THE CITY LIBRARY

ISSUE 148 – JULY 2017

COMPLIANCE OFFICER BULLETIN

The Travers Smith Regulatory Investigations Group comprises members of the firm's Financial Services and Markets and Dispute Resolution teams, all of whom are leading experts in regulatory investigations and disciplinary and enforcement proceedings. The Group has extensive experience in advising individuals and companies in relation to both internal and external investigations and enforcement proceedings by the FCA (and before that, the FSA), the Serious Fraud Office, the London Stock Exchange, HMRC and various non-UK regulators (including the SEC). The Group provides advice on a wide range of issues in this area including: manipulation of trading records, client money failings, mismarking, market abuse, systems and controls failings, loss of customer details, mis-selling, money laundering failings and breaches of the requirements regarding the marketing of unregulated collective investment schemes and other non-mainstream pooled investments.

The co-heads of the Regulatory Investigations Group are **Jane Tuckley** and **Stephen Paget-Brown**.

FCA AND PRA ENFORCEMENT ACTIONS: THEMES AND TRENDS

1. Introduction and overview

The poet Alexander Pope once wisely observed that "blessed is he who expects nothing, for he shall never be disappointed". While the events of 2016 may have confounded many people's expectations in more ways than one, those anticipating a return to record FCA individual fines and an aggregate penalty figure of around the £1 billion mark were particularly disappointed. At the end of 2016, total FCA fines stood at only £22.2 million (or a little over £35 million if a separate amount of voluntary redress payable by one individual is also included), compared with a total of over £900 million the year before. On the face of it, this might appear to presage a change to a less aggressive enforcement strategy by the regulator, but the reasons for this sharp decline may in fact be more complex. It is certainly true that the number of individual enforcement cases declined: in 2015, the FCA issued 40 enforcement final notices, whereas in 2016, this was reduced to approximately 20. However, the largest factor behind the sudden reduction was the absence of any substantial LIBOR or foreign exchange manipulation penalties issued against firms in 2016, whereas 2015 had seen a record number of fines for such conduct. It is also notable that many of the fines issued in 2016 were against individuals, who generally have a reduced financial capacity compared to firms and therefore pay smaller penalties. To the extent that the lower aggregate level of fines in 2016 results from the FCA seeking to hold specific individuals to account, it is unlikely to be of particular comfort to many firms or their staff.

It is also worth noting that the first few months of 2017 may represent something of a return to "business as usual", with the FCA having issued a £163 million fine against

CONTENTS

1 Introduction and overview
2 Market conduct
3 Money laundering systems and controls
4 Failure to comply with client asset and client money rules
5 Failure to act with due skill, care and diligence
6 Failure to be open and co-operative with the regulator
7 Failure to operate adequate systems and controls
8 Identification of connected parties in FCA and PRA notices

THOMSON REUTERS™

Compliance Officer Bulletin is published by Thomson Reuters trading as Sweet & Maxwell. Registered in England & Wales, Company No.1679046. Registered Office and address for service: 5 Canada Square, Canary Wharf, London, E14 5AQ.

ISSN: 1478-1964

Compliance Officer Bulletin is published 10 times a year. Subscription prices available on request.

Printed and bound in Great Britain by Hobbs the Printers Ltd, Totton, Hampshire.

Deutsche Bank in January 2017, representing a record-breaking amount in the context of money laundering failures. Tesco's potential liability of up to £85 million under a restitutionary scheme imposed by the FCA in March 2017 in connection with the false market created by its inaccurate profit announcements hints at the regulator's increasing desire to hold firms responsible for compensating those who might be adversely affected by market misconduct. Similarly, the penalty of almost £129 million payable by a Tesco subsidiary under a deferred prosecution agreement with the Serious Fraud Office arising from the same facts highlights that it is not only the FCA that might seek to impose substantial financial punishments.

1.1 References to third parties

The FCA's decision to take its long-running dispute with Achilles Macris to the Supreme Court was vindicated in March 2017 when the regulator won an important victory, giving it considerable flexibility about how to refer to third parties in its enforcement notices. Nonetheless, this has raised concerns (not least amongst the minority judges in the Supreme Court) about whether there is sufficient substantive protection for individuals against being adversely impacted by the content of FCA notices in circumstances where they will not be given a right to make representations prior to publication. Time will tell whether the judgment has struck the right balance between regulatory efficiency and the protection of individuals against unfair treatment which has the potential to cause them serious detriment. In the meantime, practitioners and commentators will be watching to see if there is an appreciable change in the FCA's approach in this area.

1.2 Market misconduct

As always, market misconduct remains a prevalent theme, with the FCA achieving a number of successful criminal prosecutions against individuals involved with the manipulation of LIBOR and several other market participants engaged in flagrant insider dealing. In terms of civil market conduct cases, the FCA has shown a particular interest in situations involving the creation of false or misleading impressions in connection with listed instruments. These include both the *Tesco* case referenced above and the approval of misleading public information by Niall O'Kelly and Lukhvir Thind for publication by Worldspreads Group following its AIM listing in 2007. The civil insider dealing actions brought against Gavin Taylor in May 2016 and Duncan Breeze in July 2016 also demonstrate the FCA's determination to pursue wrongdoing using its civil powers where criminal action would be inappropriate or impractical. When viewed as a whole, the market conduct cases send a clear signal that ensuring clean and fair markets remains high on the FCA's supervisory agenda and that the regulator aims to continue to discourage improper behaviour by making examples of those who are found to have breached the relevant rules. The increasing use of the FCA's powers to require restitution to investors affected by false markets may also lead to extremely significant costs for firms or individuals engaging in market abuse in future cases.

1.3 Anti-money laundering

In light of its published supervisory updates, it should come as no surprise to firms that the FCA has continued to focus on anti-money laundering ("AML") systems and controls throughout the period, with the Deutsche

Bank fine referenced above becoming the largest AML-related penalty ever imposed by the regulator. Sonali Bank was also fined in October 2016 for similar failings, with the FCA noting that the bank had a defective AML culture with insufficient recognition of the importance of proper money laundering controls and a lack of experience amongst senior management to oversee the necessary processes. The case is particularly important due to the parallel enforcement action taken against the bank's money laundering officer, Steven Smith, which emphasises the possibility that specific individuals within a firm may also be held responsible for serious AML failings. This apparent return to a focus on individual accountability may increase when the senior management and certification regime is extended to a much larger population of FCA-regulated firms in 2018. In addition, in light of the potential renewed focus on AML requirements following the entry into force of the Fourth Money Laundering Directive ("MLD 4") this year, firms should ensure that they review and implement the new requirements thoroughly to avoid similar regulatory action.

1.4 Client money and assets

Failure to comply with the FCA's client assets and client money rules remains another persistent theme. As in previous years, firms have failed to implement the reconciliation and segregation requirements effectively, leading to inaccurate records and client money shortfalls, both of which are viewed in a particularly poor light by the regulator. Towergate Underwriting Group received a £2,632,000 penalty in July 2016 in connection with failures resulting from its operation of a system that pooled cash in central accounts without adequate reconciliation. Two Aviva group companies were also fined a total of £8,246,800 in October 2016 as a result of deficient oversight of their compliance with the client money rules, which resulted in inaccurate records, incomplete resolution documentation and inaccurate regulatory reports. The FCA's message in relation to client assets and money remains consistent: namely, that firms face significant fines for any *potential* risk of loss that clients may face as a result of the firm's failings, even if no actual loss occurs. In light of the regular breaches in this area, firms would be well advised to review their current systems, the management information that they record and the levels of expertise within their staff and to remedy any deficiencies as a matter of urgency.

1.5 PRA enforcement

As in previous years, the PRA has undertaken fewer enforcement actions, although this may result from its narrower regulatory focus and the fact that in many cases, such action may exacerbate a firm's already declining prudential situation. Nonetheless, the Bank of Tokyo Mitsubishi and QIB (UK) Plc were subject to separate PRA penalties during the period under review, the former due to its failure to disclose important information about a foreign regulatory investigation to the regulator and the latter due to regulatory capital failings. While PRA enforcement cases may be comparatively rare relative to the FCA's actions, it is clear that they can still result in significant fines with the two Bank of Tokyo Mitsubishi entities receiving penalties totalling £34 million.

In this issue, we consider a selection of the more significant or interesting FCA and PRA enforcement actions that were published between 1 March 2016 and 31 May 2017 and explore the lessons that can be learnt by firms and individuals.

2. Market conduct

A. Criminal actions

The latter half of 2016 and the beginning of 2017 have contained mixed fortunes for the FCA and the Serious Fraud Office ("SFO") in relation to criminal prosecutions, as indicated by the selection of cases below.

2.1 Jonathan Mathew, Jay Merchant, Alex Pabon, Peter Johnson, Stylianos Contogoulas and Ryan Reich (Crown Court verdicts: July 2016 and April 2017)

2.1.1 Penalty

Mr Mathew received a four-year prison sentence, while Mr Pabon received a sentence of two years and nine months. Mr Merchant was originally sentenced to six and half years in prison, but in February 2017, had his sentence reduced to five and a half years on appeal. Mr Mathew and Mr Pabon were also made subject to confiscation orders for £37,400 and £2,300 respectively, while Mr Merchant's confiscation proceedings remain ongoing at the time of writing. Mr Johnson had previously pleaded guilty in October 2014 and was sentenced to four years in prison and ordered to pay £115,000 by way of a confiscation order and £30,000 to the cost of his prosecution.

Mr Contogoulas and Mr Reich were acquitted of all charges by a jury in April 2017, following a retrial after the original jury failed to reach a verdict in their cases.

2.1.2 Summary

The cases arose out of the defendants' alleged involvement in, or collusion with, benchmark manipulation, resulting in charges of conspiracy to defraud in connection with the manipulation of US dollar LIBOR. Each defendant was accused of dishonestly agreeing to procure or make submissions of false or misleading rates during the rate-setting process. Mr Johnson entered an early guilty plea, while Mr Mathew, Mr Pabon and Mr Merchant were convicted following a jury trial. In his sentencing remarks, HHJ Anthony Leonard QC noted the impact of the men's actions on market confidence and integrity, the large number of victims affected by the conduct and the fact that all of the men had abused positions of trust within their firms.

The SFO sought a retrial for Mr Contogoulas and Mr Reich after the original jury was unable to reach a verdict, but ultimately failed to secure convictions in relation to either man, bringing back memories of the SFO's failure to secure convictions of the six co-defendants of Tom Hayes back in January 2016.

2.1.3 Lessons to be learnt

- Any individuals within the financial services sector who are tempted to engage in fraudulent activities should take particular note of the lengthy custodial sentences imposed on each defendant. This partly reflects the fact that individuals working in financial services roles are likely to be considered to be occupying positions of trust and to have abused those positions when engaging in fraud.
- Despite the setback in relation to Mr Contogoulas and Mr Reich, the SFO's activities in connection with the alleged manipulation of interbank offered rates continue, with a further six individuals awaiting trial in September 2017 for the alleged manipulation of EURIBOR. It is clear that the FCA and SFO are determined to pursue all those who are suspected of involvement in benchmark manipulation, even though in certain cases they have failed to secure convictions.

2.2 Manjeet Mohal and Reshim Birk (Crown Court hearing: November 2016)

2.2.1 Penalty

Mr Mohal pleaded guilty to two counts of unlawful disclosure of inside information and in January 2017, was given a suspended sentence of 10 months' imprisonment with 180 hours of community work. Mr Birk pleaded guilty to one count of insider dealing and was given a 16-month suspended sentence with 200 hours of community work. He was also made subject to a confiscation order for £162,876 and both defendants were ordered to pay prosecution costs of £42,593.

2.2.2 Summary

Mr Mohal came into possession of inside information in May 2012 during the course of his employment as a business analyst at Logica Plc ("Logica"), where the FCA noted that he was a "trusted member of the management reporting team at the heart of the company". The information related to CGI Holdings (Europe) Ltd's proposed takeover of Logica, which at the time was listed on the London Stock Exchange. Mr Mohal provided the information to his neighbour, Mr Birk, who then purchased Logica shares and options two days prior to the announcement of the takeover, resulting in profits of over £100,000.

2.2.3 Lessons to be learnt

- Although both Mr Mohal and Mr Birk were able to avoid an immediate custodial sentence, the case is nonetheless another illustration of the FCA's determination to deprive those who engage in insider dealing of any financial benefits they receive as a result.

2.3 Mark Lyttleton (Crown Court hearing: November 2016)

2.3.1 Penalty

Mr Lyttleton was sentenced to 12 months' imprisonment (reduced with credit from 18 months), made subject to a confiscation order for £149,861 and ordered to pay costs of £83,225, following a guilty plea in respect of two counts of insider dealing.

2.3.2 Summary

Mr Lyttleton was a former equity portfolio manager at BlackRock who placed personal trades in shares and options on the basis of inside information that he received in his capacity as an employee of the fund manager. He instructed a Swiss asset manager and financial advisory company, Caldwell & Partners ("Caldwell"), to execute trades in the name of a company registered in Panama, the beneficial ownership of which was registered in the maiden name of his wife. Mr Lyttleton paid Caldwell's asset managers in cash rather than through bank transfers. The first case of insider dealing concerned a proposed acquisition of shares in EnCore Oil Plc ("EnCore"), a company in which BlackRock was a major shareholder. The potential acquirers of EnCore sought BlackRock's support for the acquisition in a formal letter of intent and as the relevant portfolio manager within BlackRock whose managed portfolios held EnCore stock, Mr Lyttleton was consulted in October 2011. Following the relevant meeting, Mr Lyttleton instructed Caldwell to purchase 175,000 shares in EnCore, which increased in price two days later, following the announcement of the proposed acquisition. Mr Lyttleton then had Caldwell close his position shortly thereafter, resulting in a profit of £44,000. Mr Lyttleton engaged in further insider trading in November 2011 when he learned from a fellow portfolio manager at BlackRock that Cairn Energy Plc ("Cairn Energy"), a company in which BlackRock was also a major shareholder, had received positive results from one of its wells in Greenland. He subsequently instructed Caldwell to purchase 120 call options in Cairn Energy, but the company's eventual announcement of its findings was less positive than expected and the options therefore never became profitable.

At Mr Lyttleton's sentencing hearing in December 2016 following his early guilty plea in November, the sentencing judge, HHJ Goymer, reiterated that insider dealing is not a victimless crime and that the offences were serious because they were premeditated and dishonest.

2.3.3 Lessons to be learnt

- The FCA's pursuit of Mr Lyttleton involved an international investigation, seizure of digital devices and searches of premises in both the UK and Switzerland, emphasising the lengths to which the regulator will go to secure convictions for insider dealing offences, even where the perpetrators attempt to carry out complex deceptions.
- The case also demonstrates that the FCA will pursue instances of insider dealing which do not in fact result in any profit for the perpetrator.

B. Civil actions

2.4 Mark Taylor (FCA Final Notice: 5 May 2016)

2.4.1 Penalty

Mr Taylor was fined £36,285 (reduced from £78,819 due to a combination of early settlement, serious financial hardship and credit for full admissions given in an early interview under caution) and made subject to a prohibition order. This resulted from Mr Taylor engaging in market abuse through insider dealing in March 2015.

2.4.2 Summary

Mr Taylor was a financial planner within Towry Ltd ("Towry"), a private wealth management company, with almost 25 years' experience in the financial services sector. Outside of work, he also traded in a personal capacity through a self-invested personal pension ("SIPP") account, acting through a broker.

On 1 December 2014, Towry emailed its staff, including Mr Taylor, its revised personal account dealing policy. The policy document contained, amongst other information, a section warning employees that they must not undertake any action which would amount to criminal insider dealing or which would breach the FCA's market conduct rules.

On 2 February 2015, Towry made an offer to acquire Ashcourt Rowan Plc ("Ashcourt Rowan"), another wealth management company which was listed on the London Stock Exchange's Alternative Investment Market ("AIM"). The initial price of the offer was £2.70 per share. On 12 March 2015 at 10.14, Towry's CEO accidentally emailed all Towry staff, stating that Towry had increased its offer price to £3.49 per share. The increased offer had not yet been publicly announced and the CEO sent a subsequent email a few minutes later informing staff of this fact and warning them that they must not trade on the basis of the information in the email because this could constitute insider dealing.

At 11.32 on 12 March, Mr Taylor used an online trading account at his broker to buy 5,582 shares in Ashcourt Rowan at a price of approximately £2.68 each, totalling approximately £15,000. A minute later, the broker emailed Mr Taylor's work email address to provide a confirmation of the trade. Upon receiving that email, Mr Taylor changed the settings of his trading account to specify that all future trade confirmations should be sent to a separate personal email address. He admitted in an interview with the FCA that he did this because he was aware that by placing the order for Ashcourt Rowan shares, he had acted improperly.

At 12.30, Towry's CEO sent a subsequent email to staff, informing them that Towry had now made a public announcement of its revised offer. Mr Taylor sold all 5,582 shares in Ashcourt Rowan that he had purchased that morning 17 minutes after he received that email for an increased price of approximately £3.31 per share, resulting in a profit of £3,498.

On the following day, Mr Taylor telephoned his broker to ask whether it was possible to reverse the trades in Ashcourt Rowan shares he had placed the day before because he was concerned that he had committed an insider trading offence. The broker informed him that reversing the trade was not possible and that he should speak to Towry's compliance department about what action to take. However, Mr Taylor took no steps to contact the compliance team or to speak to the FCA, even though he was aware that he was guilty of insider dealing, instead hoping that the problem would solve itself. Nonetheless, the broker contacted the FCA to inform them of its suspicion of insider dealing, as required under the FCA rules. During an interview under caution with the FCA, Mr Taylor admitted his misconduct at a very early stage, providing a full account of his activities. In July 2015, he was dismissed from Towry for gross misconduct as a result of the relevant trades.

The FCA concluded that Mr Taylor had engaged in deliberate market abuse and had taken steps to conceal his misconduct by changing the email address on his trading account. He was aware that the content of the CEO's original email was inside information and had traded on the basis of that information in expectation of a personal financial benefit. However, the FCA also noted that Mr Taylor made relatively little profit from his activities, had committed the market abuse only on one isolated occasion and had not had an appreciable effect on market confidence. Assessing these factors in the round, it determined that the conduct was still of level 4 seriousness on its 5-level scale. This is important because the penalty for market abuse of level 4 or 5 seriousness which arises in connection with an individual's employment is subject to a starting point of £100,000 (but can be considerably larger, depending on an individual's income and the amount of profit (s)he makes as a result of the abusive activities). However, the FCA also considered that Mr Taylor's extensive co-operation and early admission of liability during the investigation was a substantial mitigating factor, resulting in a 25% reduction to the basic penalty. This was followed by a 30% stage 1 settlement discount and a further reduction to reflect serious financial hardship. Mr Taylor was also required to disgorge the profit from his trading with added interest.

2.4.3 Lessons to be learnt

- The FCA stated in the final notice that upon an application from Mr Taylor, it would be minded to revoke his prohibition order two years after it was issued provided that there was no additional evidence that he was not a fit and proper person. In particular, the FCA noted that while his actions were deliberate, he had admitted his misconduct and had been open and contrite in his discussions with the regulator. This is unusual, as examples of deliberate dishonesty typically result in blanket prohibition orders, subject only to the right of the recipient to make an application to the FCA (or, if necessary, the Upper Tribunal) for the variation or revocation of the order at some future point. Clearly, significant co-operation with the FCA can provide substantial benefits in appropriate cases.

- The case is a clear example of the potential consequences of engaging in insider trading, including the disgorgement of all profits, a substantial fine and a ban from the financial services industry. While Mr Taylor's case was dealt with under the civil market abuse regime, there is also a risk that similar cases could be addressed under the criminal regime instead. Any individuals who may be tempted to engage in such market misconduct should be clear that they stand to lose considerably more than they might gain.
- The erroneous email sent by Towry's CEO is also a good example of the danger of accidentally disseminating inside information more widely than is necessary. Mr Taylor's trading resulted from his access to that information and would not have been possible without it. Firms that receive inside information must ensure that they have proper processes in place to minimise potential leakage and misuse of that information.

2.5 Niall O'Kelly and Lukhvir Thind (FCA Final Notices: 7 April 2017)

2.5.1 Penalty

Mr O'Kelly was made subject to a prohibition order and a penalty of £11,900 (reduced from an original penalty of £468,756 to reflect serious financial hardship and a 30% settlement discount). Mr Lukhvir was made subject to a prohibition order and a penalty of £105,000 (reduced by 30% from £150,000 for early settlement).

Both men were found to have committed market abuse by disseminating information likely to give a false or misleading impression as to a qualifying investment, contrary to s.118(7) of the Financial Services and Markets Act 2000 ("FSMA") (as it was then in force, prior to the entry into force of the EU Market Abuse Regulation).

2.5.2 Summary

Mr O'Kelly was the CFO and Mr Thind was the financial controller at Worldspreads Ltd ("WSL"), a company which provided spread-betting services and was a wholly owned subsidiary of Worldspreads Group Plc ("WSG"). Mr O'Kelly was an FCA-approved person, holding various controlled functions during the relevant period, including the CF1 (Director), CF28 (Systems and controls) and CF10a (CASS operational oversight) functions. Mr Thind, however, was not an FCA-approved person.

WSL generated the vast majority of the Worldspeads group's income, accounting for approximately 94% of WSG's overall revenue. During the relevant period, WSG's shares were listed on AIM and were therefore qualifying investments for the purposes of the market abuse regime in the FSMA. The Worldspreads group's business activities involved providing online trading facilities, primarily to retail customers, allowing them to place spread bets and enter into contracts for difference ("CFDs") in relation to various instruments traded on the global financial markets.

In 2006, certain subsidiaries of WSG were suffering from financial difficulties. Certain directors of one of the subsidiaries, including Mr O'Kelly, made personal loans to the company, amounting to €1,625,000 in total. However, the amounts transferred were not properly classified as loans in WSG's accounts and were not disclosed as related-party transactions, despite the fact that the FCA found that Mr O'Kelly would have been aware of the requirements to do so, given that he was a qualified accountant. The loan was also not disclosed in WSG's AIM admission document.

WSG's admission to AIM occurred in 2007. Mr O'Kelly assisted with the drafting of the necessary admission documents, but failed to include a range of information which was highly relevant to WSG's financial position. As a result, the admission documentation and the information provided to prospective investors were substantially inaccurate and materially misleading.

Between 2003 and 2009, directors and other members of staff at certain of WSG's subsidiaries undertook "internal hedging" trades whereby they would take opposite positions to the trades placed by their clients. However, when undertaking such trades, the individuals did not use personal trading accounts in their own names, but instead used client trading accounts (without the clients' knowledge) or false trading accounts. The details of these accounts were used to mislead the group's auditors into believing that the trading activities were genuine. If the hedging trades had been genuine, where the original client trade had been successful, the hedging trade would have resulted in a payment being due from the person placing the hedging trade to the relevant WSG subsidiary, offsetting the liability to the client. Conversely, where the original client trade had been unsuccessful, an amount would be payable by the relevant WSG subsidiary to the person placing the hedging trade. In reality, however, the directors and staff undertaking the "internal hedging" would not generally settle any liabilities arising from their trading, meaning that the risk that the client trades represented was not genuinely offset. Nonetheless, the fictitious hedging reduced the costs of true hedging with external brokers and was also used as a vehicle to repay amounts due to directors under the directors' personal loans discussed above. Emails within WSG, which included Mr O'Kelly on the distribution list, explicitly acknowledged that the use of the "internal hedging" strategy had only a cosmetic effect and did not result in genuine money being paid in to the relevant subsidiaries. The FCA concluded that individuals within WSG were aware that the use of "internal hedging" was "an inappropriate and unethical practice".

In addition, from 2006 to 2009, Mr O'Kelly had been deliberately falsifying WSG's accounts in order to inflate the group's profits, including by recognising the supposed effects of the "internal hedging" accounts on the balance sheets of certain of WSG's subsidiaries. In 2009, the relevant subsidiaries were sold and the new owners eventually carried out a retrospective audit of the companies' accounts. In relation to one subsidiary, this revealed that the company's profits had been overstated by €2.5 million in 2009 alone.

WSG's AIM admission document did not include information on the directors' internal loans or the "internal hedging" activities. Instead, the document confirmed that there were no outstanding loans from any director to any member of WSG's group and that WSG had adopted a "conservative approach to risk management" in relation to hedging activities. It also included profit figures which Mr O'Kelly knew were artificially inflated.

Even after WSG's listing on AIM, Mr O'Kelly and other directors of WSG continued to falsify the company's accounts by making adjustments to the costs, revenue, assets and liabilities of the company and its subsidiaries, in order to improve the reputation of the business in the market. Within WSG, the growing divergence between the stated financial position of the company and its true financial position became known as the "Blackhole". Mr O'Kelly maintained a secret balance sheet which tracked the growth of the Blackhole over time, reaching between €9 million and €10 million in 2011.

When WSG's subsidiaries, such as WSL, entered into true hedging arrangements with external brokers, they were required to fund margin accounts. If the balances in the margin accounts became too low relative to the hedging trades, the broker would make a margin call, requiring the relevant WSG company to deposit additional funds in the account. WSL frequently suffered from cash-flow difficulties in connection with margin calls, which resulted in Mr Thind, who was responsible for running client money reconciliations within WSL, secretly transferring client money held by WSL to its house accounts in order to fund the external hedging. These transfers caused WSL to incur a client money shortfall, which Mr Thind then disguised by using a fictitious balancing figure in the firm's client money reconciliations and by falsifying reports in the firm's trading systems. As a result of these false entries, the shortfall was also concealed from the firm's auditors, and by March 2011, it had exceeded £15 million. This false information led to misstatements on WSL's balance sheet which then had a material impact on WSG's consolidated balance sheet. In turn, this led analysts to issue recommendations to buy WSG's shares on the basis of the misleading position. Throughout the relevant period, WSG also published various statements in its public accounts, trading updates and results announcements emphasising its strong cash position. These quotes were approved by Mr O'Kelly, who was aware that they were inaccurate.

The FCA found that investors in WSG had been misled by the false information in WSG's AIM admission document, the incorrect figures provided in WSG's accounts and trading updates and the misleading statements made to market analysts. In addition, Mr O'Kelly's failure to update WSG's auditors, or its full board of directors, or the market more generally that the information was false was deemed to constitute a continuing act of dissemination for the purposes of the market abuse offence in s.118(7) of the FSMA. The FCA also concluded that Mr Thind had disseminated false information when he had created false trading system reports and provided false information to WSL's auditors, knowing that this would have a material impact on the presentation of the group's financial position in its published annual report and accounts. As with Mr O'Kelly, Mr Thind's failure to inform WSG's auditors or its board of these material inaccuracies constituted a continuing act of dissemination.

Mr O'Kelly was found to have been deliberately dishonest in knowingly providing false information to auditors, operating fictitious trading accounts and deliberately misusing client money. As a result of this dishonesty, the FCA concluded that he was not fit and proper to carry out any controlled functions in an FCA-authorised firm.

Although Mr Thind was subordinate to, and subject to the oversight of, Mr O'Kelly, the FCA concluded that he was still a senior individual and an experienced chartered accountant. As a result, in the circumstances it was clear that he was responsible for the content of WSL's accounts and knew that the figures in those accounts would have a material impact on the group accounts published by WSG. In the FCA's view, Mr Thind's deliberate falsification of financial information and his involvement in effecting transfers of client money in breach of WSL's internal procedures and knowingly providing false information to auditors was clear evidence of a lack of honesty, justifying a prohibition order.

2.5.3 Lessons to be learnt

- The fact that a person is subordinate to a more senior individual within a firm's hierarchy does not preclude the FCA from taking action against that person where it is appropriate to do so. Individuals should not therefore assume that they can "hide behind" the responsibility of a superior.
- Although the market abuse provisions in the FSMA were repealed when the EU Market Abuse Regulation entered into effect in July 2016, they remain relevant for historical behaviour which occurred while they were still in force. In addition, it seems likely that many of the considerations that were relevant in relation to the behaviour of giving false or misleading impressions to the market under s.118(7) of the FSMA will be similar under the equivalent offence in the Market Abuse Regulation of disseminating false or misleading information.
- In the case of both Mr O'Kelly and Mr Thind, when applying its five-stage penalty analysis, the FCA determined that the breaches were of level 5 seriousness (i.e. the maximum level). The FCA's guidance states that it would normally expect instances of deliberate market abuse to constitute level 4 or level 5 breaches, but also stressed that there were particular factors in the present case which pointed towards the maximum level, including that:
  - the market abuse had continued over a sustained period of more than two years;
  - both men had breached positions of trust (being the CFO and financial controller respectively);
  - both men had acted deliberately, with Mr O'Kelly being found to have intended to mislead the market and Mr Thind being reckless as to whether the market was misled; and
  - the actions of both men had resulted in investors in WSG being misled, resulting in a serious adverse effect on market confidence.
  - As a result, senior individuals within firms who are involved in providing false or misleading information to the market should expect to receive severe penalties.
- Such penalties are likely to be exacerbated by the fact that for as long as individuals leave the resulting false or misleading impression uncorrected, they will be deemed to be engaged in an act of continuing dissemination to the market. It is therefore important that where individuals have made false or misleading statements, they take all necessary steps to correct these as soon as possible (e.g. by making an announcement to the market).
- Deliberate acts of dishonesty, such as the falsification of information, will almost invariably result in the FCA concluding that a person is not fit and proper and therefore making a prohibition order against that individual. Any individual who might therefore be tempted to create or disseminate false information intentionally (whether internally within a firm, or externally to the market) should be aware that (s)he risks being banned from working in the UK financial services industry for life.
- As the FCA's press release on the case makes clear, Mr O'Kelly and Mr Thind were fortunate to have avoided being subject to criminal prosecution in connection with their actions. The FCA stated that although it considered criminal charges, based on the evidence available, it decided to pursue both men under the civil market abuse regime instead.

2.6 Tesco Plc (FCA Final Notice: 28 March 2017)

2.6.1 Penalty

Tesco Plc ("Tesco") was ordered to pay redress for market abuse to investors in accordance with a restitutionary scheme imposed by the FCA under s.384(5) of the FSMA. The FCA estimated that the total amount of compensation payable under the scheme would be approximately £85 million, plus interest.

The compensation scheme resulted from Tesco admitting to having committed market abuse in relation to a misleading trading update published in August 2014 which resulted in a false or misleading impression about the value of listed Tesco securities, contrary to s.118(7) of the FSMA (as then in force).

One of Tesco's subsidiaries, Tesco Stores Ltd ("TSL") entered into a deferred prosecution agreement ("DPA") with the Serious Fraud Office under which it agreed to pay a financial penalty of £128,992,500. The DPA also included a representation that the Tesco business would introduce a new oversight body to ensure consistency in the management of the business's commercial income and that it would appoint accountants to report on, and make recommendations to improve, governance and processes in relation to the recognition of such income.

2.6.2 Summary

On 29 August 2014, Tesco published a trading update which contained an expected trading profit for the six months ended 23 August 2014 of approximately £1.1 billion. When preparing its accounts, Tesco relied on financial information provided to it by a number of its subsidiaries, including TSL. The information provided by TSL was incorrect, resulting in Tesco overstating its profits for the relevant period.

On 22 September 2014, Tesco announced that it had overstated its expected profit for the first half of the 2014/15 accounting year due to accelerating the recognition of certain commercial income and delayed costs accrual. At that time, Tesco indicated that the estimated overstatement of its expected profit was £250 million, but that it was continuing to assess the relevant issues.

On 23 October 2014, Tesco published a set of interim results which indicated that the overstatement of its expected profits for the six months was in fact £263 million. This represented an adjustment to the trading profit for the first half of the 2014/2015 accounting year of £118 million, as well as approximately £70 million from the preceding financial year and approximately £75 million for financial years prior to that.

Six months later, on 22 April 2015, Tesco published its preliminary results for the 2014/2015 financial year. These included a statement that, after further investigation, the commercial income that had been recognised in Tesco's accounts had been overstated by £53 million for the 2013/2014 financial year and by £155 million for the preceding financial years.

Finally, on 3 September 2015, Tesco published an adjustment to its financial results for the first half of the 2014/2015 financial year which increased its trading profit for that period by £42 million.

The overall effect of these announcements was that the total overstatement of actual and expected profit totalled £284 million, comprising:

- the £76 million expected profit overstatement for the first half of the 2014/2015 accounting year (i.e. the original £118 million overstatement identified in October 2014, reduced by the £42 million adjustment identified in September 2015);
- the £53 million overstatement in profit for the 2013/2014 financial year identified in April 2015; and
- the £155 million overstatement for the years prior to the 2013/2014 financial year, also identified in April 2015.

The FCA concluded that Tesco and TSL knew, or could reasonably be expected to have known, that the financial information in the original announcement in August 2014 was false or misleading, even though there was no evidence that the Tesco board knew, or should have known, that the information was inaccurate. This was on the basis that there were sufficiently senior individuals within Tesco, albeit at a lower level of seniority than the board, who had the necessary knowledge and that was deemed sufficient for the purposes of the market abuse offence.

The FCA found that Tesco's August 2014 announcement had created a false market in Tesco shares and certain bonds issued by Tesco which were listed on the London Stock Exchange or the Irish Stock Exchange, resulting in them trading at a higher price than they would have done if the information in the announcement had been accurate. The provision of the misleading information to Tesco by TSL and the August 2014 announcement had both occurred in the UK, ensuring that the FCA had jurisdiction under s.118A of the FSMA (as then in force).

2.6.3 Lessons to be learnt

- The Tesco case is the first time that the FCA has exercised its powers under s.384 of the FSMA to require a firm to pay redress for market abuse (although it had exercised those powers against an individual in the case of Gavin Breeze, discussed below). The restitutionary scheme put in place by the FCA required Tesco to compensate each person who purchased the relevant Tesco shares or bonds at an inflated price as a result of the misleading market announcement, with the calculation of the relevant amount determined by an FCA-appointed expert. The FCA's transaction reporting database suggested that there were approximately 10,000 investors (including both retail and institutional investors) who had purchased approximately 320 million shares during the relevant period and who could be eligible for compensation. Firms should therefore be aware that the potential costs for creating a false market could be very significant if the FCA requires restitution.
- It is clear that it is not necessary for there to be knowledge at the level of the board (or equivalent body) of a legal entity for that entity to be found to have committed the market abuse offence of giving false or misleading impressions. Where sufficiently senior individuals within a firm know, or could reasonably be expected to know, that the relevant information is false or misleading, this will be sufficient, even if the board itself is unaware of that fact. This emphasises the importance of the board putting in place effective supervisory processes and of senior management escalating key issues to the board level. It also means that boards cannot turn a deliberate "blind eye" to any potentially abusive behaviour which may be known to senior management lower down the hierarchy in an attempt to avoid the firm as a legal entity being considered to have the requisite knowledge for the market abuse offence.
- The FCA decided not to impose a separate additional penalty on Tesco for the market abuse in light of the "exemplary co-operative approach" taken by both Tesco and TSL, including Tesco accepting responsibility for the market abuse and agreeing to the compensation scheme. This indicates the potential benefits of early co-operation with the FCA, but firms will need to weigh this carefully against the potential disadvantages of such an approach.
- The FCA concluded that the false market in Tesco securities "substantially" came to an end when Tesco published the announcement in September 2014 with its first estimated profit overstatement figure of £250 million. Although the question of whether or not a subsequent announcement is sufficient to end a false market is likely to be a question of fact in any particular case, this emphasises the importance of firms acting quickly to correct any false or misleading impression that they have created. The longer the false market in Tesco securities had continued, the greater the number of investors who might have been eligible to claim under the compensation scheme (and, in other cases, the greater the potential resulting financial penalty).

2.7 Gavin Breeze (FCA Final Notice: 15 July 2016)

2.7.1 Penalty

The FCA fined Mr Breeze £59,557 (reduced by 30% from £85,057 due to early settlement) for engaging in market abuse (insider dealing) in breach of s.118(2) of the FSMA, and published a statement of censure in respect of improper disclosure in breach of s.118(3) of the FSMA. It also required him to pay restitution of £1,850 plus interest of £259 to persons who suffered loss as a result of his actions.

2.7.2 Summary

Mr Breeze was a shareholder in and non-executive director of MoPowered Group Plc ("MoPowered"), an AIM listed public company, and was resident in Jersey.

In June 2014, MoPowered decided to raise £3.5 million of capital through a share placing. MoPowered's CEO approached a limited number of MoPowered's largest existing shareholders, including Mr Breeze (who owned 8.1% of the issued shares) to inform them of the potentially dilutive effect of the placing and to offer the opportunity to subscribe for shares. Information about the share placing was price sensitive and as such was tightly controlled with the number of existing shareholders approached intentionally limited in order to minimise the risk of insider dealing.

On 12 September 2014, the CEO telephoned Mr Breeze and informed him of the proposed share placing at a discounted price. The CEO then instructed MoPowered's nominated adviser ("NOMAD") to include Mr Breeze on the insider list for the placing. Shortly after the call, the CEO emailed Mr Breeze a presentation setting out the timetable for the share placing and its announcement, MoPowered's plans for use of the funding and its unpublished interim financial results, including details of pre-tax losses that had increased from £1.4 million to £2.3 million. The presentation contained a warning about inside information. Shortly after receiving the presentation, Mr Breeze forwarded it by email to another shareholder who was not an insider, without first ascertaining whether or not that other shareholder was an insider, asking: "What do you think?"

On 18 September 2014, following receipt of a further email from the CEO explaining that one institutional investor would only invest in the placing at a significant discount to the market price, Mr Breeze instructed his broker to sell all of his MoPowered shares "at any price". The broker responded that, due to the relative illiquidity of MoPowered shares, they would not be able to sell his entire shareholding in one order. They suggested starting with an order of 10,000 shares but warned that that order could have a negative effect on MoPowered's share price. Mr Breeze replied: "I would like to sell as much as I can, as soon as I can."

By the close of the market on 19 September 2014, Mr Breeze's broker had sold 10,000 of his 1,273,500 MoPowered shares at a price of 26p per share. The closing price of MoPowered's shares that day was 20.25p per share.

On Friday 19 September 2014, MoPowered announced its interim financial results, including its increased pre-tax losses, and that it proposed a share placing to raise £3.5 million. On 22 September, MoPowered announced it had raised approximately £3.5 million through its share placing at an issue price of 5p per share. As a result of those announcements, MoPowered's share price fell to approximately 8p within the first hour of trading following the announcement on 22 September. It closed at 7p that day. Mr Breeze cancelled his order to sell his shares on 22 September.

Mr Breeze's sale of 10,000 shares on 19 September 2014 allowed him to avoid a loss of £1,900. Whilst the FCA recognised that it was unlikely that Mr Breeze would have been able to sell his entire shareholding at that price, if he had, he could have avoided a loss of up to around £242,000.

The FCA found that Mr Breeze's dealing in MoPowered shares on 18 and 19 September 2014, and his disclosure of inside information to the other shareholder on 12 September 2014 amounted to market abuse (insider dealing and improper disclosure) in breach of s.118(2) and (3) of the FSMA. In particular, the FCA concluded that:

- MoPowered shares were qualifying investments admitted to trading on a prescribed market, AIM.
- Mr Breeze became an insider when he was given inside information in his capacity as a significant shareholder in MoPowered for the purpose of establishing whether he wished to participate in the proposed placing. Mr Breeze accepted in interview that he understood at the time that he had been given inside information.
- The information that Mr Breeze received about MoPowered's proposed placing and interim financial results was inside information: it was sufficiently precise, was not generally available and would have had a significant effect on MoPowered's share price had it been generally available.
- Mr Breeze forwarded the inside information to the other shareholder in order to obtain his opinion as to the merits of subscribing for shares in the placing (i.e. otherwise than in the proper course of the exercise of Mr Breeze's employment, profession or duties).

In setting the amount of the fine, the FCA took the following factors into account:

- The market abuse was deliberate: Mr Breeze was aware that the information was inside information and foresaw that the likely consequences of his actions would result in market abuse.

- He intended to benefit financially from the market abuse by avoiding a loss.
- He had a prominent position in the market, holding seven directorships, including at two listed companies. He was also an experienced user of the markets and therefore recognised that the information was inside information.
- The level of loss which Mr Breeze intended to avoid was significant (up to around £242,000). However, it was also relevant that Mr Breeze in fact avoided relatively little loss as a result of the market abuse.
- There was no, or limited, effect on the orderliness of or confidence in the markets as a result of Mr Breeze's market abuse.

Given the lack of impact on the market as a result of the recipient not trading on the basis of the information, the FCA did not consider Mr Breeze's improper disclosure to the other shareholder to be sufficiently serious to warrant a separate financial penalty. However, the FCA nevertheless wished to make clear that passing on inside information on the basis of an assumption that the recipient would receive it formally as an insider in due course might amount to serious misconduct in other circumstances. Firms and individuals should not, therefore, take false assurances from this aspect of the case.

Mr Breeze's co-operation during the FCA investigation was a significant mitigating factor. He voluntarily travelled to the UK to attend an interview under caution, and in interview he made various voluntary admissions which reduced the cost and time of the investigation. He also provided additional documents to the FCA voluntarily following his interview.

The FCA opted to use its rarely used restitution powers in s.384 of the FSMA in this case, finding it appropriate for Mr Breeze to pay the full amount of the loss suffered by the purchasers (£1,850, calculated by comparing the price paid by the purchasers for the shares with the value of the shares immediately after the announcement was made), plus interest at 8% per annum, for the FCA to pass on to the purchasers. It is more common in market abuse cases for the FCA to rely on its powers to require a person to disgorge any financial benefits they derived directly from their market abuse. In those cases, the sums disgorged are not typically passed onto third parties who have suffered detriment. However, recent cases may suggest more of a move towards a restitutionary approach.

2.7.3 Lessons to be learnt

- Insider trading is still not always well understood or appreciated, even by experienced industry professionals. This final notice was issued just days after the FCA revealed that suspicious trades that precede takeover announcements had risen to their highest level since 2011, potentially indicating market abuse before 19% of UK takeover announcements. This was the second time within a relatively short period that the FCA imposed a fine for market abuse where the abuse had resulted in only a small profit (see the final notice issued to Mark Taylor above), emphasising that the FCA will target all abusive traders, irrespective of the scale of their trading.
- Prohibited insiders should ensure that they do not assume that others with a similar status, such as fellow shareholders, have also been made insiders. The FCA stated twice in its Final Notice that Mr Breeze should have taken positive steps to ascertain whether the other shareholder had already been made an insider, and whether it was appropriate to share the information, before doing so.
- Mr Breeze's case and that of Tesco Plc discussed above illustrate an increasing use by the FCA of its restitutionary powers under s.384 of the FSMA. This may, in part, be motivated by a desire to ensure that market participants who are adversely affected by market misconduct are properly compensated. However, it also illustrates one of the risks of engaging in market abuse; namely, that a potentially large and unpredictable class of persons could be adversely affected by a person's market misconduct and may become entitled to compensation. As a result, restitution may also be a larger part of the FCA's efforts to discourage market abuse by increasing the potential costs for perpetrators.

3. Money laundering systems and controls

3.1 Deutsche Bank AG (FCA Final Notice: 30 January 2017)

3.1.1 Penalty

The FCA fined Deutsche Bank AG ("DB") £163,076,224 (comprising disgorgement of £9,076,224 of commission earned by DB for the trades in question, and a penal element of £154,000,000) for breaches of Principle 3 (management and control) and various rules in the FCA's Senior Management Arrangements, Systems and Controls ("SYSC") sourcebook in respect of its AML control framework between 1 January 2012 and 31 December 2015. This was the largest financial penalty for AML controls failings ever imposed by the FCA or its predecessor, the FSA, and reflects the seriousness of the issues identified. The penalty was reduced by 30% from £229,076,224 for early settlement.

3.1.2

Summary

DB notified the FCA in early 2015 of concerns regarding its AML control framework after it began an investigation into a form of suspicious securities trading, known as "mirror trading", involving Deutsche Bank Moscow Ltd ("DB Moscow"), a Russian subsidiary of DB. The mirror trades were used by customers of DB and DB Moscow that were connected to each other (through common directors, owners, employees, or addresses) to transfer more than $6 billion from Russia, through DB in the UK, to overseas bank accounts, located in jurisdictions such as Cyprus, Estonia, and Latvia. The orders for both sides of the mirror trades were received by DB Moscow's front office ("Moscow Front Office") corporate banking and securities business ("CB&SB"), which executed both sides at the same time.

There were more than 2,400 mirror trades between April 2012 and October 2014 that involved the following arrangement:

- a Russian customer of DB Moscow bought highly liquid Russian securities from DB Moscow, paying in Roubles (the Moscow Side); and
- at the same time, a non-Russian customer of DB (the onboarding of which had been initiated and facilitated by Moscow Front Office) sold the same number of the same securities to DB in exchange for US Dollars (the London Side).

The London Side of the mirror trades was executed by Moscow Front Office on behalf of DB via remote booking, a process by which DB offices in certain locations around the world, including DB Moscow, could directly book trades to DB's trading books in the UK.

The mirror trading customers were able to place their orders with Moscow Front Office on behalf of others whose identities and source of wealth were not known to DB. The effect, and evident purpose, of the mirror trades was to convert roubles into US dollars and to transfer (covertly) more than $6 billion out of Russia, via DB in the UK, to overseas bank accounts.

Following the commencement of its investigation into the mirror trades, DB identified a further $3.8 billion in suspicious securities trades executed by Moscow Front Office through the UK between January 2012 and February 2015. The FCA found that some, if not all, of those additional suspicious trades must have formed one side of an additional 3,400 mirror trades that would have resulted in approximately $10 billion being transferred out of Russia, through DB.

The FCA found that Moscow Front Office was able to execute the mirror trades undetected for such a lengthy period because of widespread deficiencies in DB's AML control framework, particularly in relation to the establishment of new customer relationships and ongoing monitoring of transactions, including:

- *Due diligence failures*. DB's customer due diligence ("CDD") and enhanced due diligence ("EDD") were inadequate and failed to obtain sufficient information about the mirror trading customers (such as their intended business activities or their source of funds) to inform the risk assessment process and to provide a basis for transaction monitoring. For example, the ownership structures were not reliably documented using independently sourced information, passport copies for the purported ultimate beneficial owners ("UBOs") were not verified, reliance was placed upon poorly understood foreign-language documents, and there was a failure to identify politically-exposed persons ("PEPs") as connected parties. DB was therefore unable to verify the identities of the mirror trading customers or determine whether there were any connections between them.

- *Confusion as to roles/responsibilities*. The culture within CB&SB failed to instil a sense of responsibility in the front office business for the identification and management of non-financial risks. As a result, CB&SB front office ("London Front Office") did not appreciate that it was ultimately responsible for KYC obligations in respect of its customers. That lack of accountability was compounded by the firm's complex management structure, which failed to define roles and responsibilities clearly as between London Front Office, the operations team and the AML team. DB's AML control framework therefore lacked appropriate oversight and supervision.
- *Flawed AML rating methodologies.* DB failed properly to evaluate its level of money laundering risk partly because its customer and country risk rating methodologies were inadequate. In CB&SB, DB underestimated the level of AML risk associated with its customers, with under 5% being categorised as high risk, significantly out of line with its peers. The FCA concluded that DB's AML country risk ratings, which determined the customer risk ratings if no other AML risk factors were present, were developed using an "informal and opaque methodology". Only 33 countries were categorised as high risk, and Russia was not among them. DB's customer risk rating methodology was also inadequate because it failed to take into account the type of legal entity in question and the different risks associated with the different delivery channels for providing customer services.
- *Deficient AML policies and procedures.* DB's KYC policies were not sufficiently prescriptive and failed to provide sufficient guidance on key aspects of the onboarding process, for example, how to evidence or establish the legitimacy of a customer's sources of wealth and funds. Further, the onboarding policies and procedures did not require the gathering of information about expected account activity, which meant that DB could not monitor whether a customer's behaviour was consistent with its profile. In addition, its policies and procedures for UBOs were incomplete. Although they covered individuals who owned or controlled 25% or more of a business, they did not include those individuals who otherwise exercised control over a business, except in respect of legal representatives.
- *Deficient AML IT infrastructure.* DB lacked a single authoritative repository of KYC information because it used multiple IT systems. That resulted in a lack of reconciliation between the trading and customer onboarding systems, because customers could be assigned different identifiers in each of the systems where their data was recorded. As a result, DB was unable to connect trading activity with underlying KYC information.
- *Lack of adequate transaction and payment monitoring and oversight.* Because the CB&SB division lacked automated AML systems for detecting suspicious trades, it could not effectively monitor the high volume of securities transactions that it executed on behalf of its customers. The business also failed to implement an effective system for monitoring the money flows associated with transactions. The alerts generated by the payments monitoring system were reviewed in accordance with strictly defined criteria that did not allow for a risk-based review of individual alerts. That process-driven approach limited the effectiveness of the system. Further, failure to recalibrate the system between 2011 and 2014 meant it was significantly out of date during the period in question.
- *Failure to oversee trades.* DB did not have adequate controls for addressing the risk of inappropriate trading behaviour being booked in the UK. The London side of the mirror trades was booked into the UK by Moscow Front Office. Although London Front Office was responsible for the trading book, it was concerned with aggregate and open risk positions rather than individual trades, and was therefore not aware of the identities of the customers that were entering trades into the book. London Front Office considered DB Moscow to be responsible for monitoring the remotely booked trades. That reliance was misplaced, partly because the relevant parts of DB Moscow that were responsible for trade monitoring did not have access to a system that could provide data about the trades booked in the UK by DB Moscow. Further, even if DB Moscow had had such access, it would have been unable to introduce an effective automated trade surveillance system because of a lack of resources. (It is worth noting the scale of the remote booking activity in this case: approximately 30% of the assets on DB's UK balance sheet related to remotely booked activity from approximately 50 cities across 35

countries. In 2015, more than 500 traders were allowed to remotely book trades to the UK and there were approximately 2,000 books, corresponding to more than 150 business units, that were remotely booked to the CB&SB balance sheet in the UK.)

DB's failure properly to consider its money laundering risk was exacerbated by the lack of sufficient resources for its AML function. These resource constraints, which resulted in understaffing, undermined the effectiveness of the AML teams in the UK and Russia and restricted their ability to challenge the front office business and to provide effective oversight. They also prevented the implementation of appropriate KYC and AML transaction monitoring systems. Staff shortages in the UK AML team were regularly highlighted as AML risks in reports to DB management from 2012 onwards.

The FCA also found that DB received, but missed, several warning signs in relation to the mirror trading throughout the period in question. These included London Front Office identifying several mirror trades and asking questions to Moscow Front Office which were never answered, as well as DB Moscow itself raising concerns about the trades and noting that they lacked a clear economic justification.

However, the FCA concluded that the AML control framework failings were not committed deliberately or recklessly and that there was no evidence that senior management at DB or any DB employee in the UK was aware of the existence of or involved in the suspicious trading.

3.1.3 Lessons to be learnt

- As the FCA urged in its press release, this case should prompt firms to review their own AML policies and procedures. In particular, multinational firms should ensure that their policies and procedures are properly joined up, with consistent and uniform oversight and monitoring across business units and jurisdictions.
- Failure to obtain sufficient evidence at the outset of a client relationship may have a serious adverse effect on a firm's ability to monitor that relationship, and activity on the client's account, on an ongoing basis. It is therefore critical that firms understand the client's identity, the source of the client's funds and the intended purpose of the client relationship in order to be able to identify and respond to changing risk factors in the future. Further, firms must ensure that they have in place detailed and robust KYC policies that allow them to understand the bigger picture in respect of such matters as beneficial owners and expected business pattern.
- It is important for firms to instil a strong AML culture and sense of responsibility for the identification and management of non-financial risks. KYC roles and responsibilities must also be clearly defined to ensure sufficient oversight, supervision and accountability, particularly within a complex management structure which may span a number of different branches and jurisdictions. In particular, there must be a clear structure of responsibility for the escalation of AML concerns, to ensure proper investigation and response.
- Firms that operate remote booking models through overseas branches should ensure that they have robust systems and controls to ensure that proper customer due diligence is applied and that customer activity is properly monitored and reviewed.
- Firms must commit proper resources to their AML and KYC function, processes and transaction monitoring, particularly as regards IT infrastructure and the storage and availability of KYC information. They must also pay proper attention when concerns are raised that understaffing may lead to compliance problems.

3.2 Sonali Bank (UK) Ltd and Steven Smith (FCA Final Notices: 12 October 2016)

3.2.1 Penalty

The FCA fined Sonali Bank (UK) Ltd ("SBUK") £3,250,600 and imposed a restriction preventing it from accepting deposits from new customers for 168 days. It also fined SBUK's former money laundering reporting officer ("MLRO"), Steven Smith, £17,900 and prohibited him from performing the SMF16 (compliance oversight) and SMF17 (money laundering reporting) senior management functions, and the CF10 (compliance oversight) and CF11 (money laundering reporting) controlled functions at regulated firms. Both fines reflected a 30% discount (from £4,643,800 and £25,600 respectively), and the 168-day restriction on SBUK was reduced from 240 days, as a result of SBUK's and Mr Smith's early settlement.

3.2.2 Summary

3.2.2.1 SBUK

SBUK is the UK subsidiary of Bangladesh-based Sonali Bank Ltd, ultimately owned by the Bangladeshi government, and provides banking services to the UK Bangladeshi community. During the period in question, SBUK operated six UK branches offering personal and corporate accounts, money remittance services to Bangladesh (conducted face to face and by telephone) and trade finance.

The FCA found that, between August 2010 and July 2014, there were serious and systemic weaknesses in SBUK's AML governance and control systems that affected almost all levels of its business and governance structure, including its senior management team, MLRO function, oversight of its branches, and AML policies and procedures.

SBUK: Breach of Principle 3: The FCA found that, by failing to take reasonable care to manage its AML risks, SBUK had breached Principle 3 of the FCA's Principles for Businesses (taking reasonable steps to organise its affairs responsibly and effectively, with adequate risk management systems), including in the following areas:

- *AML culture.* The bank failed to take adequate steps to ensure that the importance of AML compliance was ingrained throughout the business, despite receiving clear warnings of a culture of non-compliance.
- *Remediation failure.* Following an AML thematic visit in 2010, the FCA had notified SBUK of a number of serious concerns. Although SBUK put in place a remediation plan, the FCA found that it had failed to test adequately its implementation and whether the steps taken were effective. After a follow-up visit in 2014, the FCA again identified a number of serious concerns with SBUK's AML systems.
- *Board and senior management.* SBUK's board and senior management were not provided with sufficiently clear information to ensure that they were aware of the AML risks faced by the business and able to assess how they were being addressed. The board received regular financial crime reports, but it raised insufficient challenge to the conclusions reached and failed to make enquiries into the content of those reports. The board also lacked experience and expertise in relation to regulatory and compliance matters and had manifest differences in opinion and approach to complying with regulatory requirements which affected the board's ability to operate effectively as a collective unit.
- *Audit warnings.* SBUK ignored repeated warnings of weaknesses in its governance from a firm appointed to conduct audits of its systems and controls. The auditors had graded the risks and controls associated with SBUK's governance and regulation activities as the most or second most serious grade available (i.e. "actual/potential serious/very serious implications"). The auditors also noted that those failings persisted despite the assurances of senior management that they would be remedied. Notwithstanding the auditors' findings, SBUK reduced the number of days that senior management were allocated to focus on governance and regulation matters from 18 in 2011 to 8 by 2013.
- *MLRO department.* SBUK's MLRO department was understaffed, had insufficient access to resources and was not properly overseen by senior management. In particular, the MLRO, Steven Smith (who was also the subject of a separate enforcement action; see below) was required to perform significantly more work than would traditionally fall to the MLRO. SBUK also failed to implement updates to software that would have improved the AML function.
- *Branch management.* SBUK did not properly oversee its branches. Reporting lines from the branches to head office were unclear and management did not focus sufficient attention on the effectiveness of AML systems within branches. Branch employees had a very limited understanding of AML issues and processes. Those issues were exacerbated by the inadequate resourcing of the MLRO department which oversaw branch AML.
- *AML policies.* SBUK's AML policies provided inadequate practical guidance to its employees. For example, they specified that "sufficient" due diligence should be undertaken, but gave no guidance as to what that meant. Employees were also required to obtain "evidence" of source of funds for

cash remittances over a certain threshold, but were given no guidance on what form that evidence should take. In addition, SBUK's policy relating to the risk assessment of customers was "unclear and contradictory".

- *Due diligence.* Both the CDD and EDD carried out by SBUK when establishing new business relationships were inadequate, and it took inadequate steps to identify PEPs and apply EDD measures to those PEPs. Each of the 2,457 customer files reviewed was found to contain insufficient documentation. These problems persisted despite the FCA having alerted SBUK to them in 2010.
- *Ongoing monitoring.* SBUK failed to conduct ongoing monitoring of some of its client relationships, including PEPs, until 2014. In addition, the monitoring it did conduct was undertaken on a sample basis (the rationale for which was unclear), insufficiently documented and omitted to consider some transactions. SBUK operated two separate systems for money remittances, but the MLRO department was unaware that it only received daily reports in respect of one of those systems. SBUK's systems were also unable to detect linked transactions or transactions from a number of remitters to a single beneficiary. Branches could not access the remittance history of a customer from other branches and the MLRO department could not access remittance histories from branches other than the head office.
- *Suspicious activity reporting.* SBUK employees failed to identify and report suspicious activity. Although SBUK's annual MLRO reports warned that it was submitting a "surprisingly low" number of suspicious activity reports ("SARs") to the National Crime Agency ("NCA"), particularly in respect of its trade finance business, it nonetheless failed to take any steps to ascertain the reason for that and, as a result, failed to identify that its employees were not escalating suspicious activity and submitting SARs in appropriate circumstances. Following the skilled person's review, SBUK submitted an additional 243 SARs to the NCA in relation to historic issues.

The FCA decided to impose the restriction on deposits from new retail customers on the basis that a restriction on SBUK would act as "a more effective and persuasive deterrent than the imposition of a financial penalty alone".

SBUK: Breach of Principle 11: The FCA also found that, in 2015, while under investigation for the AML breaches, SBUK breached Principle 11 (dealing with regulators in an open and co-operative way) by failing to notify the FCA for at least seven weeks that it had become aware of a potentially significant fraud. (A customer had alleged that £23,000 was missing from his account and had been misappropriated by a senior SBUK employee.) Of the fine imposed on SBUK, £140,000 was attributable to its breach of Principle 11.

3.2.2.2 Steven Smith

Mr Smith was appointed as SBUK's MLRO and compliance officer in February 2011, shortly after the then-FSA's visit to SBUK in 2010 when it highlighted a number of serious concerns it had with SBUK's AML systems and controls. The FCA found that Mr Smith was on notice of the FSA's findings, as well as the remediation steps that SBUK had agreed to take. Mr Smith held the CF10 (compliance oversight) and CF11 (money laundering reporting) controlled functions throughout the period in question.

The FCA found that Mr Smith had breached Statement of Principle 6 (exercising due skill, care and diligence in managing the business of the firm for which he was responsible), was knowingly concerned in SBUK's breach of Principle 3 (taking reasonable steps to organise its affairs responsibly and effectively, with adequate risk management systems), and had demonstrated a serious lack of competence and capability, for the following reasons:

- In successive years, and despite the warnings of the internal auditors, Mr Smith failed to implement compliance monitoring plans that were appropriately focused on the risks faced by SBUK and which adequately demonstrated that SBUK's AML systems were working effectively.
- Despite being personally overworked and suffering from a lack of resources in the MLRO department, Mr Smith failed to impress those factors upon senior management, even when it was adversely affecting the MLRO department's monitoring work. When he was given permission to recruit further resources, Mr Smith failed to do so quickly.
- Mr Smith continued throughout the period in question to reassure the board and SBUK's senior

management that SBUK's AML systems were working effectively.

- Mr Smith did not take sufficient steps to address the concerns raised by the internal auditors and failed to report adequately the results of internal testing. In particular, he failed to put in place effective systems for ensuring that staff were aware of their AML responsibilities and complied with their AML obligations yet continued to reassure the board and senior management that staff understood their responsibilities. Despite being aware of the "surprising" lack of SARs made by staff in three successive years, he failed to investigate the reasons.
- Mr Smith failed to identify serious and systemic AML failings throughout SBUK's business, including in relation to CDD, EDD, and customer and transaction monitoring. He also failed to identify a serious lack of knowledge and understanding of AML issues amongst SBUK's branch staff and failed to ensure that they were sufficiently aware of and understood their AML responsibilities.
- Mr Smith failed to implement any effective process for the ongoing assessment of the AML risks posed by individual customers. He also recommended the rejection of the internal auditors' recommendations that SBUK's system for transaction monitoring be reviewed, without conducting any analysis of the effectiveness of the system.

The FCA accepted that Mr Smith had suffered from a serious lack of vital management support in conducting his role. However, it noted that there were nevertheless a number of steps available to an MLRO who did not enjoy such support and who had concerns about the AML systems in place at a firm, including: ensuring that concerns were appropriately reported to senior management; escalating concerns to the board or to relevant risk or audit committees; highlighting concerns to internal or external auditors; requesting independent expert advice on the areas of concern; and outlining concerns fully and appropriately in annual MLRO reports or reporting concerns to the FCA (which could be on a confidential basis).

3.2.3 Lessons to be learnt

- Taking enforcement action against firms with poor AML systems and controls has been one of the FCA's priority areas over the past few years. In particular, the number of enforcement cases concluded against compliance professionals, including MLROs, is on the rise. The message is clear: compliance professionals must have the experience and resources to take a robust approach to challenging colleagues when necessary. If they are ignored, they will need to consider the appropriate response, which could in extreme cases include escalating their concerns to the FCA or the PRA.
- The FCA's imposition of a business restriction on SBUK was driven by its concern that fines alone are not providing sufficient deterrent in certain cases. The 168-day restriction (reduced from 240 days) is by far the longest imposed on a firm to date. In addition to allowing time for a firm to rectify its deficient AML procedures, such restrictions may help to address the unfair competitive advantage that non-compliant firms receive over their competitors.
- The FCA's findings in respect of SBUK's Principle 11 breach should serve as a valuable reminder to firms of their obligation to deal with the regulator in an open and co-operative manner, not just in respect of matters that might already be specifically under investigation, but also any issues of which the regulatory would reasonably expect notice.
- Firms should be particularly careful about "siloed" AML record keeping and monitoring systems which are not joined up across business areas. In both the SBUK and Deutsche Bank cases, this resulted in staff being unable to apply holistic risk assessments and monitoring to customers. This is particularly important because many instances of money laundering may involve transactions which individually appear to be legitimate, but which when viewed in a wider context appear suspicious or unusual.
- A lack of resources and management support and an unmanageable workload will not excuse regulatory failings by an MLRO. As explained above, the FCA noted that there were a number of steps that Mr Smith could have taken, despite the challenges he faced, including seeking independent expert advice and/or highlighting concerns to the internal auditors and/or the FCA.
- The introduction of new requirements under MLD 4 from 26 June 2017 is likely to increase the burden on firms and their MLROs. Firms must ensure that they have properly reviewed and implemented the MLD 4 requirements and that the individuals and departments responsible for AML compliance have

the resources and knowledge to oversee the resulting processes.

4. Failure to comply with client asset and client money rules

4.1 Towergate Underwriting Group Ltd (FCA Final Notice: 13 July 2016)

4.1.1 Penalty

The FCA fined Towergate Underwriting Group Ltd ("Towergate") £2,632,000 (reduced by 30% from £3,760,000 due to early settlement) for breaching the FCA's client money and client asset ("CASS") rules in connection with a client money shortfall in its insurance mediation business.

4.1.2 Summary

Towergate was an insurance intermediary which arranged cover for its clients and retained a portion of each payment as commission for its services. The firm held money received from its clients in two different capacities: either as client money or as insurer money, depending on the terms of the contract with the relevant underlying insurer. Where the money was held in a client money account, Towergate was required to comply with the applicable requirements in the FCA's CASS rules. Where insurer money was held in a separate insurer trust account, the firm was not required to apply the CASS rules, but remained under a general obligation under the FCA's Principles for Businesses to take reasonable care to operate adequate risk management systems in connection with the accounts.

As part of its cash management process, Towergate operated an automated daily transfer (or "sweep") of the money held in the client and insurer money bank accounts of its different underlying business units into central bank accounts. However, the client money calculations required under the relevant FCA CASS rules were performed by the individual business units, even though the funds were held in the separate central accounts. On the first working day of every month, Towergate's business units would carry out the necessary calculations, but in order to compare the amounts of client money held with the levels required, each unit would refer to its own ledger. The units were unable to refer to actual cash balances held in their local accounts because the cash had already been swept into the central accounts by Towergate's daily sweeping process. Towergate's central finance department would then receive each of the calculations performed by the business units on a monthly basis and would collate these centrally. The effect of this arrangement was that when carrying out the client money reconciliations, the business units would typically rely on notional balances in their client money ledgers, as the actual cash balance in the local bank accounts operated by that business unit would be nil. The central finance department did not carry out a reconciliation of the business units' aggregated entitlement to money held in the central accounts with the cash actually held in the accounts, meaning that Towergate's reconciliation processes were ineffective. Although the insurer money held by Towergate was not subject to the specific CASS requirements, the firm effectively followed the same processes for the balances in the insurance money accounts.

In January 2010, the FSA sent a "Dear CEO" letter to Towergate, expressing its concern about general standards of compliance with the CASS rules across the financial services industry. The letter specifically requested that Towergate confirm that it was in compliance with the relevant rules, which the firm did by return letter approximately one week later.

In May 2013, Towergate carried out a review of its internal client money and insurer money controls, which resulted in the firm identifying a shortfall of approximately £9 million in the central accounts. A subsequent investigation identified that this was caused by a transfer of £10.5 million that had incorrectly been classified as commission due to Towergate out of the accounts, as well as £1.45 million in interest being incorrectly received into the client money accounts and not reallocated, even though Towergate's client agreements permitted the firm to retain interest earned on client money balances. In late October 2013, Towergate notified the FCA of the client money shortfall and several days later, it transferred over £9 million into the relevant accounts in order to eliminate the deficit. The FCA concluded that the firm had taken over four months from the original identification of the shortfall to notify the regulator (in breach of the requirement in the FCA rules to provide an immediate notification) and had failed to correct the client money shortfall as soon as it had become aware of it. Further investigations revealed a shortfall of approximately £3.6 million in Towergate's insurance money account which the firm remedied in November 2013.

During 2010 and 2011, Towergate transferred £10.5 million from its central accounts to the office account of one of its group companies in order to fund certain business expenses. However, the individual business units were not informed of these transfers and therefore in their monthly calculations, they continued to include amounts that had previously been withdrawn. The aggregation of these defective calculations gave the impression that there were additional surplus funds which could be transferred to cover business expenses. This resulted in shortfalls of £5 million in the client money accounts and £5.5 million in the insurer money accounts. Towergate failed to understand the significance of the discrepancies between the figures of cash actually held in the central accounts and the aggregated expected cash figures derived from aggregating each local business unit's calculations until May 2013 when the shortfall was discovered.

Towergate also operated a governance structure whereby the client money and insurer money processes undertaken by its central finance department fell outside the scope of its compliance monitoring and internal audit functions. This meant that the operation of the central accounts was not subject to detailed internal scrutiny and Towergate continued to rely on its external auditors, even though the FCA had previously expressed concern about overreliance on CASS audit reports to the detriment of firms performing their own checks.

The FCA concluded that Towergate had breached Principle 3 (the requirement to take reasonable care to organise and control a firm's affairs responsibly and effectively, with adequate risk management systems) and Principle 10 (the requirement to ensure adequate protection for client assets) of the FCA's Principles for Businesses. In addition, Towergate also breached a number of detailed rules in CASS. The breaches were particularly serious because they had continued over an extended period of eight years, involved a number of combined failures and, as Towergate was one of the UK's largest insurance intermediaries, could have had a wider effect on the UK insurance market. The FCA also noted that the firm had received and replied to the "Dear CEO" letter and had been subject to heightened scrutiny in relation to client money issues. Both of these were aggravating factors which justified an uplift to the final penalty.

4.1.3 Lessons to be learnt

- Compliance with CASS rules has frequently been an area where firms have run into difficulties in the past. It is also a key area of regulatory focus for the FCA, which will punish firms for creating any risk of loss to clients, even if no actual loss is ever identified. Given this continuing focus and the FCA's strict approach to CASS rule breaches, firms should ensure that they understand which rules are applicable to their businesses and that in addition to compliance with the technical requirements, they conduct regular reviews of their systems and controls in this area.
- Firms should not rely solely on their external auditors to identify deficiencies in their systems and controls or breaches of the FCA's rules. While external auditors can provide valuable oversight and challenge in relation to the firm's operations, it is the firm itself that remains responsible for compliance with the applicable regulatory requirements and the firm will not escape liability because an issue was not identified by its auditors.
- The Towergate case is a good illustration of how centralisation at group level can reduce oversight and create compliance risks unless it is properly managed. The breakdown in communication between Towergate's central finance department and its individual business units led to incorrect client money calculations and ultimately a client money shortfall which was not remedied for a considerable time. While there may be benefits to operating pooling arrangements or centralising other functions, firms need to review the systems and controls they operate in connection with such arrangements to ensure that the associated risks are minimised.
- Firms should treat "Dear CEO" letters extremely seriously and should not provide any attestations to the FCA without ensuring that the content of those attestations is correct. The FCA takes a very dim view of false assurances provided by firms and may choose to apply an uplift to any penalty to reflect this. Individuals who are responsible for signing incorrect attestations could also find themselves at risk of enforcement action.

4.2 Aviva Pension Trustees UK Ltd and Aviva Wrap UK Ltd (FCA Final Notice: 5 October 2016)

4.2.1 Penalty

Aviva Pension Trustees UK Ltd ("APT") and Aviva Wrap UK Ltd ("AWL") were jointly fined £8,246,800 (reduced by 30% from £11,781,262 due to early settlement) for breaches of Principles 3 and 10 of the FCA's Principles for Businesses and a number of rules in CASS. APT and AWU also breached certain rules relating to outsourcing in the FCA's SYSC rules.

4.2.2 Summary

AWL operated the "Aviva Wrap" online platform which permitted clients to invest in a range of products through tax-efficient structures. APT operated the Aviva Personal Pension Plan, as well as a number of smaller pension schemes. Between January 2013 and September 2015, AWL's average daily client money balance was over £64 million and its average daily custody account balance was over £1.4 billion. In the same period, APT had an average daily custody account balance of over £189 million.

In 2013, AWL's external auditors expressed concerns about AWL's internal client money reconciliations and the accuracy of its client asset records, noting that external reconciliations required under the CASS rules had been outsourced to third-party administrators. The audit report identified a number of CASS breaches whereby discrepancies highlighted by client asset reconciliations had not been promptly identified and resolved. The FCA considered that the contents of the CASS audit report should have led both AWL and APT to identify CASS compliance as a potentially high-risk area and to review their systems and controls.

In February 2015, the FCA's CASS Department visited AWL and APT and noted a number of concerns, including:

- deficient oversight of the firms' CASS functions;
- a lack of individuals within the firms who had CASS knowledge combined with financial experience;
- the absence of a dedicated committee to oversee the CASS functions outsourced to third-party administrators;
- a lack of specific compliance reports to monitor the firms' adherence to the CASS rules;
- the incorrect classification of certain transactions when carrying out the client money calculation; and
- inaccuracies in the firms' Client Money and Asset Returns ("CMARs").

As a result of these failings, in August 2015, the FCA instructed AWL and APT to appoint a skilled person to conduct an independent review of their CASS compliance. The resulting report, issued in January 2016, confirmed the FCA's conclusions and noted additional instances of non-compliance or areas of concern, including:

- instances of both over- and under-segregation of client money, including a period during which there was under-segregation of almost £75 million;
- inaccuracies and omissions within both firms' CASS resolution packs;
- inadequate management information provided to the firms' management;
- the firms' use of a non-standard method of internal client money reconciliation which did not provide the same degree of protection as the standard method in the CASS rules;
- the firms' failure to allocate sufficient resources to ensure effective oversight of CASS compliance; and
- a failure to give sufficient priority to CASS compliance, leading to delays in remedying identified issues.

The FCA noted that the CASS procedures used within AWL and APT were often informal and inconsistent in nature, with a lack of formal guidance about, or monitoring of, which individuals were supposed to be discharging which functions. Both firms relied on summary data provided by their third-party administrators and failed to monitor the outsourced functions sufficiently.

The FCA was particularly critical of both firms' failure to take account of other well-publicised cases and guidance relating to client asset and client money failings and the fact that the firms' non-compliance was not identified internally, but had to be highlighted by external auditors and the FCA. As a result, the regulator applied a 10% uplift to the relevant penalty.

4.2.3 Lessons to be learnt

- The Aviva case is a clear demonstration of the risks of firms outsourcing important functions to third parties without ensuring that there is sufficient oversight over the outsourced services. As outsourcing does not remove a firm's responsibility for compliance with the relevant rules, it will need to have in place proper systems and controls to monitor the services provided and to engage with the provider where necessary to remedy any deficiencies.
- CASS compliance is a key regulatory focus for the FCA and firms must ensure that they act quickly to address any potential breaches highlighted by their own internal processes, external auditors or the FCA itself. As in previous cases, the FCA emphasised that the mere risk of loss of client assets or money is sufficient to justify enforcement action, even if that risk never actually materialises or is not considered likely to materialise.
- Firms must also ensure that there is sufficient internal oversight over their CASS functions and proper formal procedures in place to identify and resolve CASS issues. This will require sufficiently experienced individuals to take responsibility for CASS compliance and for suitable management information to be provided to senior individuals within the firm.
- Firms must ensure that they update their CASS resolution packs regularly in order to ensure that these would be suitable if the firm were to become insolvent. The FCA noted that APT and AWL did not operate a clear timetable to ensure proper updating of their resolution packs and frequently delayed adding information about newly opened bank accounts.

5. Failure to act with due skill, care and diligence

5.1 Tariq Carrimjee (FCA Final Notice: 22 November 2016)

5.1.1 Penalty

The FCA fined Mr Carrimjee £89,004 for breaching Statement of Principle 2 of the Authority's Statements of Principle for Approved Persons (failure to act with due skill, care and diligence) and also imposed a prohibition order preventing him from performing the compliance oversight (CF10) and money laundering reporting (CF11) significant influence functions in relation to any regulated or exempt firm.

5.1.2 Summary

5.1.2.1 Final Notice of 26 March 2013

In a final notice dated 26 March 2013, the FCA set out its decision to: (i) fine Mr Carrimjee £89,004; (ii) make a prohibition order preventing him from carrying out any function in relation to an authorised or exempt firm; and (iii) withdraw his individual approvals, on the basis that he had acted without integrity in breach of Statement of Principle 1.

Mr Carrimjee was an investment adviser and senior partner at Somerset Asset Management LLP ("Somerset"), which provided wealth management advice to clients. Mr Carrimjee was approved to perform the CF3 (chief executive), CF4 (partner), CF10 (compliance oversight) and CF11 (money laundering reporting) significant influence functions on behalf of Somerset. The FCA found that Mr Carrimjee had failed to act with integrity in breach of Statement of Principle 1 in recklessly assisting his client, Rameshkumar Goenka, in his plan to manipulate the closing price of global depository receipts ("GDRs") in the Russian gas conglomerate Gazprom in April 2010, and in Reliance Industries Ltd ("Reliance") in October 2010. Mr Goenka was a significant "trophy client" for Somerset, representing 7–8% of its business, as well as a personal friend of Mr Carrimjee.

Mr Goenka held certain structured products that related to a basket of GDRs relating to Gazprom and Reliance, *inter alia*. The final payment to Mr Goenka from the structured products depended on the LSE closing price of the different GDRs on the stated maturity dates.

The FSA (as it then was) found that, although Mr Carrimjee had suspected that market manipulation was Mr Goenka's goal, he had turned a blind eye to the risk of his client's planned market abuse and had recklessly assisted his client in his attempt to achieve that goal.

The FSA also found that Mr Carrimjee had introduced Mr Goenka to a London-based broker, Vandana Parikh, a close family friend of Mr Carrimjee, for the specific purpose of trading in the LSE closing auction for Gazprom and Reliance GDRs. He had made that introduction, participated in discussions about trading and assisted with the arrangements for trading despite suspecting that the objective of Mr Goenka's plan was to secure the price of Gazprom GDRs and Reliance GDRs at a false or artificial level.

Mr Goenka's plan to manipulate Gazprom GDRs was abandoned at a late stage due to a sudden drop in the price of Gazprom's securities. However, on 18 October 2010, Mr Goenka (through Ms Parikh) effected large orders to trade which artificially inflated the closing price of Reliance GDRs on that day. By increasing the closing price, Mr Goenka was able to avoid a loss of $3,103,640 under the terms of his structured product.

5.1.2.2 Upper Tribunal

On 23 April 2013, Mr Carrimjee referred the Decision Notice to the Upper Tribunal which held that the FSA had not made out its case that Mr Carrimjee had acted without integrity in breach of Statement of Principle 1. It did not find cogent and compelling evidence that Mr Carrimjee knew or suspected that there was a risk that Mr Goenka was engaging in market abuse and turned a blind eye to it. However, it decided that Mr Carrimjee had failed to act with due skill, care and diligence in breach of Statement of Principle 2 because he should have been aware of the risk that Mr Goenka might be seeking to engage in price manipulation. For that reason, the Tribunal upheld the FSA's decision to impose a financial penalty of £89,004.

As regards the prohibition order, the Tribunal chose to remit the matter to the FCA for fresh consideration, noting that:

- The Tribunal had not concluded that Mr Carrimjee had acted without integrity or recklessly assisted Mr Goenka to commit market abuse, as the FCA had alleged.
- Its findings attributed the same level of culpability to Mr Carrimjee as had been attributed to:
  - the broker, Ms Parikh, who was found by the FSA to have acted without due skill, care and diligence in breach of APER Principle 2. The FCA fined Ms Parikh £45,673.50, but did not impose a prohibition order on her; and
  - David Davis, who held the CF10 and CF11 significant influence function roles at Ms Parikh's firm. The FSA concluded that Mr Davis had not taken adequate steps to address concerns that Ms Parikh had escalated to him about Mr Goenka. It imposed a fine of £70,258 on Mr Davis, and a prohibition order preventing him from performing the CF10 and CF11 significant influence functions in the future, on the basis that he lacked competence and capability to perform those functions.
- It was relatively rare for the FCA to impose a prohibition order in cases where individuals had failed to act with due skill, care and diligence on one occasion.

The Tribunal noted that the second and third factors listed above suggested that imposing a prohibition order on Mr Carrimjee would be irrational and disproportionate.

5.1.2.3 Further Decision Notice

Despite the Tribunal's decision, on 26 November 2015, the FCA issued a further Decision Notice which set out its decision to make an order prohibiting Mr Carrimjee from performing the compliance oversight (CF10) and money laundering reporting (CF11) significant influence functions in the future.

The FCA found that Mr Carrimjee had demonstrated a serious lack of competence in relation to the performance of the compliance oversight function while also holding the money laundering reporting function, and that he was not a fit and proper person to hold those functions. In particular, it noted the following:

- Mr Carrimjee had either failed to identify appropriately the risk of market abuse or did nothing to allay his concerns about potential market abuse other than to seek inadequate reassurances from Ms

Parikh. This serious failure was compounded by the fact that the FCA "relies on those who hold the compliance oversight (CF10) function to provide it with market intelligence in order to identify and prevent market abuse".

- The FCA disagreed with Mr Carrimjee's submission that he had learnt his lessons and would not repeat his mistakes. It found that, although he would not repeat his mistakes of April 2010 if faced with the same facts, Mr Carrimjee lacked the fundamental skills and judgment required to discharge the compliance oversight function effectively when faced with novel and unfamiliar circumstances. The FCA noted that Mr Carrimjee had not, despite having had ample time, undergone any further compliance training, acquired or refreshed his expertise or otherwise taken steps to establish that he now had the judgment to identify and properly respond to compliance risks.
- Even though Mr Carrimjee had relinquished the compliance oversight (CF10) and money laundering reporting (CF11) functions, a prohibition order would still serve "a lawful purpose" in acting as a deterrent promoting the FCA's consumer protection and integrity objectives. The fact that Mr Carrimjee had employed a compliance officer was no basis to conclude that Mr Carrimjee himself had the competence necessary to discharge the compliance oversight and money-laundering reporting functions properly.
- Mr Carrimjee's treatment was not inconsistent with that of Ms Parikh or Mr Davies: unlike Ms Parikh, Mr Carrimjee held the compliance oversight function and had the client relationship with Mr Goenka, and Mr Davis (who in any event did receive a prohibition order) was not as intimately involved as Mr Carrimjee in the material events and had no client relationship with Mr Goenka.
- Although a separate issue to the compliance oversight function, a prohibition order in respect of the money laundering reporting function was also appropriate and proportionate. The FCA noted that there were close parallels between the skills, judgment and capabilities required for both functions, which both require the identification, monitoring, evaluation and, where appropriate, reporting of suspicious activity in the market. These are the very skills, judgment and capabilities that Mr Carrimjee failed to exhibit.

5.1.2.4 Back to the Upper Tribunal

On 21 December 2015, Mr Carrimjee referred the further Decision Notice to the Tribunal. In its decision of 20 October 2016, the Tribunal upheld the FCA's decision to impose the prohibition order, on the basis of the following findings, *inter alia*:

- Mr Carrimjee's failure to notice the clear warning signs of the possibility of market manipulation was "a fundamental and basic error not to be expected of any reasonably competent compliance officer". It was not reasonable for Mr Carrimjee to have relied upon Ms Parikh, and the fact that she was a close family friend was all the more reason for him to have sought objective advice on the situation from an independent external source.
- There is a clear risk to market integrity and confidence if those who perform compliance oversight functions do not display the necessary competence to identify clear warning signs of potential market abuse. It is in the nature of compliance responsibilities that those who exercise them need to be able to respond to circumstances which are rare and unusual. It is therefore no answer to say that the failure arose in the context of "highly specific circumstances" when it is precisely the ability to identify and respond to those circumstances that is the skill required to discharge those functions effectively.
- Mr Carrimjee's failure to spot the warning signs occurred either as a result of a lack of ability on his part to identify and understand the issues with which he was confronted or an inability to understand what he should appropriately do when faced with those issues. In either event, the failure was "basic, fundamental and serious".
- In those circumstances, the FCA's decision to impose a limited prohibition order in respect of the compliance oversight and money laundering reporting significant influence functions, in the absence of strong evidence that Mr Carrimjee had adequately addressed the failings found in the first Tribunal decision, clearly fell within the range of reasonable decisions open to it.

In light of that decision, the FCA issued its Final Notice on 22 November 2016.

5.1.3 Lessons to be learnt

- This case reinforces the importance of approved persons, and particularly significant influence function holders with compliance oversight responsibilities, being alive to the risk of market abuse and escalating any concerns that they have in an appropriate and timely manner. In particular, approved persons should ensure that they do not rely on the judgment of others (even if those others are also approved persons) when considering such matters, and must instead make up their own mind, based on all of the facts available to them. Although the FCA accepted that Mr Carrimjee may have been less experienced in auction trading than Ms Parikh, it found that, as an approved person and a SIF holder, he was required to make robust enquiries and to challenge the information he received from Ms Parikh (namely that the Gazprom GDRs were too liquid to manipulate and that there were market safeguards against manipulation).
- The case also demonstrates that firms should be rigorous in their approach to possible market abuse and other regulatory issues regardless of the client's status, and not be tempted to pass over potential problems or ignore warning signs where the client is particularly important to the firm. The FCA noted in its first final notice that Mr Goenka represented a "feather in Somerset's cap" and that Mr Carrimjee may have hoped to attract other well-known investors to the firm through his retention of Mr Goenka's business.
- When seeking to demonstrate competence to the FCA or before the Tribunal, it is important to be able to point to concrete examples/experience.

5.2 Christopher Niehaus (FCA Final Notice: 29 March 2017)

5.2.1 Penalty

Mr Niehaus was subject to a £37,198 penalty, reduced from a total original amount of £53,140 to reflect his admission of misconduct and early settlement. The penalty was imposed in connection with Mr Niehaus's improper disclosure of client confidential information using an instant messaging application, thereby breaching Statement of Principle 2 of the FCA Statements of Principle for Approved Persons, requiring individuals to act with due skill, care and diligence.

5.2.2 Summary

Mr Niehaus was employed as a managing director responsible for European industrial groups in the investment banking division at Jefferies International Ltd ("Jefferies"). At the relevant time, he was an approved person authorised to perform the CF30 (customer) function. Between 24 January 2016 and 16 May 2016, Mr Niehaus shared confidential information that he had obtained during the course of his employment in relation to two clients via the instant messaging application "WhatsApp".

Between 24 and 25 January 2016, Mr Niehaus conversed with one of his clients ("Client A") and disclosed confidential information about another client ("Client B"), including the client's identity and its intended acquisition of part of another company. Mr Niehaus also disclosed the proposed transaction in a conversation with a friend, to whom he also mentioned that he, along with others at Jefferies, had received a mandate from another client to raise finance and reduce debt, revealing specifically the amount needed to be raised and the fees for the mandate. On 22 April 2016, Mr Niehaus spoke with Client A at a social gathering about Client B completing a rights issue and disclosed further information in conversations over WhatsApp, despite Client A being a competitor of Client B.

These disclosures did not result in any dealing in investments, nor did Mr Niehaus share the information in the expectation of such activity. The only explanation that Mr Nieuhaus could provide for the disclosures was that he wanted to impress Client A and his friend. Nonetheless, the FCA concluded that he had failed to act with due care, skill and diligence by sharing confidential information without permission from his clients in circumstances that did not warrant such disclosure. This demonstrated a lack of due regard for the interests of his clients, especially given that Client A and Client B were competitors.

The FCA noted that the breaches occurred on several occasions, albeit within a short period of time, and Mr Niehaus was an experienced industry professional. However, the FCA also concluded that there were a number of mitigating factors, including Mr Niehaus's full co-operation throughout the investigation, his full and early admission of liability and the fact that he provided details of all the relevant breaches when interviewed under caution, even though he was not under an obligation to answer questions. This resulted in a 15% reduction for mitigating factors prior to the application of the 30% stage 1 early settlement discount.

5.2.3 Lessons to be learnt

- In the current age of social media and instant messaging, Mr Niehaus's case is a reminder of the dangers of breaching confidentiality and sharing information too freely. The relative informality of these methods of communication can lead individuals to share excessive details or to send messages which breach professional rules or restrictions. It is particularly important that individuals within financial services firms ensure that confidential information is not disseminated inappropriately. This is both because this may result in serious detriment to clients and because in certain situations, the information could constitute inside information and therefore its improper disclosure may amount to market abuse.
- It is clear that the FCA will seek to make an example of individuals within the financial services sector who engage in inappropriate sharing of confidential information as a means of improving standards. Firms should ensure that staff are reminded regularly that they must keep client information confidential and of the risks of failing to do so.
- The additional discount that the FCA applied to Mr Niehaus's penalty to reflect the high degree of co-operation he provided is a reminder of the potential benefits of providing additional assistance to the regulator during an investigation. However, firms and individuals will need to think carefully in each case about the potential disadvantages of such a course of action and whether additional co-operation would be appropriate.

6. Failure to be open and co-operative with the regulator

6.1 The Bank of Tokyo Mitsubishi UFJ Ltd and MUFG Securities EMEA Plc (PRA Final Notice: 9 February 2017)

6.1.1 Penalty

The Bank of Tokyo Mitsubishi UFJ Ltd ("BTMU") was fined £17,850,000 (reduced from £25.5 million due to early settlement) and MUFG Securities EMEA Plc ("MUS") was fined £8,925,000 (reduced from £12.75 million due to early settlement).

BTMU was found to have breached Fundamental Rule 6 (the requirement to organise and control its affairs responsibly and effectively) and Fundamental Rule 7 (the requirement to be open and co-operative with the PRA) of the PRA Rulebook. These breaches arose in connection with its failure to disclose information to the PRA about the settlement of an investigation carried out by the New York Department of Financial Services ("DFS"). MUS was also found to have breached Fundamental Rule 7 in connection with the same investigation.

6.1.2 Summary

BTMU was a large and systemically important international bank with its headquarters in Tokyo and a large international branch network, including branches in New York and London. The London branch was dual-regulated by the FCA and the PRA. MUS was a UK subsidiary of BTMU.

In June 2013, BTMU entered into an agreement with the DFS in connection with the DFS's investigation of BTMU's improper processing of US dollar clearing activity through its New York branch, in breach of US sanctions, between 2002 and 2007. Under the agreement, BTMU agreed to pay a $250 million fine, which was based on a review of transactions undertaken between April 2006 and March 2007 carried out by PricewaterhouseCoopers ("PwC").

The DFS subsequently carried out an investigation of PwC in connection with the transaction review and concluded that certain findings had been removed from the report due to pressure exerted by BTMU. The

DFS considered that those findings contained evidence that BTMU had written procedures which required its staff to remove information about the origin of certain transactions which would have contravened US sanctions. In August 2014, PwC entered into its own settlement agreement with the DFS whereby it agreed to pay a $25 million penalty and to restrict certain of its consulting activities for two years. The press release published by the DFS asserted that information had been removed from PwC's reports at BTMU's request. This prompted senior management from within BTMU and MUS to convene a meeting the following day to consider the potential risk of further DFS action against BTMU, notwithstanding the original settlement agreement.

In September 2014, the DFS contacted BTMU's lawyers and indicated that as a result of its findings from its investigation into PwC, it considered that there were new grounds to investigate BTMU. However, the DFS also indicated that a further investigation could be avoided if BTMU reached a quick settlement in relation to the new issues. New York State banking law prohibited BTMU, once it had begun settlement negotiations with the DFS, to disclose any confidential supervisory information to a third party (including foreign regulators) unless BTMU had obtained an appropriate waiver.

In early October 2014, MUS became aware that the DFS might require BTMU to take action against one of its employees who was the chair of MUS and had previously been employed as a managing executive officer and deputy CEO of a business unit within BTMU. When representatives of MUS met with the PRA later in October, they did not disclose the potential action against the chair or its possible implications. However, throughout October, discussions took place within BTMU about the possible consequences of the DFS's investigation into the chair and his ability to continue occupying positions within the group.

In early November 2014, BTMU's compliance function was informed by one of MUS's directors that the PRA would need to be notified of the issues that gave rise to the settlement discussions between the DFS and BTMU once the outcome of those discussions was known. The compliance team expressed concern about the DFS's confidentiality restrictions and asked the director to avoid taking any immediate action. The following day, the director became aware that BTMU had broadly finalised its settlement with the DFS and that the terms would include restrictions that would apply to the chair of MUS. The director and other senior management asked BTMU's US lawyers whether they could contact UK lawyers to obtain advice as to whether the FCA and PRA needed to be notified about the relevant issues. The US lawyers advised that the bank could seek UK legal advice, but that there was a risk that the DFS might be displeased to learn that BTMU had disclosed confidential information for the purposes of obtaining such advice. However, the US lawyers also stated that it was likely that the need to obtain UK legal advice could be explained to the DFS if necessary, but that any information disclosed should be as limited as possible. BTMU interpreted this to mean that it might be unable to disclose sufficient facts to obtain meaningful advice and it should not contact UK lawyers in relation to the issue.

Between September and November 2014, BTMU provided regular updates to its regulators in Japan and other US regulators in relation to its ongoing discussions with the DFS, having requested and obtained the necessary permission from the DFS. At no point did BTMU seek permission from the DFS to notify the PRA about the ongoing discussions.

On 13 November 2014, a senior individual within MUS informed the firm's compliance department that it might need to change its chair imminently and provided some limited details about the matters under discussion with the DFS. MUS's compliance department considered that it would be necessary to inform the PRA of this intended change. As a result, the senior individual sought advice from an external adviser about whether disclosures to the FCA and PRA were required. On the basis of the limited facts disclosed, the external adviser concluded that MUS did not have sufficient information to make a notification to the UK regulators at that time.

Eventually, following a number of discussions between BTMU's London and Tokyo branches, MUS, the wider banking group and external advisers, it was agreed that the PRA would only be notified of the new settlement agreement after it had been announced by the DFS. Publication occurred in the afternoon of 18 November 2014, with the PRA being informed approximately an hour later by telephone. Under the agreement, BTMU agreed to pay a $315 million penalty and to impose certain restrictions on some of its employees, including MUS's chair.

The PRA concluded that BTMU's "hub and spoke" model had meant that individuals within BTMU's Tokyo hub did not have sufficient knowledge and understanding of the responsibilities of PRA-regulated entities in the UK. This meant that the compliance department within BTMU's London branch only became aware of the existence of regulatory investigations into BTMU elsewhere in the world at a late stage. The PRA concluded that these failures breached Fundamental Rule 6 because BTMU had failed to put in place proper systems and procedures to ensure that the teams negotiating with the DFS considered the regulatory implications for BTMU. BTMU had also failed to provide MUS with sufficient information to allow MUS to assess its own regulatory responsibility to notify the PRA about the potential action being taken against MUS's chair.

The PRA also found that both BTMU and MUS had breached Fundamental Rule 7 by failing to be open and co-operative with the PRA in relation to the ongoing discussions with the DFS. The PRA noted that BTMU had requested confidentiality waivers from the DFS to facilitate the disclosure of information to US and Japanese regulators, but failed to do the same in relation to the PRA. The potential for a significant financial sanction and reputational damage to BTMU was clearly something of which the PRA would reasonably expect notice and the bank's failure to inform the PRA of this risk in advance interfered with the regulator's ability to supervise BTMU's UK operations. Similarly, MUS had failed to inform the PRA of the possibility of regulatory consequences for its chair. Such issues were relevant to the ongoing assessment of fitness and propriety of a senior individual within MUS and therefore were also something of which the PRA would reasonably have expected notice.

6.1.3 Lessons to be learnt

- The determination of whether a particular event must be notified to the FCA or PRA is frequently difficult for firms and typically involves an element of judgment. However, there are clearly cases where the FCA and PRA have previously indicated that they would expect to be informed at an early stage, including, as in the BTMU case, any regulatory action being taken by an overseas regulator which could have material consequences for the firm or senior individuals within it.
- Firms with large or complex structures (e.g. banks with multiple international branches) need to ensure that there are proper lines of communication so that important information is disseminated appropriately. Part of the difficulty in the BTMU case was that BTMU's London branch did not understand until very late in the process the nature of the discussions with the DFS and the potential implications for BTMU as a whole.
- There may be difficult circumstances where overseas regulators seek to impose confidentiality requirements on a firm in connection with issues that the FCA or PRA would expect to be notified to them. In such situations, the firm will need to consider, taking specialist advice where appropriate, whether it is possible obtain the consent of the relevant overseas regulator to the disclosure and/or the extent to which the overseas regulator's rules might permit certain limited information to be disclosed.

7. Failure to operate adequate systems and controls

7.1 QIB (UK) Plc (PRA Final Notice: 8 April 2016)

7.1.1 Penalty

QIB (UK) Plc ("QIB") was fined £1,384,950 (reduced by 30% from £1,978,500 for early settlement) for breach of Principle 2 (the requirement to conduct business with due skill, care and diligence) and Principle 3 (the requirement to have adequate systems and controls) of the then-FSA's Principles for Businesses due to its failure to comply with certain regulatory capital requirements.

7.1.2 Summary

QIB was a deposit-taking bank offering investment and finance products. As such, during the relevant period from June 2011 to December 2012, it was subject to regulatory capital rules in the FSA Handbook derived from the EU Capital Requirements Directives. Certain of those rules required QIB to carry out an individual capital adequacy assessment process ("ICAAP") on an annual basis and to keep this under ongoing review in order to determine the level of regulatory capital it should hold (termed the "Overall Pillar 2 Rule").

During September and October 2011, QIB's audit and risk committee considered the draft ICAAP document and noted that the bank had been suffering from a regulatory capital shortfall since June 2011 which was continuing to grow. The draft ICAAP was in fact never approved and the firm failed to meet its obligations under the Overall Pillar 2 Rule to complete the necessary assessment due to a mistaken belief that it was not subject to the relevant requirements. This was only remedied when the FSA brought this to the bank's attention.

The regulatory capital rules also contained certain requirements relating to "large exposures" (i.e. those exceeding 10% of the firm's regulatory capital resources), which were designed to prevent firms from concentrating risk in excessive exposures to a single counterparty. QIB was required to monitor and report such large exposures to the FSA and to avoid incurring an exposure to a third party (or group of connected third parties) that exceeded 25% of its regulatory capital resources. QIB had exposures to three companies which were all wholly owned subsidiaries of the same parents and therefore were deemed to be connected for these purposes. However, the bank failed to report certain of these exposures in its regulatory capital reports over the period and also failed to identify that in one case, it had breached the 25% limit due to the connected exposures. QIB's internal large exposures policy did not contain clear guidance about how connected clients should be identified and in May 2012, an internal report within the bank concluded that large exposures were not being properly reported and the bank was at risk of breaching the hard 25% limit without having obtained the FSA's consent to do so. Despite this, QIB failed to take any action to address these issues and they were only resolved after the FSA contacted the bank to question certain inconsistent entries in its regulatory capital reports.

The PRA concluded that QIB had failed to conduct its business with due skill, care and diligence in light of its failure to understand the requirements of the Overall Pillar 2 Rule or the large exposures regime. The bank had also failed to operate its business with adequate systems and controls due to its failure to identify the mistakes in its reporting to the FSA and to carry out the ICAAP assessments required under the regulatory capital rules.

7.1.3 Lessons to be learnt

- Due to their complexity, regulatory capital rules are frequently misunderstood by some firms, which can result in regulatory capital shortfalls. The FCA and PRA treat such errors very seriously, as these can affect the financial stability of a firm and therefore may result in risks to business continuity and, in extreme cases, to the stability of the wider financial system. Firms must therefore ensure that they understand the relevant requirements, taking specialist advice where appropriate, and apply these accurately within their businesses.
- The PRA was particularly critical of a number of aspects of QIB's conduct, including that the regulatory capital breaches had triggered a requirement for an emergency recapitalisation and had lasted for over 18 months. It also noted that the bank itself had failed to determine that it had breached the FSA's rules, but had instead needed to be informed of this fact by the regulator. This underlines the importance of firms undertaking regular compliance reviews in order to identify any potential infractions and of escalating and resolving any problems or uncertainties quickly.

7.2 CT Capital Ltd (FCA Final Notice: 1 June 2016)

7.2.1 Penalty

The FCA fined CT Capital Ltd ("CT Capital") £2,360,900 (reduced by 20% from £2,951,179 for early settlement) for breaches of Principles 3 (management and control) and 6 (customers' interests) of the Principles for Businesses in relation to its historic payment protection insurance ("PPI") complaint handling processes.

7.2.2 Summary

CT Capital was the parent company in the CT Group, a group of companies that acted as brokers and lenders of secured and unsecured loans.

In acting as a loan broker, CT Group employed telephone sales advisers to sell customers loans provided either by a member of the CT Group or by a third-party lender. The advisers frequently sought to sell customers PPI alongside the loans on an advised basis so that the adviser was responsible for recommending whether the particular PPI policy was suitable. Between January 2005 and October 2008, the CT Group sold 31,591 regulated PPI policies, receiving approximately £63 million in commission.

CT Capital was responsible, between May 2011 and November 2013, for handling PPI complaints on behalf of the CT Group.

7.2.2.1 Breach of Principle 3

The FCA found that, during the relevant period, CT Capital had breached Principle 3 (management and control) in connection with its PPI complaints-handling process. Specifically, the FCA identified the following failings arising between 10 May 2011 and 31 October 2011:

- *Procedures*. CT Capital's PPI complaints-handling procedures did not give effect to the FCA's guidance and rules on handling PPI complaints which outlined a number of potential sales failings that firms had to consider when handling a PPI complaint. Instead, they focused on whether the sales adviser had followed the internal sales procedures rather than whether there were failings at the point of sale. This meant that complaints handlers did not consider in individual cases whether there had been sales failings and whether those failings had led to customer detriment.
- *No quality assurance process.* Despite the firm handling 840 PPI complaints during this period, it had no effective or documented quality assurance process in place for monitoring whether customers were obtaining fair outcomes or for reporting the results to management.
- *Inappropriate refusal policy.* CT Capital operated an inappropriate policy of refusing all PPI complaints in relation to sales made more than six years beforehand without considering when the customer may have become aware of the cause for complaint. The firm was advised by external consultants in March 2011 that this policy was likely to be considered as not treating customers fairly.

The FCA also found that between November 2011 and November 2013, despite introducing new complaints-handling processes, CT Capital still handled PPI complaints inappropriately in the following ways:

- The firm continued, until January 2013, to operate an inappropriate time bar on complaints by instructing complaint handlers to reject complaints made in respect of sales made more than six years previously, unless the cause for complaint "related to something within the last three years". Since almost all PPI complaints related to the time of sale, the exception was unlikely to arise. The firm should instead have considered when the customer became aware (or ought reasonably to have become aware) of the cause for complaint. CT Capital continued to apply this policy even after it became aware that a Financial Ombudsman Service ("FOS") adjudicator had ruled against it in a case in which the procedure had been applied.
- It directed its complaint handlers that certain sales failures, including failure to disclose the cost of the PPI and to inform the customer that the policy was optional, should only lead to a complaint being upheld if the sales documentation sent to the customer after the call did not make the position clear. The FOS noted in at least six decisions provided to CT Capital between 2010 and 2013 that issuing sales documentation was not sufficient to correct original sales call failings.
- It failed to provide its PPI complaint handlers with appropriate guidance on how to conduct an assessment of whether reasonable care had been taken to establish the suitability of the PPI policy. Instead, it directed complaints handlers actively to seek reasons why the policy may in fact have been suitable, or to seek to dismiss grounds for asserting that it may have been, rather than completing an impartial assessment.
- There remained weaknesses in the firm's systems for assessing its PPI complaints-handling processes and for monitoring the fairness of complaint outcomes. In particular, when forming the PPI complaints-handling department, CT Capital had seconded senior staff from compliance and internal audit departments but had not replaced their original roles, meaning that there was no internal department offering independent oversight of customer outcomes.

- CT Capital undertook a root cause analysis in November 2011, and that analysis identified that the CT Group's PPI sales practices may not have complied with applicable sales rules. For example, it found that failings relating to the disclosure of the consequences of early policy cancellation had been identified by the FOS in 71% of cases. However, the root causes analysis failed to consider how the failings it had identified should affect the firm's PPI complaints handling.

The FCA also found that, throughout the relevant period, even when PPI complaints were upheld, CT Capital operated an alternative redress methodology which resulted in some customers receiving significantly less redress than they were due.

7.2.2.2 Breach of Principle 6

The FCA found that CT Capital's failings in handling PPI complaints did in fact lead to unfair customer outcomes, and that CT Capital failed to identify those unfair outcomes and mitigate the risks involved. The firm therefore also breached Principle 6 because it failed to pay due regard to the interests of its customers and to treat them fairly when handling PPI complaints. The FCA found that the effect of this was that CT Capital:

- unfairly rejected some PPI complaints and consequently unfairly failed to pay redress to those customers whose PPI complaints it unfairly rejected; and
- unfairly paid insufficient redress to some customers whose complaints were upheld but whose redress was calculated using the alternative redress methodology.

7.2.3 Lessons to be learnt

- Firms must adequately analyse FOS decisions and adjudications (including overturn rates), and use them to inform and update their internal policies and guidance. The FCA considered that the FOS decisions should have alerted CT Capital to the weaknesses in its complaints-handling processes. Firms must also take into account any published FCA guidance.
- Redress payments to customers must be accurate and timely. The FCA has criticised a number of firms, including CT Capital, for redress methodologies that fail to take into account all relevant information. Given the possibility of FCA penalties and the expense of having to revisit original cases, it is often a false economy for firms to attempt to operate more aggressive redress methodologies in order to limit the amounts paid to customers.
- Firms must design their complaints-handling procedures in a way that complies with the need to investigate complaints impartially and to assess them fairly. The FCA criticised CT Capital for encouraging its complaint handlers to try to undermine a finding that PPI had been unsuitable by looking for additional information or factors that mitigated the initial assessment.
- Firms should ensure that, if they move staff from compliance departments to cover other areas of the business, such as complaints handling, there is sufficient cover in the original department from which staff have been moved. The FCA found that CT Capital had seconded senior staff from its compliance and internal audit departments, but had not replaced their original roles, with the result that there was no internal department offering independent oversight of customer outcomes.

8. Identification of connected parties in FCA and PRA notices

8.1 Achilles Macris (Supreme Court judgment: 22 March 2017)

8.1.1 Summary

This case did not involve the FCA imposing a penalty on Mr Macris, but instead related to whether he had been identified in a final notice issued to JP Morgan Chase Bank N.A. ("JPM") and published on 19 September 2013. If Mr Macris had been identified, he would have benefited from certain rights conferred to identified third parties under the FSMA in order to allow him to make representations to the FCA prior to the publication of the notice. Although this is not, strictly speaking, an enforcement case in itself, the principles established in the Supreme Court's judgment have important and widespread implications for individuals who may be implicated in, or otherwise connected with, future FCA or PRA enforcement cases against other persons and therefore deserve consideration.

In 2012, Mr Macris was JPM's international chief investment officer and was the head of the London Chief Investment Office ("CIO"). The CIO was responsible for managing JPM's synthetic credit portfolio ("SCP") which, by the end of 2012, had lost approximately $6.2 billion. In September 2013, the FCA issued a final notice imposing a £137,610,000 fine on JPM for pursuing a high-risk trading strategy with insufficient management of the associated risks, with the result that the bank had created a potential threat to the wider UK financial system. In addition, the FCA also found that JPM had failed to be open and co-operative with the regulator by failing to disclose in a prompt manner important information about the scale of the losses resulting from its trading.

As JPM had negotiated an advance settlement with the FCA in relation to the penalty, the regulator served the warning notice, decision notice and final notice simultaneously on JPM on 18 September 2013, with the decision notice and final notice being published on the FCA's website the following day. Mr Macris was not served with copies of any of the notices and was not permitted to make any representations to the FCA about their subject matter. At the time, Mr Macris was himself under investigation by the FCA for his potential role in JPM's misconduct, which subsequently resulted in him being fined £792,900 for failing to be open and co-operative with the FCA in a separate final notice issued on 9 February 2016.

Mr Macris alleged that he had been identified in various statements that were prejudicial to him in the warning notice and decision notice served on JPM by the FCA. As a result, he claimed that, pursuant to s.393 of the FSMA, he should have been supplied with a copy of the relevant notices and given a reasonable time to make representations to the FCA prior to their publication. As this had not happened, he referred the matter to the Upper Tribunal for consideration. Mr Macris contended that while he was not specifically named in the notices and nor was his job title used, the notice contained a number of references to certain actions taken by "CIO London management" or other similar phrases. Although he was not the only manager within the CIO, Mr Macris argued that individuals working in his industry sector would have understood such references to be references to him. In support of that position, he had entered two witness statements into evidence before the Upper Tribunal from individuals in the financial services industry who stated that having read the FCA's notices, they had concluded that the relevant references were intended to refer to Mr Macris. Mr Macris also argued that a committee of the US Senate had produced and published a report on JPM's SCP trades which had named him and, if read alongside the notices published by the FCA, it would be possible for individuals to infer that the term "CIO London management" was intended to refer to him. The FCA denied that the use of the term had amounted to identifying Mr Macris for the purposes of the rules in s.393 of the FSMA.

In April 2014, the Upper Tribunal found in Mr Macris's favour and concluded that he had been identified and should have been given the right to make representations prior to publication. It based its decision on a number of factors, including that the notices referred to the CIO taking actions, such as sending an email, which implied that the reference was intended to be to a specific individual, not an entire management body. The FCA appealed to the Court of Appeal, which handed down its judgment in May 2015. The court reached the same result as the Upper Tribunal, but using different reasoning. It concluded that parallels could be drawn between s.393 of the FSMA and the general law of defamation and that the relevant question was whether the words used in the notices were such that they would reasonably in the circumstances lead a person acquainted with Mr Macris, or who operated in his area of the financial services industry, to believe that the references were to him. The court accepted that, in light of the witness statements produced to the Upper Tribunal by Mr Macris and the existence of the US Senate committee report, there was sufficient evidence to conclude that he had been identified by the FCA. The FCA appealed to the Supreme Court.

There was a disagreement amongst the judges in the Supreme Court about the correct approach to interpreting s.393 of the FSMA. The key tension was between whether the protection conferred by the section should be interpreted broadly, thereby increasing the rights of individuals but constraining the FCA's activities, or interpreted narrowly, thereby increasing the flexibility available to the FCA, but also increasing the risk that individuals could suffer adverse effects from the publication of FCA notices without any effective recourse.

The majority of the court, following reasoning outlined by Lord Sumption, preferred a narrower interpretation and held that in order for a person to be identified in an FCA notice for the purposes of s.393 of the FSMA, (s)he must be identified either by name or by a synonym, such as his or her office or job title. Where a synonym is used, it must be apparent from the notice itself that the term used could only apply to one person and that person must be identifiable from information that is either contained in the notice or is publicly available elsewhere. However, for these purposes, information that is publicly available can only be taken into account if it only permits a person to interpret, but does not otherwise supplement, the language used in the FCA notice.

Lord Sumption reasoned that there would almost always be people who, when reading FCA notices, would have the knowledge to ascertain that even general expressions such as "management" would include particular individuals who were likely to be responsible for failings within the relevant firm. That might include, for example, other individuals within the firm or third parties interacting with the firm who have sufficient knowledge of the firm's internal procedures. The FCA would not necessarily know what information people might be able to discover from publicly available sources and it was necessary for the regulator to be able to determine, solely on the basis of the way it drafted its notices, whether or not a particular third party was identified in the notice or not. It was not necessarily the case that terms such as "CIO management" were references to a specific single individual within JPM; those phrases could have comprised a number of individuals. Ultimately, the language used in the notice would not have conveyed to a reasonable member of the public that it was a reference to Mr Macris without extrinsic information to supplement its content.

There were strong dissenting judgments.

8.1.2 Lessons to be learnt

- On its face, the Macris case may seem to relate to an excessively technical discussion of a narrow legal provision in s.393 of the FSMA relating to third-party rights. However, in reality, the outcome of the case is likely to have a significant practical impact on the position of individuals who may be implicated in, or may otherwise have a connection with, FCA investigations into other persons (e.g. their employer). This is because the majority of the Supreme Court endorsed a very narrow construction of the protection contained in s.393 of the FSMA, meaning that an individual will only gain a right to make representations in connection with an FCA enforcement notice issued to another person if the individual can show that the notice refers either to him or her by name, or to his or her specific office or position.
- The fact that a reference to an office or person must be shown to apply only to the specific individual draws the test particularly narrowly. This would mean, for example, that references in FCA notices to small departments, teams or management groups within a firm are unlikely to give rise to third-party rights protected under s.393 of the FSMA because it would not be possible to show that they referred only to one specific individual. Nonetheless, depending on the precise content of the notice, there may still be a significant adverse effect for the individuals within such groups who may be "tainted by association".
- The applicable legal test is still somewhat unclear. When arguing that (s)he has been identified in an FCA notice, a person is now only permitted to refer to publicly available information that is external to the notice if that information merely helps *interpret* the relevant term or phrase used, but does not *supplement* it. It is not entirely clear what this means in practice. There may therefore be scope for disputes about how this test should be applied to phrases used in future FCA notices. The extent of the disagreement between the Supreme Court judges highlights the difficulty in interpreting this area of law.
- There will often be a potential tension between the interests of firms and individuals working within them when FCA enforcement actions arise. Some firms may decide that it is preferable to reach a fast negotiated agreement with the FCA in order to avoid uncertainty, quantify their liability and minimise the required level of management time spent dealing with the dispute. Conversely, individuals may wish to contest particular allegations in order to avoid adverse reputational damage which may impact on their present or future careers, even if they are not themselves under investigation. The effect of the Supreme Court's interpretation of s.393 of the FSMA is that many individuals whose activities are connected with the subject matter of those notices will receive no advance warning before the notices are published and no right to make representations on their subject matter. Where the relevant firm is keen to reach a negotiated agreement with the FCA, it may have little incentive to dispute particular allegations involving individuals or groups within the firm. This may result in individuals having no ability to contest allegations made against the firm in which they may be indirectly implicated.

Issue 149—Fund Management Update

Authors: Charlotte Hill, Covington & Burling

The fund management industry is operating in an increasingly challenging environment. Political, regulatory and commercial factors combine to give the industry more than its fair share of headaches. The industry is faced with complying with European Union Directives and Regulations—notably, MiFID II—which are bringing seismic change, whilst simultaneously having to consider the impact of Brexit and indeed, whether they should be looking to establish themselves elsewhere in mainland Europe—a decision complicated by major uncertainty and lack of information, as the political in-fighting continues. Nearer to home, in its Asset Management Market Study, the FCA has recently carried out one of the most major root-and-branch examinations of the asset management industry, with far-reaching implications. This edition of the Compliance Officer Bulletin will include coverage of the following topics:

- Brexit: One year on
- MiFID II: Best execution and research payments
- The FCA's Asset Management Market Study
- PRIIPs
- UCITS update
- The Senior Managers and Certification Regime
- The Fourth Money Laundering Directive

COMPLIANCE OFFICER BULLETIN

The regulatory environment in which financial institutions operate has been one of constant change and evolution in recent years, not only as a result of the UK regulators' own initiatives, but also as a direct consequence of the need to implement European directives within the UK, and domestic and international responses to the credit crisis.

For over 14 years, *Compliance Officer Bulletin* has been dedicated not only to aiding compliance officers to keep up to date with an unending series of changes to the UK regulatory regime, but also to providing unrivalled commentary and analysis on how FCA and PRA regulations impact on them and their business.

Published 10 times a year, *Compliance Officer Bulletin* provides in-depth, authoritative analysis of a specific regulatory area—from the complaints process to FCA investigations, money laundering to conduct of business, and from Basel to corporate governance. Each issue offers you a concise and practical resource designed to highlight key regulatory issues and to save you valuable research time.

Compliance Officer Bulletin gives you a simple way to stay abreast of developments in your profession.