Linklaters

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Regulatory Investigations Update

The first half of 2015 has drawn to a close, along with a number of important regulatory investigations, bringing in their wake further record fines. The penalties imposed on five global banks in November 2014 in response to misconduct regarding the FX market and on Clydesdale Bank for failures in relation to its PPI complaints handling process, have to some extent been overshadowed by those levied on two other banks for misconduct in the same areas of their businesses. The last two months have also seen the fining of individuals at different levels of the professional strata, and witnessed the start of the first trial of a trader in relation to LIBOR rigging. Whilst the level of fines imposed indicates that the FCA continues to see enforcement as a powerful means of getting its message across to the market, there continues to be a significant focus at both regulators on ensuring firms address the root causes of misconduct by focusing on culture and the proactive management of conduct risk.

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UK: News

New Faces at the FCA – appointments filled for Director of Enforcement and Market Oversight and Director of Risk and Compliance Oversight: 5 June 2015

On 5 June 2015, the FCA announced appointments in two key roles: Mark Steward as the new Director of Enforcement and Market Oversight and Barbara Frohn as the new Director of Risk and Compliance Oversight. These appointments were said by the FCA to mark the *"next stage of the implementation of the FCA's new strategic approach and the associated new leadership structure which was announced last December"*. Further information on the FCA's strategic reforms can be found in our December 2014 Update.

As current head of enforcement at the Hong Kong Securities and Futures Commission (the "**SFC**"), Mr Steward was amongst the favourite candidates in the search to find a replacement for Tracey McDermott, who became Director of Supervision and Authorisations earlier this year. Mr Steward has earned the SFC a tough reputation during his time in Hong Kong, with the first criminal insider trading prosecution occurring under his watch along with other high profile initiatives requiring the full gamut of regulatory powers available to the SFC to tackle perceived misconduct. The UKLA and Market

Monitoring teams have been merged to form a new Market Oversight Division, which Mr Steward will lead together with the Enforcement Division. His early priorities will include: (i) shaping the future enforcement priorities for a 420-strong team as the investigations into the rigging of LIBOR and the FX markets draw to a close; (ii) implementing the recommendations of the HM Treasury review of enforcement decision-making; and (iii) overseeing the review of the FCA's approach to penalty-setting, announced earlier this year.

In her current position as Managing Director for Public Policy at Banco Santander US, Barbara Frohn is understood to be on secondment to the Institute of International Finance in Washington D.C. In her new role she will be heading the FCA's new Risk and Compliance Oversight Division, which the FCA has said is intended to provide "*a strategic approach to the management of internal and external risk"* and, for the first time, a direct link between the risk function and the Chief Executive.

Both are expected to take up their new roles in London in the early autumn.

Trial in relation to attempted LIBOR manipulation offences gets underway

The trial of Tom Hayes, the first trader to stand trial for offences arising out of the alleged attempted manipulation of LIBOR commenced on 26 May 2015. Mr Hayes worked for UBS as a derivatives trader in Tokyo from September 2006, before moving to Citigroup's Tokyo office in late 2009. Press reports state that Mr Hayes was dismissed by Citigroup in September 2010 following complaints regarding his trading methods.

Mr Hayes has been charged with eight counts of conspiracy to defraud. Mr Hayes has pleaded not guilty to the charges, ostensibly on the basis that he lacked the requisite dishonest state of mind to commit the offences. There has been significant focus at the trial on apparent admissions made by Mr Hayes in hours of recorded interviews, statements which Mr Hayes now says he made simply in order to ensure he was charged by the SFO in order to avoid extradition to the United States.

UK: Policy and Practice

PRA publishes consultation paper on "Corporate Governance: Board Responsibilities": 21 May 2015

On 21 May 2015, the PRA launched a consultation entitled *"Corporate governance: Board responsibilities"* (CP 18/15), which seeks views on a draft supervisory statement (the "**draft statement**") aimed at identifying key aspects of board governance *"to which the PRA attaches particular importance and to which the PRA may devote particular attention in the course of its supervision*". Though not intended as a comprehensive guide for boards on what constitutes good or effective governance, it is required reading for all PRA-regulated firms, providing guidance on the PRA's expectations in relation to: (i) setting strategy; (ii) culture; (iii) risk appetite and risk management; (iv) board composition; (v) the respective roles of executive and non-executive directors; (vi) knowledge and experience of non-executive

directors; (vii) board time and resources; (viii) management information and transparency; (ix) succession planning; (x) remuneration; (xi) subsidiary boards; and (xii) board committees. It also seeks to clarify the PRA's views regarding the interaction between collective board responsibilities and the responsibilities of individual members under the Senior Managers Regime ("**SMR**"), which comes into force in March 2016.

The draft statement clarifies that the primary responsibility for maintaining the safety and soundness of regulated firms lies with the board, noting that a number of major financial failures in recent years have been partially the result of board failures in managing key risks. Going forward, the PRA's aim is to ensure firms have effective boards, capable of running the business prudently and in a way that is consistent with the firm's own safety and which supports the continuing stability of the financial system. It identifies an effective board as one which establishes a sustainable business model and clear strategy consistent with that model, articulates and oversees a clear and measurable statement of risk appetite against which major business options are actively assessed and, finally, meets its regulatory obligations, is open with regulators and sets a culture that supports prudent management.

Alongside the collective responsibilities of the board, the draft statement explains that the individual responsibility of Senior Managers under the SMR is *"additional and complementary"*. Time alone will tell how this will work in practice in circumstances where enforcement action is contemplated. In particular, it will be interesting to see how the collective responsibility of the board is taken into account when the regulators seek to apply the "presumption of responsibility" to the conduct of individual Senior Managers for breaches occurring within the area of the business for which they are responsible.

The consultation closes on 14 September 2016.

FCA explains how firms can learn from Final Notices and sets out its views on claims of privilege in the context of FCA investigations: June 2015

At a recent seminar, the FCA's Director of Long-Term Savings and Pensions, Nick Poyntz-Wright, provided insight into the approach adopted by the FCA when assessing a firm's culture, explaining that it consisted of collating information on, amongst other things, a firm's discussions with individuals, executives, the board, its customers and its business partners. Whilst he acknowledged that firms with retail clients would be of particular interest, he also noted the importance of treating counterparties as well as customers fairly. He said the FCA was clear that improvements to a firm's culture needed to occur at all levels, ensuring there was room for effective challenge and that appropriate arrangements were in place to enable firms to react appropriately when things went wrong.

The points raised by Mr Poyntz-Wright were complemented by a speech made by the FCA's Director of Investigations, Jamie Symington. Mr Symington emphasised the need for firms to focus on addressing the root

causes of past failings, using findings of misconduct as set out in Final Notices to consider whether the root causes of those issues might also be relevant to their own organisation. By way of example, he noted the similarities between the misconduct identified in the FCA's investigations into Forex related matters and the earlier findings of the FCA in relation to attempted manipulation of LIBOR. He warned that failing to address the root causes of earlier misconduct could be treated by the FCA as an aggravating factor in future enforcement against the same firm.

Mr Symington also addressed the FCA's expectations in relation to firms self-reporting, highlighting the importance of firms engaging in dialogue with the FCA about the basis on which any internal investigation should take place prior to it being conducted. He went on to discuss tensions that might arise where internal and agency investigations were conducted in parallel, referring, in particular, to complications posed to the FCA's work where assertions of legal privilege were made in respect to interview notes.

The Fair and Effective Markets Review provides recommendations to bring an end to the "age of irresponsibility": 10 June 2015

On 10 June 2015, the Fair and Effective Markets Review (the "**Review**") published its Final Report. The Review was established by the Chancellor of the Exchequer, George Osborne, in June 2014 to conduct an assessment of the way wholesale financial markets operate.

The Final Report sets out the recommendations put forward by the FCA, the Bank of England and the HM Treasury for ways in which confidence in the fairness and effectiveness of the Fixed Income, Currency and Commodities ("**FICC**") markets could be reinforced. It examines the root causes of high-profile misconduct in the FICC markets in recent years and other potential vulnerabilities which may affect their *"fair and effective"* operation. It takes into consideration the steps already completed or underway (both in the UK and globally) to address these issues and comments on remaining gaps and how these might be addressed.

The recommendations in the Final Report centre around improving conduct in the FICC wholesale markets and emphasise the need for common (global) standards to govern conduct in the FICC markets which can be readily understood by market participants. To that end, the Final Report recommends that a new industry-led market body (the FICC Markets Standards Board) be established, which should engage with global stakeholders to: (i) put in place common standards, produce guidance and real-life case studies on how those standards should apply in practice; (ii) assist in setting qualification and training requirements for the FICC wholesale markets; and (iii) spot (and help address) new or evolving conduct challenges. In order to ensure that standards are properly embedded, the recommendations also include a variety of measures to give "teeth" to the proposed new standards framework which (if implemented as proposed) would allow regulators to enforce compliance at both an individual and firm level.

Further details concerning the recommendations in the final report and its anticipated implications can be found in our client alert on this topic, ""The age of irresponsibility is over" – Recommendations to tackle risks to the fairness and effectiveness of the Fixed Income, Currency and Commodities markets", which is available on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

New UK rules on remuneration: 23 June 2015

On 23 June 2015, the PRA and FCA published a joint policy statement (PRA PS12/15 / FCA PS15/16) on *"Strengthening the alignment of risk and reward: new remuneration rules",* together with supervisory statement (SS27/15) on remuneration. The policy statement provides new rules which apply to all material risk takers ("**MRTs**"), including senior managers, at banks, building societies, and PRA-designated investment firms. The rules cover UK branches of non-EEA headquartered firms, but do not apply to investment firms which are regulated solely by the FCA.

The key points to note from the new rules are as follows:

- Some individuals, depending on their role, will have an extended deferral period during which variable remuneration will be withheld following the end of the accrual period. This period will be seven years for senior managers, five years for risk managers with senior, managerial or supervisory roles at PRA-regulated firms, and three to five years for all other staff whose actions could have a material impact on a firm;
- The FCA will introduce clawback rules concerning the return of part or all of already-paid bonuses in instances of misconduct or failures in risk management. These rules will align the FCA with rules already introduced by the PRA from 1 January 2015;
- The PRA clawback rules will be strengthened by extending the clawback period from seven to 10 years for PRA-designated senior managers where there are outstanding internal or regulatory investigations at the end of the normal seven year clawback period. The FCA has suggested that it will also reflect this extension in its clawback rules.

As expected, the response to the clawback provisions has been mixed. Whilst politicians have argued, on the one hand, that the new rules will create more bureaucracy and place additional burden on businesses which will ultimately be dealt with at the consumers' expense, they have, on the other hand, encouraged longer deferral and clawback periods in a minority of cases. A further point for consideration is that, whilst deferred bonuses may be relatively simple to claw back, money already paid and spent or dissipated (e.g. expenditure on school fees or holidays, or passed on in a deceased MRT's estate) is likely to prove more problematic and may result in a wave of litigation claims if and when the rules are applied.

A full note on the new UK rules on remuneration can be found on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

UK: Recent Decisions

FCA publishes Decision Notices in respect of former members of Keydata: 26 May 2015

On 26 May 2015, the FCA published Decision Notices (all dated 7 November 2014) in respect of three individuals from the former senior management team of Keydata Investment Services Limited ("**Keydata**"). The notices were published following the decision by the Upper Tribunal in *Ford, Owen & Johnson v The Financial Conduct Authority* [2015] UKUT (TCC)[1] not to grant an order prohibiting publication of the notices, and set out the FCA's decision to fine the former chief executive of the firm, Stewart Ford, former sales director, Mark Owen, and former compliance officer, Peter Johnson, £75m, £4m and £200,000 respectively. They also note the FCA's proposal that all three be prohibited from taking up another role in the financial services industry. The decisions have all been referred to the Upper Tribunal, which will review the matter afresh and determine the correct course of action for the FCA to take.

The fines are significant for three main reasons: (i) they illustrate the FCA's willingness to crack down on individuals, with the fine levied on Stewart Ford (arrived at in large part on the basis that Mr Ford was said by the FCA to have received commissions of a similar amount as a result of the sales by Keydata) being the highest fine for an individual to date; (ii) they highlight the importance of SIFs critically evaluating the assurances they receive that identified issues will be addressed, and mitigating against the risk that such assurances may not be justified or fulfilled; and (iii) they emphasise the extent to which individuals must go to comply with their regulatory duties which, in the context of a compliance officer, might include handing in their notice and/or informing the FCA that senior management had failed to carry out necessary actions to address problems identified.

Keydata went into administration on 8 June 2009 and was dissolved on 2 July 2014. The background to the enforcement action concerning the three individuals is set out in a press release accompanying the Decision Notices. Between July 2005 and June 2009, Keydata sold investment products (the "**Investment Products**"), which invested primarily in US senior life settlement policies, to retail investors via Independent Financial Advisors. The FCA's Decision Notices explain that, in the FCA's view, the conduct of Messrs Ford, Owen and Johnson in the marketing and sale of the Investment Products and in their associated discussions with the FCA amounted to a breach of

[1] Released on 2 May. Whilst the application for the order was dismissed on the basis that the Upper Tribunal did not consider that there was a substantial likelihood of disproportionate damage to any of the applicants from the publication of the Decision Notices, the Upper Tribunal did give directions that the publication be delayed for 21 days to allow the applicants time to prepare, and that each of the notices be published with a clear statement confirming that the decision was provisional as a result of being referred to the Upper Tribunal.

Principles 1 and 4 of the FCA's Statements of Principle for Approved Persons, by failing to act with integrity in carrying out controlled functions and failing to deal with the FCA in an open and co-operative way.

The FCA determined that, in its view, each of the individuals was aware that it was highly likely that some of the Investment Products did not comply with ISA regulations; that the brochures marketing the Investment Products were not compliant with the regulator's financial promotion rules; that due diligence on some of the Investment Products was inadequate and incomplete (including not identifying conflicts of interest regarding their role); and that no action had been taken in light of professional advice regarding the risk of one of the underlying investment portfolios not performing. The FCA further determined that the individuals had deliberately or recklessly failed to take appropriate steps in response to the above issues (including explaining or mitigating the risk for investors).

Furthermore, the FCA considered that the individuals misled the FCA on several occasions, including at compelled interviews: for example, Mr Ford and Mr Owen had concealed information regarding the problems with one of the underlying portfolios and the other issues identified above, and failed to disclose the circumstances giving rise to conflicts of interest regarding the Investment Products, including significant personal benefits and commissions received from the sale of the Investment Products. Similarly, Mr Johnson failed to ensure the FCA was aware of problems identified with the Investment Products and their financial promotions.

The FCA justified the high fines on the basis that the breaches were of the most serious nature, particularly taking into account the significant level of consumer detriment, the subsequent payments of £330m made to investors by the Financial Services Compensation Scheme and the substantial personal benefits received by Messrs Ford and Owen.

Mr Ford, in particular, is understood to have come out fighting, making a counter-claim for damages against the FCA and its auditors, PwC, for damages of approximately £650m. Should the referral to the Upper Tribunal not go in his favour and the penalty be upheld by the Upper Tribunal, the fine levied on Mr Ford will be the highest fine ever imposed by the FCA against an individual approved person.

Mr Owen is also appealing the decision against him. One of the more controversial aspects of his Decision Notice was the suggestion that he had placed excessive reliance on repeated assurances from Mr Ford that he would resolve the problems with the investment portfolio's performance and, as a result, had failed to take steps to evaluate and mitigate the risk that these assurances would not be met or fulfilled in reality.

The FCA has made it clear that compliance officers can expect enforcement action should they enable and/or fail to report wrongdoing and, in the Decision Notice addressed to Mr Johnson, provided examples of action that he, as compliance officer, could have taken in circumstances where he believed the firm was behaving improperly. These proposals may be seen to

extend to all compliance officers and include: (i) refusing to sign off on incorrect/misleading financial promotions; and (ii) making it clear that, if the board of directors did not commit to taking actions necessary to address suspected misconduct, the compliance officer would have no choice but to resign from their position and/or notify the FCA of the issues. The Decision Notice reiterates the FCA's view that a compliance officer's remit extends directly to the regulator; even if he/she informs senior management about problems identified, they will not be seen to have discharged their duty where the challenges they present are overruled or not sufficiently acted upon.

FCA bans and fines director of Aspire Personal Finance Limited for misleading and unsuitable advice: 20 May 2015

The Keydata case was only one of a number of examples of efforts being taken by the FCA and other regulators to crack down on the individuals involved in firms' regulatory failings. On 20 May 2015, for example, the FCA issued a Final Notice on Paul Reynolds, a director of Aspire Personal Finance Limited, banning him from performing any function in relation to any regulated activities carried on by any authorised or exempt persons, or exempt professional firms, on the basis that he lacked the integrity required of a fit or proper person carrying on such activities.

The FCA held that, whilst Mr Reynolds was an approved person at Aspire Personal Finance Limited between 2005 and 2010, he recommended several complex and high risk products to his clients, many of whom were on low incomes and had little or no investment experience.

In selling such products, the FCA found Mr Reynolds had breached Principle 1 of the FCA's Statements of Principle and the Code of Practice for Approved Persons ("**APER**"), for reasons which included: (i) recklessly recommending high risk investment products to clients, who subsequently invested in the products, when aware that he could not justify their suitability; (ii) producing inflated valuations of clients' investments in an attempt to mislead them; (iii) submitting loan facility and investment applications containing false and misleading information; and (iv) making inaccurate and misleading statements to the FCA, including during a compelled interview.

Mr Reynolds was subsequently fined £290,344.

Upper Tribunal rejects FCA fine as "wholly excessive": 14 May 2015

On 14 May 2015, the Upper Tribunal issued its decision in the case of *Angela Burns v The Financial Conduct Authority* [2015] UKUT 0252 (TCC), in which it ruled that the penalty of £154,800 initially imposed on Ms Burns was *"wholly excessive"* and that a prohibition on performing controlled functions was too broad. The Tribunal concluded that the appropriate action was to impose a £20,000 penalty and prohibit Ms Burns from carrying out a CF2, non-executive director, function. The case highlights the need for the FCA to re-evaluate the penalty it proposes to impose where the Upper Tribunal reaches materially different views to those of the Regulatory Decisions Committee ("**RDC**") prior to the Upper Tribunal reference, and highlights the importance

of the FCA using its powers to impose penalties that are proportionate to the relevant misconduct.

The case stems from a Decision Notice dated 28 November 2012 recording the FCA’s view that Ms Burns should be fined £154,800 and be banned from performing any role in regulated financial services as a result of an alleged failure to disclose conflicts of interest in her position as a CF2 non-executive director at two mutual societies. Ms Burns denied the allegations on the basis that (amongst other things) the alleged conflict of interest was too speculative to constitute an actual conflict and did not, therefore, need to be declared. She referred the decision to the Upper Tribunal.

The discrete allegations of misconduct pursued by the FCA were addressed in the Upper Tribunal’s decision dated 15 December 2014, which is discussed in detail in our January client alert (accessible via the Linklaters Client Knowledge Portal). Whilst the decision went against Ms Burns in substance, finding that she was not fit and proper for the CF2 function, the Upper Tribunal nonetheless rejected a number of the FCA’s specific allegations.

In light of the above, the May decision was concerned with determining what, if any, action was appropriate for the FCA to take. The Tribunal considered the FCA's written submissions that the prohibition order and penalty set out in the RDC’s Decision Notice were still appropriate. It concluded that the FCA’s assessment of the position was unrealistic in light of the fact that six out of its 10 allegations had failed, and three of the remaining allegations were upheld only to a limited extent. It further noted that the FCA: (i) had characterised Ms Burns’ misconduct as taking place over two years, whereas the Tribunal had only established isolated incidents; (ii) had incorrectly interpreted the Tribunal’s decision as having held that Ms Burns improperly misused her position to try to benefit herself and that her conduct had caused detriment to two entities; and (iii) had wrongly used the unsatisfactory nature of aspects of Ms Burns’ evidence and omissions from her applications for her CF2 authorisation as a factor in establishing the correct financial penalty, when such points were only relevant (and, by the Tribunal’s admission, rightly used) in determining her fitness and propriety.

The Tribunal decided that, in light of the limited nature of Ms Burns’ breaches, it was appropriate to restrict the scope of the prohibition order to the CF2 function. The Tribunal recorded that it did not have the power to limit the time period of a prohibition order, but that if at some future date Ms Burns applied for the prohibition order to be lifted, the FCA would be obliged to consider any such application in the light of the circumstances pertaining at the time. The Tribunal observed, however, that it would be *“difficult to see how the order could be lifted while Ms Burns maintains her denial that she was in breach of the proper standards of conduct”*. The Tribunal further concluded that a penalty of £20,000 was more appropriate, given the limited extent to which the allegations were upheld and the prejudice suffered by Ms Burns as a result of the FCA’s unfounded allegations.

Whilst the decrease in the scope of the prohibition order and the substantial reduction in the fine are a significant outcome for Ms Burns and will hopefully

serve as a salutary reminder to the FCA of the need to exercise its powers proportionately and fairly, the December 2014 decision highlights the need for non-executive directors to be ever alert to potential conflicts and cautious in overtly using current work to secure other appointments. Whilst a close reading of the conflicts policies in place at firms should assist in knowing where conflicts might arise, the safest cause of action remains: if in doubt – disclose!

The London Whale: Court of Appeal finds against the FCA when considering scope of third party rights under section 393 FSMA

Whilst the Upper Tribunal's *"wholesale disagreement"* with the FCA's assessment of the financial penalty in Ms Burns' case emphasised the importance of reaching a proportionate outcome, the recent Court of Appeal decision concerning the case brought against the FCA by Achilles Macris, former international Chief Investment Officer at JPMorgan Chase Bank NA ("**JPMorgan**"), also highlights the need for the FCA to have due regard for its statutory obligations.

The original claim against the FCA was that Mr Macris had been prejudicially identified in a Final Notice issued to his former employer regarding the London Whale affair through use of the term "CIO London management" and, subsequently, should have been given the opportunity to make representations in relation to the notice, prior to it being issued, in accordance with rights granted to third parties prejudicially identified in a Final Notice under section 393 of the Financial Services and Markets Act 2000 ("**FSMA**"). The Upper Tribunal found that such identification had occurred, and the FCA appealed this decision to the Court of Appeal.

Whilst the Court of Appeal agreed that Mr Macris had been prejudicially identified, it proposed a different test from that suggested by the Upper Tribunal for the purposes of establishing whether third party rights have been triggered. According to its test, once it was clear that an individual (as opposed to a group of individuals) had been identified in the Final Notice, the key question was whether the words used in the Final Notice would reasonably lead persons acquainted with the individual, or operating in the same area of the financial services industry, to believe that the individual who claimed to have been identified was in fact being referred to. The term "CIO London management" in the Final Notice issued on JPMorgan was found to satisfy the Court of Appeal's test and the FCA's appeal was dismissed.

Further information regarding the Court of Appeal's reasoning can be found in our client alert (accessible via the Linklaters Client Knowledge Portal) released in June 2015.

The scope of the Court of Appeal's test is likely to cause real concerns for the FCA, given its desire to use specific examples in Final Notices to help illustrate firms' failings, whilst simultaneously seeking to avoid the delay caused in granting third party rights to individuals. In the words of the FCA's Director of Investigations, Jamie Symington, the FCA *"would either have to be more careful in the way that we draft our decisions so as not to identify and*

prejudice people…or we would have to have a longer process through which we engage other parties to allow them to make their representations". Whilst such steps might prevent future claims, the FCA already faces a number of claims similar to those of Mr Macris, which are likely to have gained weight following the Court of Appeal's decision.

In light of these potential implications, it is perhaps no surprise that the FCA recently announced on its website that it is seeking permission to appeal the decision to the Supreme Court. It remains to be seen whether the Supreme Court will regard the narrow legal issues arising in the case as satisfying the test for permission to be granted.

Upper Tribunal upholds the FCA's decision to fine and ban investment advisor, but criticises FCA for errors in publicising Decision Notices: 21 May 2015

On 21 May 2015, the Upper Tribunal upheld the FCA's decision to impose a fine of £10,000 on Mr Rosier, the director of financial advice firm, Bayliss & Co (Financial Services) Limited ("**Bayliss**"). The Tribunal upheld all but one of the FCA's findings, but when issuing its decision made a number of criticisms of the FCA in its handling of the case, particularly in relation to the late submission of evidence and in its publication of a press release, circulated to a number of media outlets, which failed accurately to reflect the Decision Notices.

The decisions to be considered by the Tribunal were: (i) the decision to cancel Bayliss' permission to carry on regulated activities under Part 4A FSMA; and (ii) the decisions to fine Mr Rosier £10,000 and to withdraw his approval to perform significant influence functions ("**SIF**") in relation to Bayliss and in relation to any regulated activity going forward.

The action proposed against Mr Rosier was based on the view that he had contravened Statements of Principles 2 and 7 of APER by failing to act with due skill, care and diligence and failing to take reasonable steps to ensure Bayliss' compliance with regulatory requirements and standards. The Upper Tribunal agreed with all but one of the FCA's findings and suggested that the £10,000 fine was *"fully justified"* given the significance of the breaches, which demonstrated *"serious systemic and cultural failings"*. Mr Rosier's reference to the Tribunal was dismissed, as was Bayliss' reference on the basis that, assuming the FCA implemented its decisions against Mr Rosier, it would be unable to satisfy the threshold conditions (which include adequate human resources) to maintain its permission to carry out regulated activities.

Despite having largely agreed with the FCA's determinations, the Tribunal was not shy in expressing its disappointment with the way the FCA had handled the case. Its criticisms were largely focused on the FCA's late submission of evidence, which the Tribunal said reflected *"an unacceptable degree of arrogance"* on the part of the FCA, and in its handling of the press release accompanying the Decision Notices, which was sent to a number of media outlets.

The errors in the press statement were largely the result of the FCA's press office taking ownership of the draft and amending it in a way that failed to accurately reflect the circumstances surrounding the Decision Notices. Not only did the press release contain inaccuracies, but it also failed to emphasise the provisional nature of the Decision Notices by complying with the FCA's protocol for dealing with the publication of Decision Notices where a reference had been made to the Upper Tribunal. Appendix 2 of the Upper Tribunal's judgment sets out the results of a hearing dated 19 March 2014, which was focused on dealing with the issues identified with the press release. At this hearing, Herrington J noted that much of the available evidence did not suggest an intention on the part of the FCA to paint a misleading picture in the press release; however, he warned that, should Mr Rosier prove his allegation that the press release was produced in bad faith and with the FCA's knowledge that its contents were inaccurate, the FCA may not be able to rely on the statutory immunity for liability in damages as provided in paragraph 25 of schedule 1ZA FSMA.

Whilst the Upper Tribunal noted its *"trust"* that nothing akin to the late submission of evidence resorted to by the FCA *"will happen again"*, Herrington J, in his March decision, set out six recommendations with regards to the publication of Decision Notices. His recommendations included: (i) the provision of clear written guidance for the press office explaining the differences between Decision Notices and Final Notices; and (ii) ensuring that the same rigorous standards be applied whether the communication is a full press release or not. The FCA press release published on the same day as the judgment confirmed that it had apologised to Mr Rosier and had reviewed its processes with a view to preventing such errors occurring again.

Record fines for misconduct on the FX market on both sides of the Atlantic: 20 May 2015

May 2015 saw record fines levied in the US and the UK to settle allegations that FX Spot rates were manipulated by some of the world's largest banks. On 20 May 2015, it was announced that Citigroup, Barclays, JPMorgan, RBS and UBS would pay around $5bn in combined penalties as part of a series of settlements with the US Department of Justice ("**DoJ**") and the Federal Reserve, and had entered into plea agreements with the DoJ. Bank of America was also fined $205m by the Federal Reserve on the same day.

The penalties imposed by the DoJ reflected its findings that, amongst other things, between December 2007 and January 2013, the banks colluded in attempts to manipulate the FX Spot Market in relation to the EUR/USD currency pair. Such attempted manipulation was alleged to have been undertaken by a group of traders who conspired to eliminate competition in the purchase and sale of the EUR/USD currency pair, in the US and elsewhere. Citigroup, Barclays, JPMorgan and RBS pleaded guilty to criminal charges, entering into plea agreements in respect of this conduct and other instances of "deceptive trading and sales practices" in the FX Spot Market identified by the DoJ. Subject to the full, continuing co-operation of the banks,

the DoJ agrees not to bring any further criminal charges in respect of the conduct identified in the agreements.

The nature of UBS's plea agreement differs from that of the plea agreements reached with the other banks. In UBS's case, the DoJ agreed not to file criminal charges in connection with FX spot trading because UBS had been the first bank to step forward and co-operate with federal investigators in connection with their FX probe, so it benefitted from the DoJ Antitrust Division's immunity programme. However, UBS's conduct in relation to certain FX markets and FX market transactions was held to have breached the non-prosecution agreement it had entered into with the Fraud Section of the Department in 2012 in relation to the manipulation of LIBOR allegations. As a result of this breach, UBS agreed to plead guilty to one criminal charge in connection with a scheme to manipulate LIBOR and other benchmark interest rates and to pay a criminal penalty of $203m.

Unusually, the DoJ required the banks to submit criminal guilty pleas at the parent company level. This was the first time in decades that a major US financial institution has pled guilty to criminal charges and follows a guilty plea by two non-US financial institutions in 2014, suggesting a change in DOJ approach, which had for years avoided bringing criminal charges against financial institutions for fear that it would have a destabilising effect on the relevant institution and the wider financial market (e.g. due to the "collateral consequences" of a guilty criminal plea). This action points towards the tougher approach expected from the DoJ.

20 May 2015 also marked Barclays' settlement with the FCA following the UK regulator's 13-month investigation into misconduct on the FX market. As with the settlements reached with Citibank N.A., HSBC, RBS, JPMorgan and UBS in November, Barclays' FCA settlement was focussed on G10 Spot FX. Unlike the five other global banks involved in the FCA's investigation, which received record fines for FX misconduct in November 2014 (please see our client note on this topic, available on the Linklaters Client Knowledge Portal), it has been widely reported that Barclays declined to settle at stage 1 of the settlement period on the basis that the New York State Department of Financial Services ("**DFS**") was not party to the settlement negotiations at that time. Its decision to settle at a later stage resulted in it forfeiting the 30% discount available at stage 1 for a lower stage 2 discount of 20%, resulting in an overall fine of over £280m. This is the largest penalty in the FSA/FCA's history. In addition to the settlements with the DoJ, the Federal Reserve and the FCA, Barclays also settled with the DFS and the US Commodity Futures Trading Commission.

Whilst the 20 May 2015 settlements mark a significant milestone for the banks, the FX investigations continue. The DoJ and the UK's Serious Fraud Office are continuing their investigations into allegations concerning the FX market and the DFS is understood to be continuing to investigate, amongst other things, the banks' alleged use of electronic systems to manipulate foreign exchange rates.

LBG settles FCA investigation into its handling of PPI complaints: 5 June 2015

The FCA has continued its stated objective of increasing fines, following up its largest ever wholesale fine in May 2015 with its largest retail fine to date. The fine of £117.4m (post a 30% early settlement discount) was imposed on 5 June 2015 on Lloyds Bank plc, Bank of Scotland plc and Black Horse Ltd (together "**LBG**") for breach of Principle 6 (Customers' Interests) because the bank failed to treat customers fairly when handling PPI complaints between March 2012 and May 2013. That the FCA imposed such a significant penalty in the absence of intentional wrongdoing highlights the importance it continues to place on the handling of PPI complaints and its consumer protection objective.

In its Final Notice, the FCA found that LBG had issued guidance instructing complaint handlers that the overriding principle when assessing complaints was that its sales processes were compliant and robust unless told otherwise (the "Overriding Principle"). However, the bank did not take adequate steps to ensure that complaint handlers would be notified of known sales process problems. Some complaint handlers relied on the Overriding Principle to dismiss customers' personal accounts of what had happened during the PPI sale or to not fully investigate customers' complaints and some issues were identified with customer contact.

The Final Notice recognised the challenges LBG faced, particularly the very high and unprecedented volume of complaints. The FCA found LBG's failings to be mitigated by its extensive remediation programme and that it was the first bank to withdraw its support for the BBA's judicial review of the FSA's PS10/12, but to be aggravated by both LBG's previous enforcement history and the number of previous FCA and FOS pronouncements on PPI complaint handling.

That such a large fine was imposed despite the case being deemed to be level 3 in seriousness at step 2 of the FCA's post-March 2010 penalty-setting framework is reflective of the large number of complaints handled by LBG, previously the largest seller of PPI in the industry.

The FCA announced earlier in 2015 that it was considering whether additional rules and guidance were required to deal with complaints from customers mis-sold PPI. Industry participants have been calling for the FCA to impose a cut off date for the bringing of PPI complaints. It is clear that the handling of PPI complaints remains a high priority for the FCA and it will be interesting to see how the contemplated rules or guidance resolve this tension. At the same time, the FCA is also considering how to deal with the Supreme Court decision in *Plevin vs Paragon Personal Finance Ltd* [2014] UKSC 61 on commission disclosure in PPI sales (and more generally) – a link to the FCA statement on this point can be found here.

Property Alliance Group Ltd v Royal Bank of Scotland – A Question of privilege: 8 June 2015

On 8 June 2015, the High Court handed down judgment in the case of *Property Alliance Group Ltd v Royal Bank of Scotland* [2015] EWHC Ch 1557. The judgment examines a number of aspects of legal advice privilege ("**LAP**") and without prejudice privilege ("**WPP**") in the context of the (internal) investigation of a breach and (subsequent) regulatory proceedings. Whilst Birss J's reasoning is at times difficult to follow, particularly on LAP, his conclusions on WPP and further conclusions on limited waiver are largely helpful.

Background

The issues of privilege arose in the context of a civil claim brought against Royal Bank of Scotland ("**RBS**") by Property Alliance Group ("**PAG**"), which is seeking £30m in damages after it entered into four interest rate swaps with RBS between 2004 and 2008 using GBP LIBOR as a reference rate, arguing that RBS made implied misrepresentations in relation to the way in which LIBOR was being set. RBS asserted that a number of documents generated during the course of prior investigations in relation to its LIBOR-related conduct were subject to either LAP or WPP.

LAP - The ESG Documents

The documents alleged to be covered by LAP concerned the progress and outcome of reviews, investigations and findings regarding LIBOR. They had been prepared by RBS's legal advisors for consideration by RBS's Executive Steering Group ("**ESG**") (the "**ESG Documents**"), a special committee formed by RBS which investigated LIBOR misconduct within the bank. In considering RBS's case for privilege, Birss J reached the (in our respectful submission, misconceived) view, contrary to the wide approach taken by the House of Lord in *Three Rivers 6* [2005] 1 AC 610, that application of LAP depended on whether the role of the committee was solely to provide legal advice or not. The judge appeared to conclude that if part of the committee's role included the task of overseeing investigations and reporting to the bank, LAP would not apply. Birss J subsequently ruled that the ESG Documents be inspected by a judge of the High Court, so that the claim to privilege could be further assessed.

WPP – settlement communications with the FCA

The documents RBS argued were covered by WPP were negotiations between RBS and the FCA in connection with the Final Notice concerning LIBOR issued on 6 February 2013 (the "**Without Prejudice Documents**").

PAG disagreed with the RBS view, arguing that WPP was limited to negotiations in civil litigation. Given the common practice for firms to enter into settlement discussions with the FCA ahead of a Final Notice, whether such discussions are protected in subsequent litigation is a question of some practical importance. Birss J's ruling is the first time the English courts have addressed it.

Helpfully, Birss J found that a protection analogous to the normal rule in civil litigation did exist so as to give a firm a right, before the FCA, the Upper Tribunal and in civil litigation, to withhold inspection of communications which were part of genuine settlement discussions between it and the FCA.

This, however, was not an unqualified right. In particular, the firm would not be able to rely on it in civil litigation if it had relied on the content of the Final Notice; the rationale being that the other side must then be allowed to see the underlying materials to be able to assess the basis on which the findings in the Final Notice were arrived at and whether they can be properly relied upon.

In this context, RBS had stated in its pleadings that there had *"been no regulatory findings of misconduct on the part of RBS in connection with GBP LIBOR".* Birss J interpreted this as an assertion of a positive statement that the FCA had not found misconduct on the part of RBS in that respect, rather than a mere statement of fact as to the content of the Final Notice.

The consequence was that the material was, on the facts, not protected, subject to one last consideration. This was whether the FCA had any right to prevent disclosure. Unlike the position under WPP generally (where the other party to the settlement discussions has such a right) Birss J held that the FCA, in this context, did not. The basis for his conclusion was that the FCA could not object to RBS putting the basis on which the Final Notice was produced in issue and, as such, was not able to prevent disclosure of the Without Prejudice Documents once RBS had taken this course. The FCA's failure in this regard may have been due to it not being party to the litigation nor present at the relevant time.

A wider application of Birss J's reasoning could, therefore, mean that rights under WPP in civil litigation could also give way if documents protected by WPP are relied on by one of the parties to the WPP documents in separate proceedings. It is unclear how Birss J can reconcile this position against the public policy considerations pertaining to the need for parties to be able to rely on the sanctity of without prejudice discussions held in the build up to settlement.

Limited waiver documents

The final category of documents was otherwise privileged material that had been provided by RBS to regulators on the basis of a limited waiver of privilege. PAG argued that, as these terms permitted onward disclosure by the regulators in limited circumstances, this meant privilege had been lost as against the world. Birss J rejected this argument; confidence in the documents was not undermined by the presence of the carve-outs as they made no difference until there was a disclosure and confidentiality in the documents had been lost. Again, however, on the facts Birss J held that RBS was no longer entitled to assert this privilege; RBS had relied upon the regulatory decisions, which entitled PAG to see the basis upon which they had been made.

Conclusions

Regarding LAP, putting aside some of the more surprising aspects of Birss J's analysis, one practical point arising from the judgment is the importance of being clear and specific as to why a claim for LAP is made out from the outset; the contrasting explanations given by RBS during the course of the litigation seems to have contributed substantially to the concern on the part of both PAG and Birss J as to whether the claim to privilege had been properly made.

As to the WPP and limited waiver points, Birss J's judgment is helpful in protecting the process of communication between firms and the FCA. Nonetheless, it starkly illustrates the risks that firms face if they then seek later to rely on the outcome of such a process in civil litigation. Given Birss J's somewhat hardline approach as to what, in the first place, constitutes such reliance, firms will have to be particularly careful as to the way in which reference is made in civil litigation to the outcome of regulatory processes.

A client note on Birss J's findings can be found on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

Hong Kong: News

Hong Kong – SFC to provide greater assistance to overseas counterparts in supervisory matters

In December 2014, the Securities and Futures Commission ("**SFC**") commenced a consultation on proposed amendments to the Securities and Futures Ordinance ("**SFO**") which would allow the SFC to provide greater assistance to overseas regulators in supervisory (i.e. non-enforcement) matters. The SFC proposed that it should be given the power to make enquiries and to obtain from a licensed corporation (or a related corporation), upon request by an overseas regulator and at the SFC's discretion, records and documents in relation to any regulated activity (or any relevant transaction/activity) carried on by the licensed corporation, where the licensed corporation or related corporation is also regulated by the overseas regulator. Under the proposals, the SFC would provide assistance for the following supervisory purposes:

- for the overseas regulator to ascertain risks to and impact on the financial stability in its jurisdiction; and/or
- for the overseas regulator to ascertain compliance with legal or regulatory requirements that it administers in relation to transactions and activities regarding securities, futures contracts, leveraged foreign exchange contracts, collective investment schemes, OTC derivative products or other similar transactions that it regulates.

On 5 June 2015, the SFC released its consultation conclusions. Having considered the feedback from various respondents (including Linklaters), the SFC decided to proceed with amending the SFO provisions which govern the SFC's supervisory powers and the assistance that the SFC may provide to

overseas regulators in relation to supervisory matters, while making the following concessions and clarifications:

- the SFC has proposed a new requirement that the requesting overseas regulator should be required to confirm in writing that: (i) it has not been and will not be able to obtain the requested information by any other reasonable means; and (ii) it is unable to ascertain the specified supervisory matters fully without the information sought;
- the extension of the scope of request to "related corporations" will be retained, since material risks stemming from a "related corporation" in one jurisdiction can have significant implications for the group as a whole;
- the current proposals do not alter the existing positions regarding legal professional privilege and privilege against self-incrimination; and
- a licensed or related corporation will not be in breach of Hong Kong's data protection legislation when disclosing client information to the SFC in compliance with the SFC's request.

The SFC believes that the legislative changes will enhance its ability to enter into reciprocal supervisory arrangements with overseas regulators and facilitate more effective supervision of licensed corporations with cross-border operations. The government will proceed with the drafting of the legislative amendments, although no indicative timeline has been given.

U.S.: News

Supreme Court leaves US antitrust extraterritoriality questions unanswered

In an Order issued on 15 June 2015, the U.S. Supreme Court declined to hear appeals in two cases, leaving undecided important questions regarding the extraterritorial reach of US antitrust law, and thus circumscribing the reach of the US antitrust regulator, the Federal Trade Commission. Both cases implicated the Foreign Trade Antitrust Improvements Act ("**FTAIA**"), which immunises some foreign conduct from the reach of the Sherman Act's antitrust provisions.

The petitions dealt with the question of whether the sale of foreign price-fixed parts to a foreign manufacturer, who ships them into the US incorporated into a product, should be considered "import commerce" under the FTAIA and thus subject to U.S. antitrust law. Additionally, both petitions dealt with the issue of whether sales of such products constitute non-import commerce having a direct effect on the United States, which would also render them ineligible for the FTAIA's exclusions.

In the first case, AU Optronics appealed from its convictions for taking part in a conspiracy to fix the price of liquid-crystal display ("**LCD**") panels. The U.S. Court of Appeals for the Ninth Circuit held that the FTAIA did not insulate AU

Optronics from prosecution under the Sherman Act because the company had imported hundreds of millions of dollars' worth of the panels directly into the US. Since a substantial volume of goods containing the price-fixed panels were ultimately sold to customers in the U.S., the sales constituted "import commerce" subject to antitrust laws.

In the second case, Motorola Mobility sought almost $3.5bn in damages from companies allegedly involved in fixing the price of LCD panels. The U.S. Court of Appeals for the Seventh Circuit dismissed its lawsuit because Motorola's foreign subsidiaries had bought the price-fixed parts and were thus the immediate victims of any collusive behaviour, unlike the U.S. parent company which purchased products incorporating the price-fixed goods. Because of the multi-step transaction involved, the court found no direct effect on US commerce, precluding Motorola from bringing a private action for damages under the Sherman Act.

The Supreme Court's decision not to hear appeals in these two cases leaves the Ninth and Seventh Circuit rulings standing.

OFAC authorised to pursue foreign cybercriminals

On 1 April, 2015, United States President Barack Obama issued Executive Order 13694, which authorised the US Department of Treasury to impose sanctions on entities connected with "significant malicious cyber-enabled activities" affecting US national security, foreign policy, or economic and financial health. The Department of Treasury's Office of Foreign Assets Control ("**OFAC**") is the US regulator charged with administering US sanctions regimes, including by imposing controls on transactions, freezing assets under US jurisdiction and granting licences permitting certain transactions with sanctioned countries or entities.

Under the Executive Order, individuals and organisations which are found to have either: (i) harmed, or otherwise significantly compromised the provision of services by a computer or network of computers that support one or more entities in a critical infrastructure sector; (ii) significantly compromised the provision of services by one or more entities in a critical infrastructure sector; (iii) caused a significant disruption to the availability of a computer or network of computers; or (iv) caused a significant misappropriation of funds or economic resources, trade secrets, personal identifiers, or financial information for commercial or competitive advantage or private financial gain, are subject to sanctions. OFAC has issued related guidance in the form of Frequently Asked Questions. For individuals or organisations subject to the new foreign cybercriminal sanctions, all property, and interests in property, that either: (a) are or subsequently come into the US; or (b) are or come within the possession or control of any United States person, are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in.

These new measures are intended to incentivise companies to disclose information on cyberattacks to the US government, in aid of prosecutions. The Executive Order also emphasises the need for companies to continue

taking measures to improve their cybersecurity, particularly in the wake of high-profile cyber-attacks on Home Depot, JPMorgan and Sony Pictures.

US Federal Agencies Issue Standards for Assessing Diversity Policies and Practices of Regulated Entities

A number of US federal agencies, including the Federal Reserve Board, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission, have issued a joint policy statement outlining standards for assessing the diversity policies and practices of the entities they regulate pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). The Dodd-Frank Act required these agencies to each establish an Office of Minority and Women Inclusion, which would be responsible for developing standards for assessing the diversity policies and practices of entities regulated by the agency.

The published standards assess an entity's diversity policies in the areas of: (i) Organisational Commitment to Diversity and Inclusion; (ii) Workforce Profile and Employment Practices; (iii) Procurement and Business Practices – Supplier Diversity; and (iv) Practices to Promote Transparency of Organisational Diversity and Inclusion.

These standards are intended to inform self-assessments by regulated entities of its diversity policies and practices, voluntary disclosure of the self-assessment to the appropriate agency, and publication by the entity of its diversity efforts in order to increase public awareness and understanding. Agencies may periodically review this public information to monitor diversity and inclusion practices and reach out to regulated entities to discuss diversity and inclusion. The policy statement provides that standards may be tailored and used in a manner reflective of an individual entity's size and other characteristics.

Read more at http://www.sec.gov/news/pressrelease/2015-114.html

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