

Appendix 3

In this appendix all the text is new text and is not underlined or struck through in the usual manner.

The DFSA Sourcebook

Chapter 6 of Regulatory Policy and Process (RPP Sourcebook)

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6 PENALTY GUIDANCE

6-1 DFSA'S APPROACH TO IMPOSING A PENALTY

6-1-1 This chapter sets out the matters that will be taken into account by the DFSA Executive when determining a "penalty", which includes a "financial penalty" or a "public censure".

6-1-2 The DFSA may also refer to this section when determining an appropriate penalty in settlement agreements, including an Enforceable Undertaking.

6-1-3 Where the DFSA considers that a Person has contravened a provision of any legislation administered by the DFSA, it may impose a penalty on such Person, including:

- (a) an Authorised Person, DNFBP or Auditor (collectively referred to as "firms" in this chapter unless otherwise stated); and
- (b) an Authorised Individual, Principal Representative, Key Individual, Persons Undertaking Key Control Functions, Audit Principal, or "senior management" for the purposes of the AML Module (collectively referred to as "Key Persons" in this chapter unless otherwise stated).

6-2 DECIDING TO TAKE ACTION

6-2-1 When determining a penalty, the DFSA will consider all relevant facts and circumstances. Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant. The factors include:

- (a) the DFSA's objectives;
- (b) the deterrent effect of the penalty on:
 - (i) Persons that have committed or may commit the contraventions; and
 - (ii) other Persons that have committed or may commit similar contraventions;
- (c) the nature, seriousness and impact of the contravention, including whether the contravention was deliberate or reckless;
- (d) if the contravention involved a number of Persons, the degree of involvement and specific role of each Person;
- (e) the benefit gained (whether direct or indirect, pecuniary or non-pecuniary) or loss avoided as a result of the contravention;
- (f) the conduct of the Person after the contravention;

- (g) the difficulty in detecting and investigating the contravention that is the subject of the penalty;
- (h) whether the Person committed the contravention in such a way as to avoid or reduce the risk that the contravention would be discovered. A Person's incentive to commit a contravention may be greater where the contravention is, by its nature, harder to detect. The DFSA may impose a more significant penalty where it considers that a Person committed a contravention in such a way as to avoid or reduce the risk that the contravention would be discovered;
- (i) the disciplinary record and compliance history of the Person on whom the penalty is imposed;
- (j) whether the Person acted in accordance with DFSA guidance and other published materials. The DFSA will not take action against a Person for behaviour that it considers to be in line with guidance or other materials published by the DFSA in support of its Rulebook and Sourcebook which were current at the time of the behaviour in question;
- (k) action taken by the DFSA in previous similar cases; and
- (l) action taken by other domestic or international regulatory authorities. Where other regulatory authorities propose to take action in respect of the contravention which is under consideration by the DFSA, or one similar to it, the DFSA will consider whether the other authority's action would be adequate to address the DFSA's concerns, or whether it would be appropriate for the DFSA to take its own action.

Actions against Key Persons

6-2-2 In addition to the general factors in paragraph 6-2-1, there are some additional considerations that may be relevant when the DFSA decides whether to take action against a Key Person. The list is not exhaustive: not all of these factors may be applicable in a particular case, and there may be other factors, not listed that are relevant. The factors include:

- (a) the Key Person's position and responsibilities. The more senior the Key Person responsible for the misconduct, the more seriously the DFSA is likely to view the misconduct, and the more likely it is to take action against the Key Person; and
- (b) whether disciplinary action against the firm rather than the Key Person would be a more appropriate regulatory response.

6-3 FINANCIAL PENALTY OR PUBLIC CENSURE

6-3-1 The DFSA will consider all the relevant circumstances of the case when deciding whether to impose a financial penalty or issue a public censure. As such, the factors set out in section 6-2 are not exhaustive. Not all of the factors may be relevant in a particular case and there may be other factors, not listed, that are relevant.

6-3-2 The criteria for determining whether it is appropriate to issue a public censure rather than impose a financial penalty include those factors that the DFSA will consider in determining the amount of a financial penalty set out in sections 6-5 to 6-7. Some particular considerations that may be relevant when the DFSA determines whether to issue a public censure rather than impose a financial penalty are:

- (a) whether or not deterrence may be effectively achieved by issuing a public censure;
- (b) depending upon the nature and seriousness of the contravention:
 - (i) whether the Person has brought the contravention to the attention of the DFSA;
 - (ii) whether the Person has admitted the contravention and provides full and immediate co-operation to the DFSA, and takes steps to ensure that those who have suffered loss due to the contravention are fully compensated for those losses;
- (c) the DFSA's approach in similar previous cases: the DFSA will seek to achieve a consistent approach to its decisions on whether to impose a financial penalty or issue a public censure; and
- (d) the impact on the Person concerned. It would only be in an exceptional case that the DFSA would be prepared to agree to issue a public censure rather than impose a financial penalty if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include:
 - (i) where the application of the DFSA's policy on serious financial hardship (set out in section 6-7) results in a financial penalty being reduced to zero;
 - (ii) where there is verifiable evidence that the Person would be unable to meet other regulatory requirements, particularly financial resource requirements, if the DFSA imposed a financial penalty at an appropriate level; or
 - (iii) where there is the likelihood of a severe adverse impact on a Person's shareholders or a consequential impact on market confidence or market stability if a financial penalty were imposed. However, this does not exclude the imposition of a financial penalty even though this may have an impact on a Person's shareholders.

6-3-3 Some particular considerations that may be relevant when the DFSA determines whether to issue a financial penalty rather than impose a public censure are:

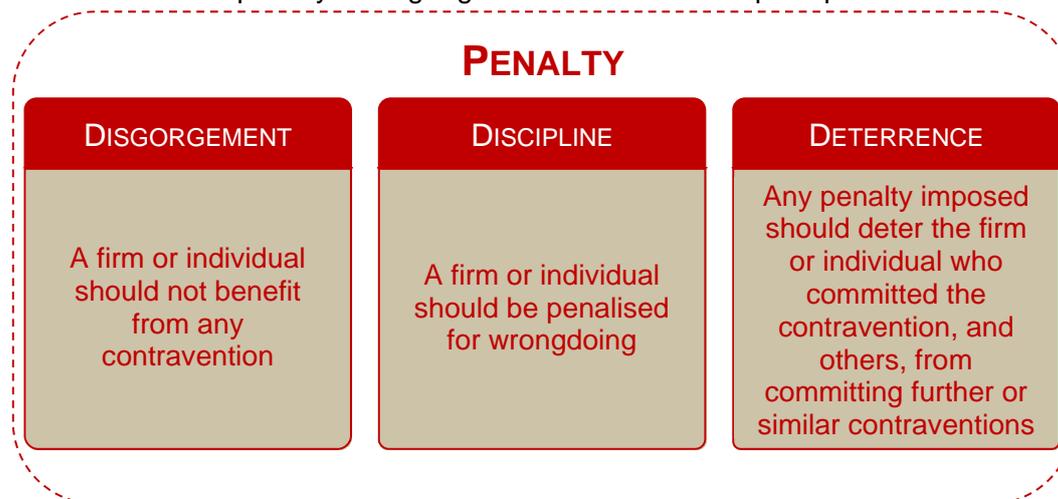
- (a) if the Person has made a profit or avoided a loss as a result of the contravention, on the basis that a Person should not be permitted to benefit from its contravention;
- (b) if the contravention is more serious in nature or degree, on the basis that the sanction should reflect the seriousness of the contravention; other things being

equal, the more serious the contravention, the more likely the DFSA is to impose a financial penalty; and

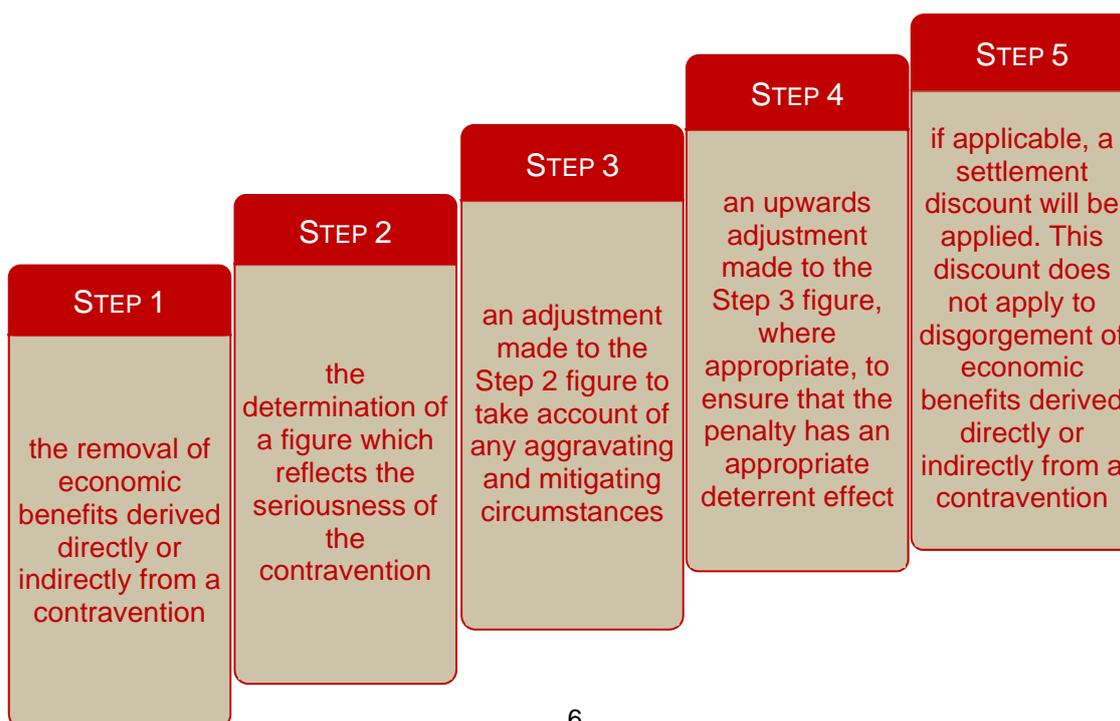
- (c) if the Person has a poor disciplinary record or compliance history, on the basis that it may be particularly important to deter future cases.

6-4 DETERMINING THE APPROPRIATE LEVEL OF FINANCIAL PENALTY

6-4-1 The DFSA's penalty-setting regime is based on three principles:



6-4-2 The total amount payable by a Person subject to enforcement action may be made up of two elements: (i) disgorgement of the benefit received as a result of the contravention; and (ii) a financial penalty reflecting the seriousness of the contravention. These elements are incorporated in a five-step framework, which can be summarised as follows:



6-4-3 The DFSA recognises that a penalty must be proportionate to the contravention. These steps will apply in all cases, although the details of Steps 1 to 4 will differ for cases against firms (section 6-5), and cases against individuals (section 6-6).

6-4-5 The lists of factors and circumstances in sections 6-5 and 6-6 are not exhaustive. Not all of the factors or circumstances listed will necessarily be relevant in a particular case and there may be other factors or circumstances not listed which are relevant.

6-5 FINANCIAL PENALTIES IMPOSED ON A FIRM

Step 1: Disgorgement

6-5-1 The DFSA will seek to deprive a firm of the economic benefits derived directly or indirectly from a contravention (which may include the profit made or loss avoided) where it is practicable to quantify this. The DFSA will ordinarily also charge interest on the benefit.

Step 2: The seriousness of the contravention

6-5-2 The DFSA will determine a financial penalty figure that reflects the seriousness of the contravention. In determining such a figure, the DFSA will take into account various factors, which will usually fall into the following four categories:

- (a) factors relating to the impact of a contravention;
- (b) factors relating to the nature of a contravention;
- (c) factors tending to show whether a contravention was deliberate; and
- (d) factors tending to show whether a contravention was reckless.

6-5-3 Factors relating to the impact of a contravention committed by a firm include:

- (a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the firm from the contravention, either directly or indirectly;
- (b) the loss or risk of loss, as a whole, caused to consumers, investors or other market users in general;
- (c) the loss or risk of loss caused to individual consumers, investors or other market users;
- (d) whether the contravention had an effect on particularly vulnerable people, whether intentionally or otherwise;
- (e) the inconvenience or distress caused to consumers; and
- (f) whether the contravention had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

6-5-4 Factors relating to the nature of a contravention by a firm include:

- (a) the nature of the Laws or Rules contravened;
- (b) the frequency of the contravention;
- (c) whether the contravention revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business;
- (d) whether the firm's senior management were aware of the contravention;
- (e) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the contravention;
- (f) the scope for any potential financial crime to be facilitated, occasioned or otherwise occur as a result of the contravention;
- (g) whether the firm failed to conduct its business with integrity; and
- (h) whether the firm, in committing the contravention, took any steps to comply with Laws and Rules, and the adequacy of those steps.

6-5-5 Factors tending to show the contravention was deliberate include:

- (a) the contravention was intentional, in that the firm's senior management, or a responsible individual, intended, could reasonably have foreseen, or foresaw that the likely or actual consequences of their actions or inaction would result in a contravention;
- (b) the firm's senior management, or a responsible individual, knew that their actions were not in accordance with the firm's internal procedures;
- (c) the firm's senior management, or a responsible individual, sought to conceal their misconduct;
- (d) the firm's senior management, or a responsible individual, committed the contravention in such a way as to avoid or reduce the risk that the contravention would be discovered;
- (e) the firm's senior management, or a responsible individual, were influenced to commit the contravention by the belief that it would be difficult to detect; and
- (f) the contravention was repeated.

6-5-6 Factors tending to show the contravention was reckless include:

- (a) the firm's senior management, or a responsible individual, appreciated that there was a risk that their actions or inaction could result in a contravention and failed adequately to mitigate that risk; and
- (b) the firm's senior management, or a responsible individual, were aware that there was a risk that their actions or inaction could result in a contravention but failed to check if they were acting in accordance with the firm's internal procedures.

Step 3: Mitigating and aggravating factors

6-5-7 The DFSA may increase or decrease the amount of the financial penalty arrived at after Step 2 (excluding any amount to be disgorged as set out in Step 1), to take into account factors which aggravate or mitigate the contravention. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

6-5-8 The following list of factors may have the effect of aggravating or mitigating the contravention:

- (a) the conduct of the firm in bringing (or failing to bring) quickly, effectively and completely the contravention to the DFSA's attention (or the attention of other regulatory authorities, where relevant);
- (b) the degree of cooperation the firm showed during the investigation of the contravention by the DFSA, or any other regulatory authority allowed to share information with the DFSA;
- (c) where the firm's senior management were aware of the contravention or of the potential for a contravention, whether they took any steps to stop the contravention, and when these steps were taken;
- (d) the nature, timeliness and adequacy of the firm's responses to any supervisory interventions by the DFSA and any remedial actions proposed or required by DFSA's supervisors;
- (e) whether the firm has arranged its resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;
- (f) whether the firm had previously been told about the DFSA's concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;
- (g) whether the firm had previously undertaken not to perform a particular act or engage in particular behaviour;
- (h) whether the firm concerned has complied with any requirements or rulings of another regulatory authority relating to the contravention;
- (i) the previous disciplinary record and general compliance history of the firm;

- (j) action taken against the firm by other domestic or international regulatory authorities that is relevant to the contravention in question;
- (k) whether DFSA guidance or other published materials had already raised relevant concerns, and the nature and accessibility of such materials; and
- (l) whether the DFSA publicly called for an improvement in standards in relation to the behaviour constituting the contravention or similar behaviour before or during the occurrence of the contravention.

Step 4: Adjustment for deterrence

6-5-9 If the DFSA considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the contravention, or others, from committing further or similar contraventions then the DFSA may increase the financial penalty. Circumstances where the DFSA may do this include:

- (a) where the DFSA considers the absolute value of the financial penalty too small in relation to the contravention to meet its objective of credible deterrence;
- (b) where previous DFSA action in respect of similar contraventions has failed to improve industry standards. This may include similar contraventions relating to different products (for example, action for mis-selling or claims handling failures in respect of 'x' product may be relevant to a case for mis-selling or claims handling failures in respect of 'y' product);
- (c) where the DFSA considers it is likely that similar contraventions will be committed by the firm or by other firms in the future in the absence of such an increase to the financial penalty; and
- (d) where the DFSA considers that the likelihood of the detection of such a contravention is low.

Step 5: Settlement discount

6-5-10 The DFSA and the firm on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, section 6-8 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the DFSA and the firm concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6-6 FINANCIAL PENALTIES IMPOSED ON AN INDIVIDUAL

Step 1: Disgorgement

6-6-1 The DFSA will seek to deprive an individual of the economic benefits derived directly or indirectly from the contravention (which may include the profit made or loss avoided) where it is possible to quantify this. The DFSA will ordinarily also charge interest on the benefit.

Step 2: The seriousness of the contravention

6-6-2 The DFSA will determine a financial penalty figure that reflects the seriousness of the contravention. In determining such a figure, the DFSA will take into account various factors, which will usually fall into the following four categories:

- (a) factors relating to the impact of the contravention;
- (b) factors relating to the nature of the contravention;
- (c) factors tending to show whether the contravention was deliberate; and
- (d) factors tending to show whether the contravention was reckless.

6-6-3 Factors relating to the impact of a contravention committed by an individual include:

- (a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the individual from the contravention, either directly or indirectly;
- (b) the loss or risk of loss, as a whole, caused to consumers, investors or other market users in general;
- (c) the loss or risk of loss caused to individual consumers, investors or other market users;
- (d) whether the contravention had an effect on particularly vulnerable people, whether intentionally or otherwise;
- (e) the inconvenience or distress caused to consumers; and
- (f) whether the contravention had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

6-6-4 Factors relating to the nature of a contravention by an individual include:

- (a) the nature of the Laws or Rules contravened;
- (b) the frequency of the contravention;
- (c) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the contravention;
- (d) the scope for any potential financial crime to be facilitated, occasioned or otherwise occur as a result of the contravention;
- (e) whether the individual failed to act with integrity;
- (f) whether the individual abused a position of trust;

- (g) whether the individual committed a contravention of any professional code of conduct;
- (h) whether the individual caused or encouraged other individuals to commit contraventions;
- (i) whether the individual held a prominent position within the industry;
- (j) whether the individual is an experienced industry professional;
- (k) whether the individual held a senior position with the firm;
- (l) the extent of the responsibility of the individual for the product or business areas affected by the contravention, and for the particular matter that was the subject of the contravention;
- (m) whether the individual acted under duress; and
- (n) whether the individual took any steps to comply with DFSA rules, and the adequacy of those steps.

6-6-5 Factors tending to show the contravention was deliberate include:

- (a) the contravention was intentional, in that the individual intended, could reasonably have foreseen or foresaw that the likely or actual consequences of his actions or inaction would result in a contravention;
- (b) the individual intended to benefit financially from the contravention, either directly or indirectly;
- (c) the individual knew that his actions were not in accordance with his firm's internal procedures;
- (d) the individual sought to conceal his misconduct;
- (e) the individual committed the contravention in such a way as to avoid or reduce the risk that the contravention would be discovered;
- (f) the individual was influenced to commit the contravention by the belief that it would be difficult to detect;
- (g) the individual knowingly took decisions relating to the contravention beyond his field of competence; and
- (h) the individual's actions were repeated.

6-6-6 Factors tending to show the contravention was reckless include:

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

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

Step 3: Mitigating and aggravating factors

6-6-7 The DFSA may increase or decrease the amount of the financial penalty arrived at after Step 2 (excluding any amount to be disgorged as set out in Step 1), to take into account factors which aggravate or mitigate the contravention. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

6-6-8 The following list of factors may have the effect of aggravating or mitigating the contravention:

- (a) the conduct of the individual in bringing (or failing to bring) quickly, effectively and completely the contravention to the DFSA's attention (or the attention of other regulatory authorities, where relevant);
- (b) the degree of cooperation the individual showed during the investigation of the contravention by the DFSA, or any other regulatory authority allowed to share information with the DFSA;
- (c) whether the individual took any steps to stop the contravention, and when these steps were taken;
- (d) any remedial steps taken since the contravention was identified, including whether these were taken on the individual's own initiative or that of the DFSA or another regulatory authority;
- (e) whether the individual has arranged his resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;
- (f) whether the individual had previously been told about the DFSA's concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;
- (g) whether the individual had previously undertaken not to perform a particular act or engage in particular behaviour;
- (h) whether the individual has complied with any requirements or rulings of another regulatory authority relating to the contravention;
- (i) the previous disciplinary record and general compliance history of the individual;
- (j) action taken against the individual by other domestic or international regulatory authorities that is relevant to the contravention in question;
- (k) whether DFSA guidance or other published materials had already raised relevant concerns, and the nature and accessibility of such materials;

- (l) whether the DFSA publicly called for an improvement in standards in relation to the behaviour constituting the contravention or similar behaviour before or during the occurrence of the contravention; and
- (m) whether the individual agreed to undertake training subsequent to the contravention.

Step 4: Adjustment for deterrence

6-6-9 If the DFSA considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the contravention, or others, from committing further or similar contraventions then the DFSA may increase the financial penalty. Circumstances where the DFSA may do this include:

- (a) where the DFSA considers the absolute value of the penalty too small in relation to the contravention to meet its objective of credible deterrence;
- (b) where previous DFSA action in respect of similar contraventions has failed to improve industry standards. This may include similar contraventions relating to different products;
- (c) where the DFSA considers it is likely that similar contraventions will be committed by the individual or by other individuals in the future; and
- (d) where the DFSA considers that the likelihood of the detection of such a contravention is low.

Step 5: Settlement discount

6-6-10 The DFSA and the individual on whom a penalty is to be imposed may seek to agree on the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, section 6-8 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the DFSA and the individual concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6-7 SERIOUS FINANCIAL HARDSHIP

6-7-1 The DFSA's approach to determining penalties described in sections 6-5 and 6-6 is intended to ensure that financial penalties are proportionate to the contravention. The DFSA recognises that penalties may affect Persons differently, and that the DFSA should consider whether a reduction in the proposed financial penalty is appropriate if such penalty would cause the subject of enforcement action serious financial hardship.

6-7-2 Where an individual or firm claims that payment of the financial penalty proposed by the DFSA will cause them serious financial hardship, the DFSA will consider whether to reduce the proposed financial penalty only if:

- (a) the individual or firm provides verifiable evidence that payment of the financial penalty will cause them serious financial hardship;

- (b) the individual or firm provides full, frank and timely disclosure of the verifiable evidence, and cooperates fully in answering any questions asked by the DFSA about their financial position; and
- (c) the individual or firm is able to satisfy the DFSA that payment of the financial penalty will cause them serious financial hardship.

6-7-3 There may be cases where, even though the individual or firm has satisfied the DFSA that payment of the financial penalty would cause serious financial hardship, the DFSA considers the contravention to be so serious that it is not appropriate to reduce the financial penalty. The DFSA will consider all the circumstances of the case in determining whether this course of action is appropriate, including whether:

- (a) the individual or firm directly or indirectly derived an economic benefit from the contravention and, if so, the extent of that economic benefit;
- (b) the individual or firm acted fraudulently or dishonestly with a view to personal gain; or
- (c) the individual or firm has spent money or dissipated assets in anticipation of DFSA or other enforcement action with a view to frustrating or limiting the impact of action taken by the DFSA or other authorities.

Individuals

6-7-4 In assessing whether a financial penalty would cause an individual serious financial hardship, the DFSA will consider the individual's ability to pay the financial penalty over a reasonable period, including agreeing to payment of the financial penalty by instalments where the individual requires time to realise his assets, for example, by waiting for payment of a salary or by selling property.

Firms

6-7-5 The DFSA will consider reducing the amount of a financial penalty if a firm will suffer serious financial hardship as a result of having to pay the entire financial penalty. In deciding whether it is appropriate to reduce the financial penalty, the DFSA will take into consideration the firm's financial circumstances, including whether the financial penalty would render the firm insolvent or threaten the firm's solvency. The DFSA will also take into account its statutory objectives, for example, in situations where consumers would be harmed or market confidence would suffer, the DFSA may consider it appropriate to reduce a financial penalty in order to allow a firm to continue in business and/or pay redress.

Withdrawal of authorisation or registration

6-7-6 The DFSA may withdraw a firm's Licence or registration, or the status of registration of an Authorised Individual, Key Individual, Principal Representative or Audit Principal, as well as impose a financial penalty. Such action by the DFSA does not affect the DFSA's assessment of the appropriate financial penalty in relation to a contravention. However, the fact that the DFSA has withdrawn such Licence or registration, as a result of which the firm or individual may have less earning potential,

may be relevant in assessing whether the financial penalty will cause the firm or individual serious financial hardship.

6-8 DISCOUNT FOR EARLY SETTLEMENT

6-8-1 Persons subject to enforcement action may be prepared to agree on the amount of any financial penalty, and other conditions which the DFSA seeks to impose by way of such action. Such conditions might include, for example, the amount or mechanism for the payment of compensation to consumers. The DFSA recognises the benefits of such agreements, in that they offer the potential for securing earlier redress or protection for consumers and the saving of cost to the Person concerned, and the DFSA itself, in contesting the financial penalty. The financial penalty that might otherwise be payable, in respect of a contravention by the Person concerned, will, therefore, be reduced to reflect the timing of any settlement agreement.

6-8-2 In appropriate cases the DFSA's approach will be to negotiate with the Person concerned to agree in principle on the amount of a financial penalty having regard to the DFSA's statement of policy as set out in section 5-17 and this chapter. Where part of a proposed financial penalty specifically equates to the disgorgement of profit accrued or loss avoided, then the percentage reduction will not apply to that part of the financial penalty.