirty" review by the Compliance Department prior to the visit had concluded that there was a very high risk of non-compliance at LBI.

2.10 On 10 June 1988 LBI wrote to inform IMRO of amendments to its application for membership:

- KM's shareholding in LBI had been transferred to LBH which was 75% owned by RM.
- RM was Chairman of LBI and was authorised as a sole signatory^a.
- LBI's share capital had been increased from £150,000 to £1.1m.
- Lord Donoughue was to be a director and executive vice chairman of LBI.

A questionnaire enclosed with the letter referred to the 1971/73 DTI inquiry in the same terms as had been used in the BIM documentation referred to at paragraph 2.3 above.

2.11 A membership review checklist was signed by the membership director on 12 July 1988 on the basis that LBI's application was in order. On 13 July 1988 a memorandum was submitted to the membership subcommittee recommending that LBI be admitted to membership: the memorandum

- recorded that a compliance visit had been undertaken
- referred to the ownership of LBI^b and of LBH and that RM was non-executive Chairman
- stated that the intention that LBI attract £50-100m of Maxwell group funds entailed a risk that LBI might become involved in supporting a Maxwell takeover operation
- referred to the 1971/73 DTI inquiry:

"He was involved in 1971 in a DTI investigation under the Companies Act into Pergamon Press".

- recorded that RM was Chairman of BIM which was manager of the assets of pension funds related to various Maxwell companies.

2.12 It was resolved that LBI be admitted to membership of IMRO at a meeting on 13 July 1988 of the membership subcommittee chaired by Mr Corsan. The minutes of the meeting do not record that Mr Corsan declared any interest in relation to LBI; one person present recalled that he was aware of Mr Corsan's connections with RM, but others could not recall whether they knew this at the time. The decision of the subcommittee was approved at a meeting of the full board of IMRO held on 19 July 1988^c.

^a The letter sent to IMRO did not identify the accounts over which RM had sole signatory authority. Mr Morgan told us that there was no rule relating to sole signatories; although he would have been surprised if the authority was for more than a modest amount, such an ability on the part of RM did not tell IMRO anything more about the fitness and properness of LBI than they already knew. Mr Dunnachie, who (as set out in the footnote to paragraph 3.2 below) was responsible for supervision of LBI from April 1990, told us that he was not aware of RM's sole signatory.

^b The shareholding of RM in LBH was transferred to a private side company in September 1990. IMRO were not told of this.

^c Mr Corsan told us that he did not consider he had any interest to declare in relation to BIM, LBI or RM at that time; he had retired as a partner of CLD on 30 September 1986 and did not become a trustee of the Maxwell Charitable Trust until January 1989.

3 Information in 1990 from the College of Regulators

- 3.1 On 6 July 1990 the Bank of England told a meeting of the College of Regulators^a called by the Bank of England and attended by representatives from IMRO (amongst others) of their concerns over the plans RM had to take control of Robert Fraser. Subsequent to that meeting IMRO (which had regulatory responsibility for the fund management company within Robert Fraser) was kept informed of the progress.
- 3.2 We were told by Mr Dunnachie^b that at the meeting on 6 July 1990 he understood that the Bank of England had not reached any decision as to the fitness and properness of RM in relation to Robert Fraser. However, he received a telephone report of a further College meeting that was held on 18 July 1990. He understood that the Bank considered that they need not decide the issue as to RM's fitness and properness as a structure was being proposed that would mean RM was not the controller. He also understood that if the Bank of England had to decide the issue of RM's fitness and properness, then they would have considered that RM was probably not fit and proper.
- 3.3 Mr Dunnachie told us that this information did not cause him to consider RM's fitness and properness in relation to LBI or BIM but he recorded the information in two memoranda to file which were copied to Mr Robinson and Mr Clark. Mr Robinson had no recollection of the memoranda. Mr Morgan (who was unaware at the time of the Bank's view) told us that he did not consider that the Bank of England had provided any new information about RM, as they were only relying on the 1971/73 DTI Reports; it would have been difficult for IMRO to have refused admission to LBI or BIM in 1988 on the basis of what had been said in those DTI reports. IMRO took no steps in 1988 to reconsider either BIM or LBI's membership^c.

^a The College of Regulators was not a formal body but a term applied to meetings between different regulatory bodies which supervised the financial service and banking activities of companies within the same group; each group was assigned a "lead" regulator based on the dominant activity of the group and it was responsible for calling meetings with other regulators concerned with the group if a need arose. The Stock Exchange was not part of this system as it was not a regulatory body dealing with financial services and banking.

^b Graham Dunnachie was a manager in the Compliance Department. He had qualified as a chartered accountant whilst working at Ernst & Whinney, where he had been a management consultant. Whilst at Ernst & Whinney he had worked on the development of IMRO's compliance procedures and had joined IMRO on 30 May 1988. He was responsible for the supervision of LBI in the period after its admission until April 1990.

^c On 22 August 1991 Maxwell Central and East European Partners plc (MCEEP) (a company of which RM was the chairman) applied for membership of IMRO. During the course of vetting the application a large number of press cuttings about RM's investment activities, financial position and management style were examined by IMRO. After the staff at IMRO considering the application had seen the *Panorama* programme on RM (on 23 September 1991), it was decided on 22 October 1991 because the onus was on MCEEP to establish its fitness and properness, RM would be required to disprove the *Panorama* allegations. A senior officer in the Investor Risk Management department at IMRO noted that the most serious allegation made in the programme was in relation to the 1971/73 DTI reports but that those reports had not been sufficient to disqualify RM from membership of IMRO.

On 25 October 1991 IMRO met with the Bank of England to discuss the application by MCEEP. The Bank of England reminded IMRO of the deliberations that had been gone into in relation to Robert Fraser and stated that they would have had to think long and hard about RM's fitness and properness had the proposals in relation to Robert Fraser proceeded. The application was under consideration when RM died.

4 Supervision of BIM and LBI

- 4.1 It is convenient to set out a brief chronology of the supervision of LBI and BIM by IMRO and then to consider topic by topic what became known to IMRO about the abuses at LBI and BIM that we have identified.

Outline chronology: supervision of LBI

- 4.2 In the period to April 1990, in addition to the submission by LBI of quarterly returns and statements of representation to IMRO, the following matters arose in the supervision of LBI:

- On 30 August 1988 LBI submitted its first quarterly financial return together with a statement of representation (in which questions relating to compliance with IMRO rules were answered).
- On examining those documents IMRO found them to reveal deficiencies: the return had not been submitted on time and showed that LBI did not have an adequate cushion of financial resources. IMRO requested an urgent review with LBI and a meeting was held with Mr Trachtenberg on 7 September 1988 in order to discuss IMRO's concerns about the issues raised by the return.
- Although a note was made on 3 November 1988 that LBI was due to be visited by IMRO on 16 November 1988 no such visit took place at that time: we were told by IMRO that pressure of work meant that the visit to LBI did not happen.
- A general risk assessment ^a of LBI was prepared on 22 November 1988^b. This assessment was reviewed by Mr Dunnachie on 9 March 1989.
- Prior to a visit by IMRO to LBI in February 1989 an assessment of LBI's fitness and properness was made^c and a planning document was completed^d.
- IMRO visited LBI on 7 February 1989; two officers from IMRO carried out the visit^e.
- Mr Dunnachie reviewed the notes of the visit on 9 March 1989 and raised various issues including that the risk assessment for LBI required to be altered in order to correct a previous error.
- During March to May 1989 IMRO and LBI corresponded about the matters arising from the visit. One of the issues raised in that correspondence was the requirement set out by IMRO that the custody agreement between LBI and Morgan Stanley be amended to reflect the fact that it was LBI's clients and not LBI that was the customer of Morgan Stanley.
- In April 1989 CLD submitted to IMRO an unqualified auditors' report in respect of LBI for year ended 31 December 1988.

^a We were told by IMRO that the general risk assessment was only a compliance tool and amounted to little more than a desk top assessment based upon the then available knowledge.

^b See paragraph 5.9.

^c See paragraph 5.3.

^d See paragraphs 5.4 and 5.10.

^e LBI were notified in advance of the visit and a convenient time agreed; this was to enable the member to have the necessary records available.

- On 23 October 1989 LBI submitted its return for the period to 30 June 1989. This submission was late and IMRO commenced an investigation into LBI's late returns which resulted in a reprimand from Mr Morgan on 28 December 1989, notwithstanding the mitigating circumstances (primarily relocation and the initiation of new back office systems) that were advanced by LBI.
- Even after this reprimand, LBI's return for 31 December 1989 was also late but was submitted after a reminder from IMRO on 7 February 1990.

4.3 IMRO told us that there were no visits to LBI during 1990^a but the following matters arose in connection with the supervision of LBI:

- In March and April 1990 LBI and IMRO corresponded about LBI's annual audited accounts. LBI informed IMRO that the accounts would not be completed on time and requested an extension until 31 May 1990. After enquiring from Mr Trachtenberg the cause of the delay, an extension until 1 June 1990 was granted by IMRO.
- The accounts of LBI for the year ended 31 December 1989 were submitted by LBI on 30 May 1990 (under cover of a letter signed by Mr Carson) together with LBI's quarterly financial return for the period to March 1990. Mr Carson asked a question about the calculation of the expenditure based requirement which led later to information being provided about loans by LBI to the private side^b.
- CLD's auditors' report on LBI for the year ended 31 December 1989 was submitted to IMRO together with the audited accounts. CLD raised certain qualifications in their audit report relating to: failure by LBI to reconcile a customer's documents of title as supplied by the custodian to LBI's own records within the required 8 month period; failure by LBI to reconcile each client bank account as recorded by LBI to the bank's records at least once a month; and separate client money accounts had not been used for several large fund transfers during the year.

4.4 In the period January to April 1991 IMRO and LBI had the following contact:

- On 5 February 1991 LBI sent to IMRO Member Assessment a statement of representation for July 1990 to December 1990: this referred to a significant increase in stocklending activity by LBI on behalf of its clients.
- On 12 March 1991, Mr Carson and Mr Ford of LBI visited IMRO.
- On 21 March 1991 LBI notified IMRO Member Assessment that it had made 3 deposits with "a fellow group company" in late 1990 and early 1991, in order to generate interest in excess of that available in the market at that time.
- On 30 April 1991 LBI submitted its annual return and auditors' report for the year ended 31 December 1990.

^a Mr Trachtenberg told us that he and Mr Carson had a lunchtime meeting with two officers from IMRO towards the end of 1990 at which they discussed MCEEP and LBI.

^b See paragraph 5.15.

- As a result of apparent discrepancies between LBI's financial statements for the year ended 31 December 1990 and those that had been submitted quarterly during 1990, IMRO wrote seeking clarification on 31 May 1991. LBI provided explanations on 4 June 1991.
- Mr Trachtenberg told us that he and Mr Carson had a lunchtime meeting with IMRO in the spring of 1991.

Outline chronology: supervision of BIM

4.5 The only contact between BIM and IMRO in the period 1988-1990 was the submission by BIM of its quarterly returns^a.

- On 29 November 1990 IMRO carried out its first visit to BIM, having notified BIM some 6 weeks in advance that the visit was to take place; the visit was carried out by two officers - one who had been with IMRO since September 1989 (with a degree in legal studies and experience in the insurance industry) and the other who was a recently qualified accountant on secondment to IMRO. KM told us that considerable preparation was put into the visit by Mr Cook on the instructions of RM. In particular, he recalled a meeting at which Mr Cook explained to RM what was going to happen during the inspection and at which RM insisted on seeing every piece of paper that was intended to be placed before IMRO. RM's approach to regulators was that nothing was routine as his attitude to any communication from a governmental body was hostile. His view was that you must check everything yourself and not leave it to others. For example, during the meeting RM reviewed the rules and it was realised that a control manual was required: CLD were immediately instructed to draft a manual. Mr Cook told us he recalled the meeting. He did not explain to RM what was going to happen as he did not know, but showed him the papers he had assembled.
- On 18 December 1990 IMRO wrote to BIM setting out the results of the visit:

"As an Occupation Pension Scheme Member many of the IMRO rules are disapplied. However, it was noted that the Member had incorporated into its compliance programme many of these rule requirements as a matter of best practice. It is also clear that considerable resources have been applied in order to ensure strong systems are in place. Based on the above it is our opinion that the member is conducting its permitted business in a satisfactory manner and that no matters have come to our attention which might affect the fit and proper status of your membership."

- On 7 January 1991 Mr Cook wrote to IMRO to inform them that their letter had been referred to a meeting of the board of BIM on 21 December 1990 and that the points made in the letter had been noted.

4.6 No information was provided to IMRO by CLD pursuant to section 109 of the Financial Services Act 1986.

^a An inquiry had been made of IMRO by Mr Trachtenberg on 10 November 1989 about potential conflict of interest in LBI dealing on behalf of BIM. He had been advised that such dealing was permissible if the applicable rules were adhered to.

5 Work in relation to the abuses at LBI and BIM

5.1 We have identified 5 main abuses of the assets under the management of LBI and BIM which are summarised at paragraph 13.3 of the Report:

- (1) The way BIM was managed and its domination by RM
- (2) Investment in related companies
- (3) Related party dealings
- (4) Loans of cash to the private side
- (5) Use of shares as collateral for the benefit of the private side

5.2 What IMRO knew about these abuses is set out below.

(1) The way BIM was managed and its domination by RM

5.3 The assessment of LBI's fitness and properness made prior to the visit by IMRO to LBI in February 1989 stated:

"R Maxwell involved in certain litigation - none in financial matters"

"Potential dominance of Robert Maxwell"

5.4 The planning document completed prior to the visit by IMRO to LBI in February 1989 noted

- LBI was controlled by RM and not KM as had been set out in LBI's application for membership of IMRO
- RM was Chairman of BIM

5.5 During the visit to BIM in November 1990 it was noted that RM and KM did all the dealing. It was also noted by IMRO that CLD visited BIM monthly in order to ensure that compliance procedures (which had been drafted by CLD) were followed; one of the IMRO staff that carried out the visit recalled being shown by Mr Cook an invoice for CLD's monthly fee and noted on the file:

"At present the auditors visit once a month on request of member to ensure systems are followed and to iron out any weaknesses. The member will reduce this to quarterly once the computer system and pricing system reveal no problems & staff are confident of the system. At present this clearly acts as a strong compliance control (at £2,200 per month it should ensure strong systems are in place & developed as necessary)."

Mr Cook told us that he had told IMRO that there had been monthly visits by CLD when BIM was in its infancy but that he did not tell IMRO that the visits were still continuing in November 1990; he did not consider that the note was accurate.

5.6 Although IMRO knew about the criticisms of the DTI Inspectors in 1971-73, this was not taken into account during the visits. In the case of the BIM visit an enquiry was made, by the officers who were to conduct the visit, of IMRO's intelligence unit; they received a report back which stated "Nothing adverse held".

(2) **Investment in related companies**

5.7 During the visit by IMRO to BIM in November 1990 the composition of the CIF at 31 October 1990 was examined, which indicated 9 holdings comprising 80% of the value of the fund:

		Number of shares	Value £m
1	MCC	36,366,482	£54.9
2	Scitex	5,400,000	£44.1
3	Euris	2,228,479	£36.1
4	Invesco MIM	46,387,317	£34.8
5	Lazard Property Unit	11,337	£30.2
6	Teva	50,392,456	£21.1
7	Marceau	1,200,000	£14.2
8	OAG "C"	250	£12.9
9	Banco Commercial Portugues	1,016,850	£12.2

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5.8 The holding in MCC shares in fact amounted to over 5 per cent. of the issued share capital of MCC and to over 5 per cent. of the CIF; OAG was a subsidiary of MCC. None of these points was noted by IMRO on the visit or in its report on the visit.

(3) **Related party dealings**

5.9 The general risk assessment for LBI made on 22 November 1988 gave a high risk rating for conflicting business areas as a result of possible conflicts from managing Maxwell funds but concluded that the overall risk rating was quite low.

5.10 The planning document completed prior to the visit by IMRO to LBI in February 1989 noted that the management of Maxwell funds could give rise to conflicts of interest.

5.11 Prior to this visit, it was also noted by IMRO that companies associated with RM had acquired a substantial holding in FTIT. In the course of the visit to LBI on 7 February 1989 documents relating to acquisition by the CIF of 10.956 million shares in FTIT were examined with a view to ensuring best execution, but it was not realised that this was the holding that had originally been acquired by LBH and that had been transferred to the CIF.

5.12 During the visit to LBI in February 1989, an IMRO officer was told by Mr Trachtenberg that LBI managed a portfolio of £75m for a UK pension fund; the IMRO officer did not ask which pension fund it was and did not recall associating it with the Maxwell group. He was, however, provided with a portfolio printout at 31 December 1988 which referred in many places to "Trevor", the codename used at LBI for the portfolio of the CIF that LBI managed for BIM.

5.13 During the visit by IMRO to BIM in November 1990 the following note was made:

"Some stocks are not purchased from the stockbrokers but are purchased from other Maxwell companies. The reason for this is that when a Maxwell owned stock is to be sold, the pension fund is given first refusal. If the fund trustees believe the stock suits their portfolio, they decide to buy. However an independent body is employed to value the stock. A Phillips & Drew report was seen which priced the stock and gave opinions on the stock. The trustees decide on this basis. All deals are reviewed at quarterly intervals and all information written down to ensure no conflict of interest. The compliance officer reviews and retains all information."

The officer of IMRO who drafted this note told us that she did so on the basis of a conversation with KM during which she was shown by him a Phillips & Drew valuation report; she was also told by Mr Cook that he and the trustees of the underlying pension schemes reviewed transactions for suitability. Mr Cook agreed with the second point but told us that the only report he might have shown to IMRO was a Bankers Trust valuation report; he had not been present throughout the meeting between KM and the IMRO officers. KM told us that his meeting with IMRO was held over lunch and took the form of IMRO putting to him for confirmation matters which they had already addressed with Mr Cook, who had done all the preparation for the visit. KM thought that he probably told IMRO something the gist of which was that when assets were transferred from the group valuations were obtained: but he thought the reference to Phillips & Drew to be an error and that IMRO had been shown a Bankers Trust valuation. He thought it likely that he had mentioned that the pension fund was given first refusal because it was the case that strategic assets were more normally sold to the pension funds than to third parties. KM recalled that the officers of IMRO whom he met were unbelievably young, even for him aged 30 and that his meeting with them was not very probing: it was not a discussion about policy but asking him to agree or disagree with what they had already been told by Mr Cook. He rather got the impression that they were visiting BIM because they had to and were seeing him because it was part of their job to see the finance officer.

(4) **Loans of cash to the private side**

5.14 In the course of the visit to LBI on 7 February 1989 documents relating to the sale by LBI of £27.5m of that part of the CIF portfolio that it managed were examined with a view to ensuring best execution; it was recorded that the funds had been paid by LBI to Morgan Stanley. It was not possible to tell from those documents that the funds had been loaned to the private side^a.

5.15 In a letter from Mr Carson of LBI on 30 May 1990 a query was raised with IMRO as to how the payment by LBI of £831,000 and receipt by LBI of £912,000 short term interest should be treated for the purposes of LBI's expenditure based requirement. IMRO requested further information from LBI in order to answer the query and were told that LBI had taken a loan of £20m which it had on lent to PHL at a margin of one per cent. IMRO do not appear to have questioned the related party aspects of the transactions but only dealt with confirmation of the accounting treatment of the

^a In December 1988 LBI had liquidated the Japanese shares from that part of the CIF portfolio that it managed and had on 29 December 1988 loaned the amount received, £27.5m, to PHL. That sum (and interest) was repaid to LBI on 30 January 1990.

interest paid and received by LBI in connection with the calculation of the expenditure based requirement.

- 5.16 On 21 March 1991 Mr Carson of LBI wrote to IMRO with a similar question on LBI's financial resources statement; in the letter he informed them that during the latter part of 1990 and the early 1991, LBI had made three deposits with a fellow group company and that these deposits were made to generate interest in excess of that available in the market at the time. The only consideration given by IMRO to the related party aspects of the loans was to disallow them as they were being held by a fellow group company and not in a bank.

(5) **Use of shares as collateral for the benefit of the private side**

- 5.17 In the course of the visit to LBI on 7 February 1989 the following was noted:

- LBI had neither made a profit nor a loss from dealing in the quarter to September 1988 - IMRO concluded that LBI had not carried out any proprietary trading in that period but made no inquiries on the subject. In fact at that time LBI was using shares from that part of the CIF portfolio it managed as collateral for loans that provided LBI with funds necessary for proprietary trading.
- The checklist for the visit asked (at question 2.17) the following question:

“Do periodic statements provide the following?
“any assets charged to secure borrowings at the closing date?^a”

Having had a conversation with Mr Trachtenberg^b, the IMRO officer at first answered this question "no". This answer was reviewed by a colleague who asked whether this meant that assets had been charged but that had not been disclosed on the periodic statements. The officer telephoned Mr Trachtenberg and his note recorded that Mr Trachtenberg had said that assets had not been charged and that he had changed the answer on the checklist to "N/A". Mr Trachtenberg could not recall this conversation.

- The printout of that part of the CIF portfolio managed by LBI that was in the custody of MSTC at 31 December 1988 examined by IMRO showed nothing about "stocklending". We asked MSTC about the use of shares from the CIF for stocklending and were provided with a different print out that showed that stocks of the CIF were being pledged or loaned at this time.
- The custodian agreement between LBI and MSTC was examined by IMRO and the fact that the agreement referred to LBI as the customer instead of LBI's clients was identified as a deficiency. IMRO wrote to LBI on 10 March 1989 identifying the problem with the custodian agreement and inviting LBI to provide details of its proposals to remedy the defect. Although LBI and

^a An IMRO rule required that charging or lending of client assets be disclosed in the periodic reports as at the date of the report (which in this case was December 1988) by the IMRO member.

^b The IMRO officer's note of the conversation states: "Lending (benefit of customer)...Might re pension fund." The officer told us that he could not recall anything about the conversation other than what was stated in the note. Mr Trachtenberg told us that it would have been obvious to IMRO that the lending was of BIM stocks since, at that time, the BIM portfolio was the only one available.

MSTC corresponded on this point from April 1990, no amendment was ever made to the custodian agreement.

5.18 During the course of the visit to BIM in November 1990 we were told that one of the officers asked Mr Cook in whose name the assets were held and he was told "All assets and money held in name of BIM". He noted this down. Mr Cook told us he did not say this as it was not correct that all the assets were in the name of BIM.

6 **IMRO's reasons why the abuses were not discovered**

6.1 The following were suggested to us by IMRO as reasons why matters were not discovered or their significance not appreciated.

6.2 The work performed by IMRO in assessing the applications for membership by LBI and BIM and during the visits to those companies did not amount to an audit. Visits by IMRO to members were spot checks designed to gain an appreciation of the business carried on by the member and to form a conclusion that the member was taking regulation seriously. Consequently, it was only the systems of the member that were examined to ensure compliance; no check, for example, would be made on the existence of assets, as these were subject to audit by the auditors.

6.3 IMRO relied on the fact that all its members had to be audited and, to that end, required, save for OPS members, reports from auditors on compliance to be submitted. In the case of LBI and BIM reliance was placed on the work of CLD as auditors and also in preparing compliance manuals.

6.4 Those working for IMRO and who made visits to members were relatively inexperienced; some were seconded from accounting and legal firms and did not have the requisite market experience to spot the difficulties. At that time the monitoring function was seen as requiring accountancy experience and thus more than 80 per cent. of the staff had accountancy backgrounds. Staff with market experience were not readily available at that time. A person with more experience in the fund management business might have noticed certain of the matters that were amiss at LBI and BIM. However, IMRO did not have the resources to employ such persons nor to allow those that it did employ more time to examine each member any more extensively than was possible during a spot check visit.

6.5 Although RM's character was taken into account on admission of LBI and BIM, it was not sufficiently taken into account in the monitoring process, particularly on the visit to BIM where it was not noted on the file as an issue. Whilst there was a general awareness of certain people at IMRO about the 1971/73 DTI reports on RM, Mr Morgan told us that, whilst he was regarded as being sharp and not scrupulous, RM was not regarded as a crook - prominent people sat on boards of his companies and he had the support of major banks.

6.6 BIM was an OPS member of IMRO and was, consequently, subject to a lesser degree of regulation than other IMRO members as certain rules (such as those relating to financial resource, accounting records, financial reporting and audit requirements) were disapplied. The assets of OPS members of IMRO were regarded as subject to a reduced risk of misuse, since it was thought that there was little scope for fraud given the roles performed by the trustees, beneficiaries, actuaries and the Occupational Pensions Board. However, the fact that BIM was an OPS member and that certain rules were disapplied did not make any material difference, save for the perception of a reduced risk of misuse of assets.

7 **The changes made at IMRO**

7.1 IMRO undertook in 1992 a detailed examination of its role in relation to BIM and LBI and a number of significant changes were made to the way it operated. We outline the main changes that were made, but as explained in chapter 23 of the Report more radical changes were brought about with the establishment of the FSA.

Admissions procedure

7.2 Two committees of the board with fully delegated powers were formed to admit members so that there was always available a committee where a member of the committee had no connection with the applicant. Full disclosure of all connections with the applicant was required of all committee members and a ruling made by the committee on whether there was a conflict. This was intended to prevent there being even the appearance of a conflict of interest (cf. what occurred on the admission of LBI - see paragraph 2.12 above).

7.3 The problem faced on the admission of BIM of having a suspicion that RM was a “crook”, but having no hard evidence (see paragraph 2.6 above) continued to be faced by all regulators as refusal of membership has to be supported by evidence of unfitness which could, if necessary, be sustained on a judicial review^a. However IMRO sought to deal with this problem by imposing conditions such as requiring modifications to the management structure or restricting the type of business or client that could be accepted by the member. IMRO then monitored the applicant until their suspicions proved either to be unfounded or confirmed. (cf. what happened in the case of RM - see paragraph 6.5 above).

7.4 The regulating requirements for the OPS category of Membership (see paragraphs 2.3 and 6.6 above) were brought into line with those applying to other members.

Monitoring

^a We were told that IMRO would not give in to the threat of judicial review as to act otherwise would be to defeat self regulation; they were quite prepared to defend any of their decisions.

7.5 Many improvements were made to the way members were monitored after admission; we were told by IMRO that:

- Risk assessment (cf. paragraph 4.2 and 6.6 above) had been refined and made more sophisticated.
- Visits were more rigorously planned and the information held by IMRO about the member taken into account (cf. what happened on the visit to BIM - see paragraph 5.6 above). There was greater continuity of the personnel in the teams that monitored members.
- Visits were no longer announced a considerable period in advance (cf. the 6 weeks given for the visit to BIM - paragraph 4.5 above); visits were often announced an hour in advance which, whilst ensuring that the staff were present, did not provide a real opportunity to cover things up.
- A much larger proportion of the staff had market experience and was therefore more easily able to understand transactions, ask the right questions and spot weaknesses (cf. paragraphs 5.8 and 6.4 above, the visit to LBI in 1989 - see paragraphs 5.11 and 5.12 above - and the visit to BIM - see paragraph 4.5 above).
- They verified what they were told by firms (cf. what happened on the visit to BIM - paragraphs 5.5, 5.13 and 5.18 above).
- They carried out reconciliations and verified assets (cf. the practice described at paragraph 6.2 above and the visit to LBI in 1989 - see paragraph 5.17 above).

7.6 A system of individual registration was implemented by IMRO. They highlighted the responsibility of individuals by making clear that the failure to report breaches of the rules or wrongdoing was the responsibility of the person who knew what was happening; concern at losing a job if wrongdoing involving senior management was reported was matched by concern that IMRO's sanction for not reporting might render the person unemployable in the industry.

7.7 IMRO relied much less on auditors (cf. the practice described at paragraph 6.3 above). They took the view that the focus of IMRO's concern was to protect the investor and see that transactions were conducted in the interests of the client. This was not the focus of the auditors' work. They therefore relied much more on their own work than assurances from others.

7.8 However although these improvements detected bad practices, failure to adhere to the rules and abuse of clients, sophisticated fraud remained difficult to detect.

The flow of information between regulators

7.9 Some improvement was made in the flow of information (cf. paragraph 3.1) between regulators.