Linklaters

February 2014

Regulatory Investigations Update.

The first edition of this Update for 2014 summarises developments which both reflect the FCA's ongoing concerns and provide an indication of the areas likely to take up significant enforcement time in the year ahead. As regards the former, we have already seen further fines for financial crime systems and controls failings and a decision to ban a senior executive. Representing the latter are decisions concerning emerging issues such as transition management. In terms of process, we have also seen the publication by the FCA of its first warning notice statements. Further analysis of the likely trends in FCA enforcement work during 2014 can be found in our recent client note, FCA Enforcement Trends 2014. One key challenge for the regulator this year will be balancing the demands of resource-intensive cross-border investigations whilst maintaining the flexibility to respond quickly to other issues which threaten its strategic and operational objectives.

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UK: News

FCA fines levied in 2013 reach record high

2013 proved to be yet another record year for the FCA in terms of the amount of fines levied by the regulator. Firms and individuals were fined a total of £472m, with average fines reaching £18.6m. This is over a third higher than the 2012 total of £311.5m. The number of firms and individuals fined fell to 45, the lowest figure since 2009, reflecting perhaps the drain on the FCA's enforcement team of resource-heavy investigations such as those in relation to alleged benchmark manipulation. The figures suggest a possible trend towards the pursuit of fewer investigations which focus on higher risk/higher impact issues, and the use of other tools such as more intrusive supervision, skilled person's reviews and early intervention techniques to address other issues. This will, however, need to be re-assessed over a longer timeframe before any firm conclusions can be drawn. The impact of the FCA's new fining policy, which applies in respect of breaches occurring after March 2010, is beginning to be felt more keenly in multiple enforcement cases. It is also notable that almost three-quarters of the payments are reported to have arisen out of investigations conducted in conjunction with overseas regulators, a trend considered further in the next report.

Figures suggest increased co-ordination between FCA and global regulators

Figures released at the end of 2013 suggest that the FCA received a record number of requests for assistance from overseas regulators in 2013. Over 1,000 requests had reportedly been received by December 2013, with a flurry of further requests expected on the final day of the year. The total number of requests received in 2012 was 857, with the highest number ever, 1,023, received in 2011. The increase reflects the impact of the increasingly cross-border nature of high profile regulatory investigations, with both home and host state regulators expressing an interest in cases involving significant control failures or market misconduct which has taken place, or had impacts in, multiple jurisdictions. The US is understood to have accounted for the majority of the requests received. Commenting on the figures, FCA Director of Enforcement Tracey McDermott noted that the complexity of the requests received from global regulators had also increased. The rise in the number of requests in respect of cases in which the FCA also has an interest, such as benchmark manipulation, is driving increased co-ordination of global investigations. There has also been a trend towards co-ordinated outcomes, with settlements encompassing regulators from the US, UK and Europe being announced together, as was the case with a number of the recent LIBOR fines. Co-ordinated regulatory sanctions have been imposed in relation to individuals as well as firms. For example, the £598,000 fine levied by the FCA upon high-frequency trader Michael Coscia last year arose following a joint investigation by the FCA and the US Commodities Futures Trading Commission, with the CFTC requiring Coscia and his firm to pay US$2.8m by way of financial penalty and disgorgement and banning them from trading on CFTC registered entities for a year. Further penalties disgorgement and trading bans were also imposed by the exchanges on which the relevant conduct took place.

FCA sees significant rise in number of whistleblowing reports

A recent freedom of information request has revealed a significant increase in the number of whistleblowing reports sent to the FCA since it began work in April 2013. Reports, which were said to have averaged around 338 a month in the FSA's final year, have increased to around 638 a month during the FCA's first months in operation. The increasing profile of the FCA credible deterrence enforcement agenda and its particular focus on the personal accountability of individuals are likely to have contributed to this trend.

Upon receipt of a report, the FCA has a duty to assess the credibility of the information received, often by comparing it with other reports or the regulator's own ongoing work. The FCA has said it regards whistleblowing reports as a valuable form of intelligence, with a number of enforcement investigations understood to have been initiated following whistleblowing reports. The FCA has taken steps recently to improve its whistleblowing processes, including the feedback it gives to whistleblowers, in so far as it is legally able. The Department of Business Innovation and Skills is also examining the broader UK whistleblowing framework at present, including the potential use of financial incentives as a mechanism for encouraging whistleblowing reports. A consultation paper is also expected later this year on the establishment of more prescriptive minimum standards for whistleblowing procedures within banks and making a senior manager personally accountable for those procedures, in response to recommendations made by the Parliamentary Commission on Banking Standards. The PRA and FCA are concerned about the impact of financial incentives and are conducting further research on this, with a view to publishing a statement later this year.

PRA and FCA announce separate enforcement investigations into the Co-operative Bank: 6 January 2014

Further to the announcement late last year that the Chancellor of the Exchequer, George Osborne, had ordered an independent investigation into recent events at the Co-operative Bank pursuant to section 77 of the Financial Services Act 2012, both the PRA and FCA have confirmed their intention to conduct their own, separate, enforcement investigations. The PRA indicated that its investigation will consider the role of former senior managers, but that no further details would be given until the investigation had concluded. The FCA stated only that its investigation would consider decisions and events up to June 2013. It is not clear whether the investigations are, in practice, being conducted by the same investigation teams – the PRA does not have a dedicated enforcement function (this was transitioned from the FSA to the FCA) and has indicated that its practice may include outsourcing investigations to third party investigators, including the FCA. The independent review ordered by the Chancellor will, therefore, only commence once it is clear that it will not prejudice any enforcement action either the PRA or FCA may determine it is appropriate to take. Given the average duration of an FCA enforcement investigation it could, therefore, be some time before the independent reviewer is in a position to begin work.

Financial Services (Banking Reform) Act 2013 receives Royal Assent: 18 December 2013

The Financial Services (Banking Reform) Act 2013 received Royal Assent in the House of Lords shortly before Christmas. The Act implements a number of recommendations of the Parliamentary Commission on Banking Standards and others made in response to the 2008 financial crisis. From a regulatory enforcement perspective, one of the most significant changes is the introduction of the legislative framework for a number of changes to the approved persons regime. In particular, the Act:

- brings into effect a new “senior management” function to replace the current significant influence function (“SIF”) regime, together with an enhanced “Senior Persons Regime” for UK banks, building societies, credit unions and PRA-regulated investment firms which have permission to deal as principal (known as “relevant authorised firms”);

- creates a licensing/certification regime for certain non-approved persons at relevant authorised firms, and the ability for the regulators to make rules of conduct which will have application to all staff at relevant authorised firms;
- extends the limitation period for taking action against individuals (not just those holding the senior management function, and not just those at relevant authorised firms) from three to six years;
- reverses the burden of proof in disciplinary cases against senior managers of relevant authorised firms where the relevant authorised firm has breached its regulatory obligations in relation to an area for which that senior manager was responsible; and
- brings into effect the new criminal offence of reckless misconduct in the management of a bank.

Further details about these provisions can be found in the October 2013 edition of this Update. We will also be publishing a more detailed briefing on these changes shortly.

The FCA and PRA are expected to issue consultations during the course of 2014 on the various rule changes required to implement these changes, with the aim of bringing the regime into force by the end of 2015 . The proposals in relation to the new senior persons regime in particular are likely to attract considerable comment.

Separately, Sir Richard Lambert has issued a consultation paper in relation to the proposed establishment of a new independent organisation, with the aim of defining and raising standards of conduct and competence in banking. The consultation paper seeks initial views in relation to, amongst other things, the proposed establishment of new industry standards of good conduct, designed to build on (and be aligned with) the new FCA/PRA rules. The consultation period closes on 7 March 2014.

UK: Policy and Practice

FCA aims to increase transparency by publishing first enforcement warning notices: 3 February 2014

The FCA has this month published two “warning notice statements”, confirming that it has issued warning notices to two unnamed individuals proposing to take action against them in connection with LIBOR manipulation. The warning notice statements are the first to be publicised on the FCA’s website. This follows amendments to s.391 FSMA introduced by the Financial Services Act 2012, the effect of which was to permit the regulators to publish details of proposed disciplinary action against a firm or individual before the regulator had itself decided that disciplinary action was justified. Crucially, warning notices are issued before the firm or individual concerned has had an opportunity to make representations to the regulator’s decision-makers in relation to the proposed action.

The notices are clear that a warning notice does not represent the FCA's final decision on a matter, outlining in bold at the outset the role of the RDC and ultimately the Tribunal in the decision making process – although this is not a point on which the media interest following publication of the statements has focused. It is not clear, however, that the publication of these notices has materially advanced the "consumer protection" objectives said by the FCA in its Policy Statement to justify early publicity: it was already well understood that the manipulation of interest rate benchmarks was considered unacceptable, and other firms have already had to take considerable steps to alter practices following the implementation of the recommendations of the Wheatley Review. Nonetheless, the publication of the statements has increased transparency in relation to the FCA's future pipeline of enforcement cases, and will serve to reassure some quarters that it is continuing to pursue cases against individuals, including those occupying managerial positions.

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PRA issues consultation on changes to its rulebook: 21 January 2014

The PRA has published a consultation paper and draft text setting out proposed revisions to its current rulebook, which it inherited from the FSA last April. The new rulebook will comprise of rules only, a significant change for firms previously subject to the FSA (and subject to the current PRA and FCA) handbooks, with their large quantity of guidance and evidential provisions. Many of the proposed amendments are concerned with removing guidance from, or reformulating it as, rules. Where further information is considered necessary to supplement its rules, the PRA will issue a standalone "Supervisory Statement". The intention behind this is said to be to make access to guidance easier for firms, particularly senior management. However, the fact that it will now be necessary to consult potentially four separate sets of materials for relevant information (the rulebook, the new Supervisory Statements, the existing Statements of Policy required to be produced under FSMA (such as that in place in relation to enforcement), and process guidance which will be placed on the PRA's website) could actually make this more difficult. In contrast to previous statements by the PRA to the effect that it did not expect to take enforcement action particularly often, the consultation paper also emphasises the armoury of enforcement powers that the PRA has at its disposal, and its intention to use them where firms breach its rules.

From an enforcement perspective, key changes to the existing rulebook include:

- Replacing the PRA's existing six Principles for Businesses with nine "Fundamental Rules", to include the Parliamentary Commission on Banking Standards' recommendation to introduce a "safety and soundness" requirement on a bank's operation. The consultation paper notes that breaches of the Fundamental Rules could form the basis of enforcement action by the PRA.

- Replacing SUP 2 (information gathering by the FSA on its own initiative) with a new rulebook called "Information Gathering". The proposed rules would require firms to permit the PRA to access documents and personnel at the regulator's reasonable request.
- Replacing SUP 5 with a rulebook called "Use of Skilled Persons", including new rules (converted from material that was previously guidance in SUP 5) regarding contracting arrangements between firms and skilled persons, the provision of information to the PRA about the estimated and final cost of the skilled person report, the provision to the PRA of interim and draft reports, as well as consenting to access to working papers and source data where requested. This will be supported by a Supervisory Statement, which incorporates much of the guidance currently contained in SUP 5.
- Replacing SUP 15 (notifications to FCA or PRA) with a section called "Notifications". Although the PRA intends to retain all the rules currently in SUP 15, it proposes making new rules to adapt existing SUP 15 guidance, including the detail on the content, form and type of notification. Making this mandatory is intended to encourage a behavioural shift away from unconsidered notification of certain events to requiring full notification in a uniform manner.

The consultation closes on 14 March 2014. The PRA will publish a policy statement, its final rules and supervisory statements after this date.

Linklaters has produced a more detailed client note on the proposed changes to the PRA's rulebook, which can be found here.

Order designating super complainants comes into force: 14 January 2014

The order designating the first super complainants recently came into force, following an announcement by the Treasury at the end of last year that four organisations had been given super complainant status. The consumer organisation Which?, the Federation of Small Businesses, Citizens Advice and the Consumer Council of Northern Ireland will all now be able to submit super complaints to the FCA in cases which involve mass consumer detriment. The procedure, which has been used for sometime in respect of complaints made to the OFT, was introduced by the Financial Services Act 2012. Commenting on the designations, the FCA emphasised that super complaints represented another means of providing it with information, rather than a method of accelerating its response to potential issues. Under FCA guidelines, super complainants are required to discuss the complaint with the regulator before it is submitted. Once submitted, the FCA then has 90 days in which to respond to a super complaint, indicating how it intends to deal with it and the reasons behind the proposed approach. Areas such as PPI mis-selling and sales of interest rate swaps to small businesses are, it has been suggested, examples of the type of issue in respect of which a super complaint might have been made.

UK: Recent Decisions

Court of Appeal upholds finality of FOS award: 14 February 2014

The Court of Appeal has confirmed that the acceptance of an award of compensation from the Financial Ombudsman Service ("FOS") precludes the applicant from subsequently bringing court proceedings based on the same facts in order to recover any additional compensation that might be due. The decision, in the case of *Clark v In Focus Asset Management & Tax Solutions Ltd*, arose following a complaint by Mr and Mrs Clark concerning negligent investment advice given by the defendant firm. In determining the complaint, the FOS concluded that they were entitled to more than £100,000 (which at the time was the statutory maximum it could award) in compensation. It therefore ordered the that In Focus pay £100,000 to the couple with a recommendation that full compensation also be paid by the firm. Mr and Mrs Clark accepted the award, but reserved their right to bring court proceedings in order to recover the balance of the compensation they considered to be due. In Focus did not pay the full recommended amount (although it did pay the £100,000 awarded) and proceedings were issued.

In Focus successfully applied to strike out the claim, relying on the judgment in *Andrews v SBJ Benefit Consultants* to argue that the doctrine of merger applied to decisions of the FOS. That decision was overturned on appeal, where the judge rejected the argument that the FOS's award and the Clarks' cause of action had merged. Consequently, the couple's acceptance of the FOS award did not operate to extinguish their civil claim to recover losses incurred in addition to the amount awarded by the FOS. In Focus appealed that decision.

Relying on the doctrine of *res judicata*, the Court of Appeal held that individuals who bring complaints to the FOS for determination cannot then go on to litigate those same grievances in court. This remained the case even if the amount the FOS considered to be due in compensation exceeded the statutory maximum it could award. In addition, it was held that the relevant provisions of FSMA did not rebut the presumption that *res judicata* was intended to apply in this context, either expressly or by implication. The decision offers welcome certainty for firms, who can now be more confident that, once an award made by the FOS has been accepted, it will be final and binding on all parties. Going forward individuals, in particular those whose claims may exceed the (now £150,000) statutory maximum the FOS can award, will have the choice of either accepting a FOS award as final compensation, or rejecting it and bringing fresh court proceedings in order to attempt to recover the full amount.

FCA imposes record retail fine for failings relating to insurance sales: 12 February 2014

Insurance intermediary firm Homeserve Membership Limited ("Homeserve") has been fined £30,647,400 for what have been described as widespread failings across its business between January 2005 and October 2011. This is the largest fine issued by the FCA in respect of a firm's retail operations. The

FCA found that the firm had breached Principles 3 (systems and controls), 6 (treating customers fairly) and 7 (communication) in relation to its sales of insurance for home emergencies and repairs. The breaches included mis-selling insurance policies and failures to identify bias in remuneration schemes which incentivised staff on the basis of volume sold, irrespective of whether the policies were suitable for recipients. Homeserve's complaints handling procedures were also criticised, with employees encouraged to close as many cases as possible, generating a risk that complaints might not be dealt with properly. Turning to senior management, the regulator concluded both that the board was insufficiently engaged with compliance matters, and that executives received insufficient training. They were also found to be unwilling to challenge practices which posed risks to consumers where this might undermine existing profit levels. In addition, poor IT systems resulted in customers being overcharged. Homeserve received a 30% discount for early settlement.

The decision places considerable emphasis on senior management failures, deficiencies in the firm's culture and inappropriate incentivisation and remuneration structures, all of which are key areas of focus for the FCA. It is interesting to note that the FCA's two highest retail fines now both involve failings concerning poorly designed incentives schemes (see further our report on the decision last December to fine Lloyds TSB Bank and Bank of Scotland £28m for failing to control sales incentive schemes). It also appears that the amount of the fine decreased during the Stage 1 process, given Homeserve's announcement last month that the FCA intended to fine it £34.5m (the figure quoted in the draft warning notice). This figure assumed a discount of 30% for early settlement. The impact of the regulator's new fining policy is clearly demonstrated by the difference between the penalties calculated under the FCA's old and new fining policies. The use of sales revenue in order to calculate the penalty under the new policy (in respect of breaches occurring after March 2010, when the new policy was introduced) generated a figure of £25m. This compares with a fine of just £5m calculated under the old regime, which applies in respect of breaches occurring over a far longer period. Homeserve has acknowledge the need to restore customer focus within its business and has to date paid £12.9m in redress. Commenting on the decision, FCA Director of Enforcement Tracey McDermott stated that it was vital that firms ensure that the interests of consumers are placed at the heart of their businesses if trust and confidence are to be restored in the financial services sector.

Financial Services firms fined in relation to failings in transition management business: 30 January 2014

State Street Bank Europe Limited and State Street Global Markets International Limited (together "State Street UK") have been fined £22,885,000 for breaches of Principles 3 (systems and controls), 6 (treating customers fairly) and 7 (client communications) in respect of failings in its transition management business between January 2010 and September 2011. Specifically, the FCA found that the firm had prioritised revenue over the interests of customers such that mark-ups were charged on certain transitions, in addition to the agreed management fee or commission. The FCA also said that pre-trade estimates and post-trade reports provided to customers did not make the full extent of the charges clear.

The focus in the FCA notice on culture and the need to prioritise customer interests are consistent themes, both from recent disciplinary notices and more generally from the FCA's supervisory agenda. The notice also contains findings from the FCA on the impact of the firms' matrix management structure on the ability of the UK business to implement effective monitoring and controls, which is again a part of a recurring thematic focus on governance at both regulators. In setting the fine, under its post-March 2010 policy, the FCA highlighted the fact that State Street UK's clients included investment management firms and pension funds managing the savings of retail customers and the fact that the overcharging was not identified by the firm. The use of a multiplier at Step 4 of the penalty setting policy to adjust the fine upwards for deterrence serves to highlight that new penalty setting framework remains more of an art than a science, and is still being flexed by the regulator to deliver what it perceives to be the "right" number.

The FCA has also recently published the results of its recent thematic review of the transition management sector. This found that, although firms broadly met with its requirements, deficiencies existed in terms of the controls, marketing materials, governance and transparency within certain firms. Consequently, organisations offering these services will need to consider carefully whether their operations are compliant in light of the review's findings and recommendations.

FCA bans senior executive in response to findings made during civil proceedings: 27 January 2014

The FCA has banned a senior executive from performing any function in relation to a regulated activity on the ground that he is not a fit and proper person. At the conclusion of High Court proceedings in the case of *Tullett Prebon plc (and Ors) v BGC Brokers LP (and Ors including Mr Verrier)*, which took place in 2010, the judge made a number of unfavourable findings in respect of the conduct of Anthony Verrier, a former senior executive at the claimant firm who announced in 2008 that he was defecting to the defendant (and rival) firm. The Court found that he had subsequently proceeded to engage in an unlawful means conspiracy, in inducing brokers (who were also defendants in the proceedings) to breach their contract with Tullet Prebon plc by leaving early without lawful justification. Prompted by these findings, the FSA issued a decision notice in March 2012 setting out its decision to prohibit Mr Verrier (see further the 31 May 2012 edition of this Update). Mr Verrier referred the decision to the Upper Tribunal, but withdrew the reference on 22 January 2014.

Mr Verrier's challenge to the FCA's decision centred around the correct interpretation of both the Authority's Fit and Proper Test for Approved Persons ("FIT") and its power to prohibit individuals. In particular, he had argued that conduct that formed the basis of the High Court proceedings was neither criminal nor related to regulated activities. A prohibition order was also, he argued, a protective measure (rather than a means of disciplining), the need for which fell away in his case as he had no intention of performing any of the functions such an order would prohibit. In rejecting his arguments, the FCA reminds firms of the decision in *R (Davies and Ors) v FSA*, in which the Court of Appeal held that the regulator's ability to issue a prohibition order existed independent of the fact that the individual in question may no longer, or no longer intend, to perform the role of an approved person. The power can also be exercised without the need for related disciplinary proceedings. The FCA also maintained that the matters it can take into account in applying the FIT test extend beyond just behaviour demonstrated whilst conducting regulated activities, a position which is supported by the recent conclusion of the Upper Tribunal in the case of David Hobbs. Mr Hobbs was banned after submitting a false defence during an FCA investigation and subsequent Tribunal hearing, notwithstanding the fact that the regulator's substantive case against him (alleging market abuse) was ultimately unsuccessful - see further the December 2013 edition of this Update. Both decisions are consistent with the FCA's current focus on the conduct of senior managers, and the importance it places on openness, co-operation and integrity in approved persons' behaviour, whether or not related to the regulated activities for which they are approved. The Verrier decision in particular demonstrates the importance of approved persons who are involved in civil disputes taking care to ensure that, however bitterly contested the dispute, their conduct remains at all times beyond the risk of subsequent reproach by the regulator.

Recent fine for AML failings highlights FCA's expectations of firms when dealing with PEPs: 22 January 2014

Standard Bank plc ("Standard") has been fined £6,640,400 for breaches of the Money Laundering Regulations 2007 in connection with its anti-money laundering ("AML") controls over its commercial banking activities between December 2007 and July 2011. The case represents the first disciplinary notice for AML control weakness in relation to the commercial banking sector. The FCA concluded that Standard had failed to take reasonable care to ensure that all aspects of its AML policies and procedures were applied appropriately and consistently to corporate customers connected to politically exposed persons ("PEPs"). In particular, an FCA review of customer files indicated that the bank had not consistently carried out adequate enhanced due diligence measures before doing business with customers connected with PEPs, nor did it conduct appropriate levels of ongoing monitoring from the point of view of both the regulator and the bank's own internal policies. This was exacerbated by the fact that a high proportion of Standard's business involved customers in high-risk jurisdictions. The bank had identified issues relating to its ongoing review of customer files early in the relevant period, but failed to address them adequately.

As the breaches covered the periods before and after the FCA's new fining policy came into effect in 2010, both were used to calculate the overall penalty. The inflationary impact of the post-2010 fining policy is evident in the fact that the fine calculated under the old policy (covering the period 2007 to early 2010) came to £3,000,000. In contrast, the fine calculated under the new policy, which covered the shorter period of early 2010 to mid 2011, came to £7,538,028, over twice as much. These figures were then combined and a 30% discount for early settlement applied.

Weaknesses in firms' systems and controls in relation to PEPs have been found in a number of cases in which the FCA (and its predecessor) have taken action against firms for AML failings. Indeed, the FCA cited the well-publicised action it has taken against other firms as an aggravating factor in its decision to fine Standard. An industry-wide thematic review of firms' handling of AML risks in 2008 highlighted widespread poor practice in respect of dealings with PEPs. As well as thematic reviews, the FCA continues to require skilled persons to be appointed to review financial crime systems and controls, and has also continued its Systematic Anti-Money Laundering Programme, a series of in-depth reviews (lasting several weeks or months) of the anti-money laundering systems and controls at larger banks. The FCA has also prevented certain banks from opening new accounts until known weaknesses have been resolved as part of its programme of early intervention. Although relevant to all firms, those with exposure to high-risk jurisdictions, PEPs and other higher risk customers in particular should pay close attention to the FCA's findings in this case.

Insurance company fined for failings in implementation of ABC policies, despite no finding of corruption occurring: 19 December 2013

JLT Specialty Limited ("JLTSL"), the specialist insurance broking arm of Jardine Lloyd Thompson, has been fined £1.8m by the FCA for a breach of Principle 3 (risk management systems and controls) in relation to the operation of certain of its anti-bribery and corruption ("ABC") procedures in the three years up to May 2012. The fine included a 30% discount for early settlement. While JLTSL had ABC procedures and systems in place for countering the risks of bribery and corruption associated with making payments to overseas third parties who introduced business to JLTSL ("Overseas Introducers"), the FCA considered that JLTSL did not take reasonable care to ensure that they operated effectively. The FCA also found that JLTSL had failed to conduct adequate due diligence before entering into relationships with Overseas Introducers. As a result, the FCA said there was an unacceptable risk that payments made by JLTSL to an Overseas Introducer could be used subsequently for corrupt purposes. However, the FCA found no evidence that JLTSL had in fact permitted any illicit payment or inducement to be made and there was no suggestion that it had intended to do so.

Court of Appeal confirms the scope of the market abuse rules: 19 December 2013

The Court of Appeal has held that effecting an order to trade in contracts for differences ("CFDs") (which were in relation to shares) could be behaviour "occurring in relation to qualifying investments" and therefore market abuse even though CFDs are not themselves qualifying investments. The Court also found that a company had committed market abuse (manipulating transactions) even though the orders in question were effected through intermediaries. The judgment, which dismisses an appeal from a decision of the Upper Tribunal by a Canadian company formerly known as Swift Trade Inc and its former director Peter Beck, has been welcomed by the FCA. The judgment also confirms that, despite its subsequent dissolution, Swift Trade had sufficient remaining existence to enable the FCA to take action against it. The regulator subsequently issued a final notice in respect of Swift Trade, confirming its intention to impose a fine of £8m on the firm. Further background to this case can be found here.

This case is a rare example of a market abuse decision being heard by the Court of Appeal. Its findings are largely unsurprising, confirming that placing orders via an intermediary, or causing an intermediary to effect an order, can still constitute “effecting transactions or orders to trade”, and that dealings in CFDs and other investments which may not themselves be “qualifying investments” can nonetheless be market abuse. The Swift Trade decision is part of a more general focus by regulators both in the UK and overseas on electronic, algorithmic and high frequency trading. The new EU Market Abuse Regulation, expected to come into effect in 2016, will expressly extend the regime to apply to CFDs, and also includes a number of additional specific provisions regarding the potentially abusive nature of certain electronic, algorithmic or high frequency trading strategies. ESMA has been consulting on this topic with a view to issuing further technical guidance to the Commission regarding the application of these provisions.

Hong Kong: News

SFC obtains first restoration orders to compensate trade counterparties of perpetrators of market misconduct

The Securities and Futures Commission (“SFC”) has continued to make full use of section 213 of the Securities and Futures Ordinance (“SFO”) to combat market misconduct. In the past few months it has secured compensation for investors who have been affected by market misconduct or false or misleading information in offering documents in four separate enforcement actions, some of which were the first of their kind. It is clear that the SFC will continue to seek remedial or preventative orders under section 213 as part of its declared enforcement strategy, after the Court of Final Appeal confirmed in May 2013 that the remedies provided under section 213 are free-standing (i.e. from the dual civil Market Misconduct Tribunal/criminal prosecution routes), and that the SFC is entitled, in performing its role as a “protector of the collective interests of the persons dealing in the market”, to seek section 213 orders in order to restore investors to their pre-transaction positions. It is also clear that a court order to directly compensate the perpetrator’s trade counterparties (both in Hong Kong and overseas) can be expected as one of the penalties that might be imposed in future market misconduct cases:

- In December 2013, the Court of First Instance (“CFI”) ordered a former managing director of a global investment bank to pay $23.9m to investors, following his conviction for insider dealing. This was the first time a restoration order to return money to trade counterparties had been made under section 213 in an insider dealing case.

- Closely following the above action, the CFI made restoration orders in two other market misconduct cases. In December 2013, the CFI ordered the U.S. hedge fund Tiger Asia Management LLC and two of its senior officers to pay over $45m to investors affected by their insider dealing and market manipulation activities, following formal admissions by the Tiger Asia parties (relevant admissions having been made last year in connection with enforcement proceedings brought by the U.S. Securities and Exchange Commission and Department of Justice).
- In the first prosecution of market manipulation in Hong Kong's futures market, a futures trader was ordered by the CFI in January 2014 to pay over $13m to investors (located both in Hong Kong and overseas) affected by his price rigging activities.
- In the last enforcement action, the SFC has succeeded in obtaining an interim freezing injunction against a listed company under section 213, in the context of a public fund raising. The SFC's allegations centred around certain statements contained in the listed company's IPO prospectus and results announcements, which the SFC alleged to be untrue. The purpose of the injunction was to stop the dissipation of assets pending the SFC's investigation, and to ensure there would be enough assets to satisfy any potential restoration or compensation orders.

U.S.: News

SEC Chair previews 2014 enforcement priorities

On January 27, 2014, Securities and Exchange Commission ("SEC") Chair Mary Jo White highlighted enforcement priorities and new investigation tools at the Securities Regulation Institute conference. As the SEC completes its "major investigations stemming from the financial crisis", it will shift its focus to the newly-created Financial Reporting and Audit Task Force. This new task force will focus on financial reporting fraud — targeting both auditors and senior executives. The SEC also plans to monitor exchanges and alternative trading systems for security failures that result in, for example, giving particular customers an "improper head start" on trading information, or failing to protect subscribers' confidential trading information. Ms White further stated that the SEC will demand admissions of liability in more settlements, including those involving "egregious conduct, where large numbers of investors were harmed, where the markets or investors were placed at significant risk, where the wrongdoer poses a particular future threat to investors or the markets, or where the defendant engaged in unlawful obstruction of the Commission's processes." The SEC also intends to focus on FCPA violations, insider trading, and microcap fraud.

Ms. White also highlighted the SEC's newer investigative technology, including the National Exam Analytics Tool ("NEAT"), which facilitates rapid analysis of trading data, and the Market Information Data Analytics System ("MIDAS"), which daily collects "one billion records of trading data, time-stamped to the microsecond", that SEC staff aggregates, analyzes, and presents on its website.

View the full text of the speech here.

Big Four accounting firms suspended for failing to turn over Chinese documents to SEC

On January 22, 2014, SEC administrative judge Cameron Elliott barred Chinese affiliates of the Big Four accounting firms from leading audits of U.S.-listed companies for six months. Judge Elliott censured the companies for failing to provide regulators with the audit work papers of Chinese companies under SEC investigation for accounting fraud. The firms argued that Chinese secrecy laws forbade them from sharing the audit work. While U.S. law requires auditors to turn over all documents requested by regulators, Chinese law prohibits transferring data to foreign parties that may contain state secrets. A May 2013 agreement between the U.S. and China allowed for heightened co-operation, but did not permit inspections, which constitute a key requirement for auditors working for U.S.-listed companies.

The decision marks the first time the SEC has gained court-ordered access to audit work conducted by Chinese accounting firms for Chinese companies that list in the United States. If the decision is finalized, multinational corporations with significant Chinese operations, as well as Chinese companies trading in the U.S., must find new auditors. However, the suspension will not go into effect until the appeals process is exhausted. All of the Chinese affiliates have said they plan to appeal.

View the ruling here.

DOJ targets banks that service third-party payment providers

In January 2014, the Department of Justice ("DOJ") filed a lawsuit under the Anti-Fraud Injunction Act and Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), alleging that North Carolina-based Four Oaks Bank failed to engage in meaningful "know-your-customer" analysis before processing payments, allowing companies to make unauthorized withdrawals of over $2.4bn from customer checking accounts. The suit, in which Four Oaks has reached a tentative $1.2m settlement with federal prosecutors, is the first arising out of the DOJ's "Operation Choke Point". The initiative, launched in 2013, uses federal diligence and fraud laws, like the Bank Secrecy Act, to target banks that provide financial services to lenders that are unlicensed or otherwise violate state law. As more states have enacted interest rate caps that effectively ban "payday loans", many lenders have moved online, where they work with third-party payment processors to automatically deduct payments from customers' checking accounts, including those opened in states where these loans are illegal. Thus far, the DOJ has

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subpoenaed over 50 payment processors and banks in relation to Operation Choke Point.

View the Complaint here.

View the Proposed Consent Order here.

New York seeks disclosure of incentive-based pay

New York State is the latest regulator pressuring banks to disclose incentive-based compensation that could catalyze material shareholder losses. Acting in his position as sole trustee of the $161bn New York State Common Retirement Fund ("Fund"), New York Comptroller Thomas P. DiNapoli has crafted a proposal requesting Wells Fargo, in which the Fund is a shareholder, to prepare a report disclosing whether it has identified employees who, by virtue of the size and riskiness of their portfolios, could expose the bank to material losses; the number of such employees, categorized by division; and, if it has decided not to enumerate these employees, to explain why. However, the bank has objected to the proposal and intends to omit it from its proxy materials, arguing the proposal falls under SEC rules allowing companies to exclude proposals dealing with a "matter relating to the company's ordinary business operations". In 2011, the SEC excluded a similar Fund proposal that asked for disclosures relating to incentive pay awarded to Wells Fargo's 100 highest-paid employees, ruling that the requested disclosures should have been limited to employees in a position to incur material losses. The Comptroller has approached Bank of America with a similar proposal, and has stated the office may put forward proposals at other banks, depending on how the SEC rules in coming weeks.

New York is not the first regulator to consider such measures: for example, the Basel Committee on Banking Supervision has passed disclosure rules that require, among other things, a description of the types of employees considered as material risk-takers at a bank, the number of such employees in each of its units, and details of their pay deals.

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