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Regulatory Investigations Update.

The summer and early autumn has been a busy time for the FCA's enforcement team. FCA Director of Enforcement, Tracey McDermott, used a speech in June to emphasise once again the importance the regulator now places on embedding good consumer outcomes into firms' business models. The priority given to consumers is borne out by three decisions (on which we report below), which cover the treatment of customers in mortgage arrears, the suitability of mortgage advice and insurance sales. In each the FCA demonstrates the high expectations it has of firms in this area. Firms are now expected to adopt a far more tailored approach to the treatment of their customers, taking steps to identify what might be in their best financial interests and ensuring that these, not the interests of the firm, remain paramount. This will involve a considerable shift in organisational thinking. The fines levied for consumer failings in the last quarter alone, however, indicate that a failure to engage with this issue could prove extremely costly.

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UK: News

FCA continues to take action against insider dealing

The FCA's fight against insider dealing continued in September with the publication of details of further charges and the award of a significant confiscation order. The FCA has announced that Paul Coyle, the former Treasurer and Head of Tax at Wm Morrison, has been charged with two counts of insider dealing relating to trading in Ocado Group plc shares between February and May 2013. The FCA is currently prosecuting eight other individuals for insider dealing with its largest investigation to date, Operation Tabernula, now looking set to come to trial in January 2016.

In separate proceedings, the regulator has secured confiscation orders totalling £3.2m against seven men convicted of insider dealing in July 2010 and March 2013. The individual orders ranged from £4,000 to £2.1m. Two of the men were also required to pay costs orders of £200,000 and £300,000 respectively. Commenting on the decision, FCA Director of Enforcement and Financial Crime, Tracey McDermott, noted that the FCA would use all the tools at its disposal in order to ensure that markets remained clean.

PRA CEO urges greater co-operation on cross-border fines

PRA Chief Executive Andrew Bailey has used a recent speech to call for greater co-operation between US and British regulators when it comes to setting penalties. The comments were made in the wake of a number of record-breaking fines levied by US regulators on global firms for AML and anti-sanctions breaches. Mr Bailey highlighted that, at a time when he and others at the PRA were attempting to build up capital reserves within banks, vast fines and the threat of business restrictions could have "unimaginable consequences" for the firms concerned. He called for clear international standards governing the issues for which firms can and cannot be held responsible. Although dialogue does currently take place, Mr Bailey felt that this should occur on a more systematic basis than at present. Although fines levied by the FCA have yet to reach the level of those imposed by its US counterparts, there remains the potential at least for conflict closer to home on this issue. Whilst the FCA's fines are not close to the levels imposed by its US counterparts, it states in DEPP that, where a breach is sufficiently serious, it will consider imposing a fine notwithstanding the fact that there is verifiable evidence that it will cause a firm serious financial hardship. It is conceivable at least that, as regards PRA-regulated firms, such a decision could place the FCA in conflict with the PRA's objective of ensuring financial stability.

Further Russian sanctions pose challenges for compliance teams

Further EU sanctions issued this summer against Russia have increased the need for regulated firms to ensure that they have robust sanctions compliance systems and controls in place. Tough new sanctions were imposed upon the Russian energy, banking and defence sectors in late July, with the regime extended further in early September in response to the Russian government's continuing involvement in unrest in Ukraine. HM Treasury also announced that from 31 July 2014 a licence will be required to release funds received by a non-sanctioned entity in the EU from a sanctioned person outside of the EU. Regulated firms face the risk of not only a fine for an actual sanctions breach, but also enforcement action from the FCA should it conclude that a firm's anti-sanctions systems and controls are insufficient. The FCA reminded firms, after the first round of sanctions were issued in March this year, of their obligation to ensure that they have robust systems and controls for dealing with actual or potential politically exposed persons. This reminder was updated on 1 August, indicating that the FCA expects firms to consider the impact of the latest sanctions on their AML policies and procedures in a "risk-based" manner. The extension of the sanctions regime into the capital markets in particular, together with the FCA's continuing focus on financial crime matters, make this an issue that should be high on the agenda of banks and other institutions.

UK: Policy and Practice

HM Treasury consults on regulation of further benchmarks: 25 September 2014

HM Treasury has recently consulted on whether seven additional major financial benchmarks should be brought into the regulatory framework originally implemented for LIBOR. On 12 June 2014 the UK government announced that it was establishing a joint review by the Treasury, the Bank of

England and the FCA into the way wholesale financial markets operate. The "Fair and Effective Markets Review" (the "Review") is now underway and will run until June 2015. Among other things, the Review will make recommendations in relation to the regulation of benchmarks. As a near-term interim output, the Chancellor of the Exchequer asked the Review to recommend a list of additional major benchmarks across the fixed income, currency and commodity markets that should be brought into the regulatory framework originally implemented in the wake of the LIBOR misconduct scandal. The Review's recommendations in response to that request have been published by the Treasury alongside the consultation, which sought views on the recommendations. The government has consulted on extending the legislation to the following seven major benchmarks:

- Sterling Overnight Index Average;
- Repurchase Overnight Index Average;
- WM/Reuters 4pm London Fix;
- ISDAFix;
- London Gold Fixing;
- LMBA Silver Price; and
- ICE Brent futures contract.

As part of the consultation process, the government held targeted industry roundtables with affected parties. The consultation closed on 23 October 2014 and HM Treasury is currently considering the responses.

Results of thematic review on best execution and payment for order flow published: 31 July 2014

The FCA has published its report (TR14/13) on the findings of its thematic review of firms' compliance with the rules on best execution and the practice of payment for order flow ("PFOF"). The FCA identifies in its report a significant risk that best execution is not being delivered to all clients on a consistent basis, and that some firms continued to receive PFOF in contravention of the FCA rules. The thematic review's conclusions included the following:

- Firms generally have a poor understanding of the scope of the best execution requirements.
- Most firms lacked effective monitoring and were unable to demonstrate that their monitoring arrangements were capable of identifying best execution failures or poor clients outcomes.
- Organisations which relied on internalisation or on executing orders through connected parties were often unable to evidence whether this delivered best execution and how they were managing potential conflicts of interest.

- Firms were often unclear about the ownership of responsibility for best execution and, generally, did not undertake substantive reviews of their execution arrangements.

According to FCA guidance published in 2012, PFOF creates a clear conflict of interest between the firm and its clients and is not compatible with inducements and best execution rules. The FCA's findings in this latest thematic review indicate that some firms have implemented an "arranging service" for both the brokerage clients and the market makers as a "recast" PFOF arrangement. The FCA concludes in its report that this arrangement still constitutes a PFOF arrangement that is incompatible with the FCA rules. The FCA intends, therefore, to keep this area under active review. It has indicated that it will take action, including enforcement, against any firm that evades requirements on PFOF.

The FCA's fining of FXCM earlier this year for failing to apply correctly the best execution rules demonstrates the importance of this area to the regulator. The FCA expects all investment firms to review their arrangements for delivering best execution and ensure that they are not receiving PFOF. Also, firms need to improve their current systems and controls since the new obligations under MiFID II will enhance reporting requirements across all relevant asset classes. In addition, the FCA has included the best execution and PFOF as two potential competition issues which it may study in more detail as part of a competition review of the wholesale sector announced in the Business Plan for 2014/2015.

Speech highlights current FCA Enforcement priorities: 22 July 2014

In her first published speech since October 2013, FCA Director of Enforcement and Financial Crime, Tracey McDermott, discussed recent action taken by the FCA's Enforcement Division, together with its ongoing priorities. The theme of the speech was "sustainability", in particular, how industry and the regulator can ensure that the financial services sector is truly sustainable.

Ms McDermott began by highlighting some of the FCA's recent enforcement activity, including its new role in regulating consumer credit and continued efforts to secure consumer redress where this is due. She also highlighted the FCA's early intervention work, on both a sector level (for example, on interest-only mortgages) and individually within firms. This is an area which has traditionally been left to the Supervision team, and reflects the increasing extent to which both Enforcement and Supervision will now be expected to collaborate. The FCA's aim in this is to "put conduct in the board room" in order to move towards a culture in which people do the right thing because "that's the way we do things", rather than simply because the rules say so. Ms McDermott noted with disappointment that firms are still not reading across from enforcement decisions and regulatory statements in one area in order to apply them in another. Firms were urged to think widely about regulatory statements and issues, focusing in on root causes. Themes emerging from enforcement actions, such as customer treatment, management of risk, investment in systems and tone from the top, will be expected to be applied more widely than simply to the set of facts underlying the particular enforcement action in question. It is clear that the deterrence element of the FCA's credible deterrence objective is intended to be industry wide, not simply confined to the firm under investigation. Failure to do so will almost certainly be an aggravating factor should the FCA uncover similar issues within a different firm, even if they occur within a different business area.

In terms of consumer outcomes, the speech used recent action against the Yorkshire Building Society and Credit Suisse International in relation to the Cliquet product to highlight the fact that it is not simply those distributing products who will be held responsible for misleading customers. In the case of the Cliquet product, Credit Suisse, which had designed both the product and the marketing material, was held equally responsible. Mention was also made of the FCA's high expectations of Approved Persons, both in terms of individual conduct and their responsibility to act as gatekeepers in ensuring that their colleagues do the right thing and informing the regulator when they do not.

In terms of the FCA's future priorities, Ms McDermott indicated that it continues to prioritise promoting greater accountability for senior managers, as well as ensuring that the risk of adverse impact from incentives schemes is mitigated and continuing to assess firms' AML processes and controls. The speech finished with a call for firms to develop an "open, transparent and flexible risk-responsive culture". The FCA is looking to firms to develop an environment in which every employee becomes an "accountable business conscience" for the firm. It does not underestimate the challenge this poses, but considers that only this type of cultural shift will create a truly sustainable financial services industry.

FCA and PRA provide information on use of skilled persons reviews: 29 August 2014

Letters from both the FCA and PRA released during the summer have provided a useful insight into both regulators' use of skilled persons reports. In response to an inquiry by Andrew Tyrie, Chairman of the Treasury Select Committee, FCA CEO Martin Wheatley highlighted the proportionate approach it believes it takes to the use of this power. He indicated that the FCA does not always consider itself able to derive the required assurance from a review led by a firm's internal audit team, largely because of actual or perceived conflicts of interest or an absence of the required skills or resources. The FCA endeavours to ensure that skilled persons reviews are used only when appropriate and that costs are kept to a minimum. Despite having the power to contract directly with skilled persons, Mr Wheatley stated that this was only likely to be done where the FCA felt the need for greater control and independence of the review due to the profile of the issue concerned. He added that, were the FCA to undertake such reviews themselves, further funding would be required and other regulatory priorities would have to be sacrificed. The PRA, in a far more concise letter, made a similar point concerning resources. It highlighted the fact that it does not always have specialist skills in house, nor does it have sufficient staff numbers to conduct such investigations on a timely basis. PRA CEO Andrew Bailey stated that a skilled persons review must be approved by a senior PRA member, with a central skilled person team providing challenge. There is also a review after the process has concluded.

These letters will do little to reassure firms concerned as to whether there is any internal consistency behind the decision whether or not to order a skilled persons review. Despite Mr Wheatley's assurances, it is clear that the FCA retains a high degree of discretion in this area. This makes it difficult for firms to predict the circumstances in which this tool might be applied. There is also often a feeling that, once the FCA has made a decision, it is extremely difficult to convince the regulator to depart from it. Although the FCA confirms in its letter that increasing the use of skilled persons is not a strategic objective, it also seems unlikely that there will be any reduction in either their frequency or cost. Although firms often voice the concern that skilled persons reviews represent an outsourcing by the FCA of its enforcement function, the actual position is likely to be more nuanced. Certainly in the case of larger firms, skilled persons reviews can be a forward-looking tool, used to help remediate a control framework. A separate enforcement investigation may then be undertaken by the regulator in order to examine the historical position.

First exercise of FCA's product intervention powers: 6 August 2014

The FCA announced in August temporary restrictions in relation to the distribution of contingent convertible instruments ("CoCos") to retail investors. These rules came into effect on 1 October 2014 and will lapse on 1 October 2015. This is the first instance of the FCA exercising its new consumer protection powers.

CoCos are complex hybrid capital securities that absorb losses when the capital of the issuer falls below a certain level. Given the pressures to maintain a prudent capital position and the current low interest rate environment, the FCA believes there is a significant risk that CoCos will be inappropriately promoted to retail investors. The FCA has, therefore, decided to step in temporarily to restrict their distribution to only professional, institutional and sophisticated or high-net-worth retail investors. The temporary rules apply to all authorised persons in the UK, including both issuers of CoCos and firms promoting or intermediating transactions in CoCos. The FCA intends to consult on proposed permanent rules on CoCos in September 2014. A policy statement is expected to be published in Q2 2015, with final rules to be scheduled to take effect on 1 October 2015, when the temporary product intervention rules expire.

UK: Recent Decisions

Building society fined for failings in dealing with customers in arrears: 29 October 2014

The Yorkshire Building Society (the "Yorkshire") had been fined £4,135,600 for failings in its dealings with customers in mortgage arrears between October 2011 and July 2012. The Yorkshire was found to have breached

Principles 3 (systems and controls) and 6 (treating customers fairly), together with rules in the Mortgages and Home Finance: Conduct of Business Sourcebook and DISP. The failings centred around the Yorkshire's call handlers' dealings with customers in payment difficulties, in particular, their failure to identify promptly the cause of their problems and future financial prospects. This resulted in significant delays in determining the most appropriate long term payment solutions, which in turn meant that already vulnerable customers incurred increased fees and associated interest. The FCA raised these issues with the Yorkshire in September and October 2012. A skilled persons review the following May found that in 64 of 87 cases considered, customers were not treated fairly; in 52 of these cases detriment could also be identified. The Yorkshire agreed voluntarily to refund all mortgage arrears, plus associated interest, charged to customers since January 2009, which is likely to cost the building society £8.4m.

In calculating the fine under its new fining policy, the FCA used as its starting point the total level of fees and interest payments received from customers only whilst their accounts were in arrears, during the period of the breaches. The failings were assessed at level three in terms of seriousness. The fact that the Yorkshire did not identify the breaches itself, its dilatory approach to implementing recommendations made by the skilled person, the fact that the FCA has published a considerable amount of guidance on handling customers in arrears and the fact the building society was fined earlier this year for failing to ensure that financial promotions for structured products were clear, fair and not misleading all served to aggravate the fine. This was mitigated by the Yorkshire's pro-active and voluntary redress scheme and the fact it stopped charging mortgage arrears until improvements in its procedures were sufficiently embedded. This was not, however, sufficient to avoid a 25% uplift in the fine. The Yorkshire did receive a 30% discount for early settlement. Commenting on the decision, FCA Director of Enforcement and Financial Crime Tracey McDermott stated that the Yorkshire's actions meant that "customers in vulnerable circumstances risked falling into further financial difficulties". This decision demonstrates the high standards to which the regulator will hold firms in terms of their dealings with customers, particularly those struggling financially.

FCA targets safe custody assets in latest action concerning client money failings: 23 September 2014

The FCA has fined Barclays Bank plc ("Barclays") £37.7m for breaches of FCA Principles 3 (systems and controls) and 10 (clients' assets), together with various related CASS rules, having concluded that it failed to protect properly clients' custody assets between November 2007 and January 2012. This is the highest fine imposed by the regulator to date for client money failings and the first occasion on which a penalty has been imposed for misconduct relating to safe custody assets. The FCA found that Barclays failed to establish adequate and effective organisational, control and risk management systems concerning the opening, operation and monitoring of external accounts in which safe custody assets were held with sub-custodians outside of the Barclays Group, in breach of Principle 3. It also concluded that the bank failed to arrange adequate protection for, and to maintain its own books and records and perform its own reconciliations in relation to the around £16.5bn worth of safe custody assets for which it was responsible as custodian or sub-custodian, in breach of Principle 10.

The FCA's investigation concluded that the failings arose out of both significant weaknesses in Barclays' systems and controls and a historical focus on business lines and products traded, in preference to giving proper consideration to which legal entity was conducting the relevant business. The failings were reported as having gone undetected for three years, until in early 2011 the firm undertook a review of its historic and current practices in this area. This revealed that it was using third party sub-custodian accounts to hold both its own and its clients' safe custody assets. In some cases, records did not reflect the fact that the accounts had been opened under agreements in Barclays' name, nor was the firm performing its own internal and external reconciliations of assets on its books (although this was being undertaken by its subsidiaries). The lack of clarity within Barclays concerning the amount and nature of the safe custody assets under its control also had an impact on its ability to report accurately to the FCA. In particular, in January 2011 Barclays' notification of the highest total value of safe custody assets held during 2010 was assessed to have omitted 91 of the 95 accounts in respect of which it was in breach. Asset valuations included in the firm's monthly CMAR's from October 2011 were also inaccurate and contained pricing errors.

As the relevant period for the purposes of the final notice (2007 to early 2012) encompassed periods during which both the FCA's old and new fining policies were in place, the total fine of £37.7m comprises a penalty of £12,702,600 covering the period November 2007 to March 2010 and £25,042,400 for the period March 2010 to January 2012. In assessing the penalty under the new fining policy, and in common with many other client money cases, the calculation of penalty under the FCA's new five-step fining policy proceeded on the basis that the revenue generated was not an appropriate indicator of harm at Step Two. Unusually, however, the FCA actually provided a reason for this, asserting that the measure is unsuitable because the bank's revenue could increase or decrease over time without the value of safe custody assets in its holding (and therefore the associated risks) being directly affected. The FCA chose instead the value of safe custody assets held by Barclays in the 95 external accounts found to be in breach as at 24 January 2012, the final date on which the bank was considered to be in breach for the purposes of the final notice. Why this date was chosen in preference to any other is not explained.

The resulting fine was increased by 20% to take into account the bank's compliance history, including a CASS fine for a related entity, which was identified as an aggravating factor. This demonstrates that the FCA will not only consider misconduct in separate business areas, but also that occurring in separate firms when assessing compliance history. The FCA's focus here on legal entity awareness, rather than merely business lines, is consistent with other current regulatory initiatives in areas such as risk reporting, governance and RRP. Consequently, this is a risk of which firms should be aware across their businesses.

RBS and NatWest fined for failings relating to mortgage sales process: 27 August 2014

The Royal Bank of Scotland plc and National Westminster Bank Plc (together, the "Firms") have been fined £14,474,600 for breaching Principle 2 (skill, care and diligence) and Principle 9 (customers: relationships of trust) as well as certain requirements in the FCA's Mortgage and Home Finance: Conduct of Business sourcebook. These breaches arose from the Firms' failure to take reasonable care to ensure the suitability of advice provided to customers on mortgage products, and adequately to remedy the failings when they were identified by the FCA (which resulted in a failure to conduct their advised mortgage business with due skill, care and diligence) between June 2011 and March 2013. The FCA's final notice issued on 27 August 2014 relates to, and imposes a joint financial penalty on the Firms on the basis that they share a joint mortgage sales unit.

The FCA found that the Firms did not have an adequate system in place for their advised mortgage sales process, and did not ensure that an individual or team within the Firms was properly accountable and responsible for that process. In particular, the FCA found that the Firms did not have an adequate procedures to determine whether customers could afford the mortgages that were being recommended to them, were not providing compliant advice to customers who were seeking to consolidate existing debts and were not advising on mortgage terms, taking into account only the customers' preferences in this area. Consequently, a risk arose that customers would not receive suitable advice. Additionally, the FCA found that the monitoring of sales was inadequate and ineffective, and that shortcomings in the Firms' mortgage adviser risk assessment system resulted in advisers being highly unlikely to receive a high risk rating regardless of performance. The FCA also took the view that the Firms did not adequately remedy the problems with the business when these were initially identified by the FCA. Delays in the implementation of required changes to the mortgage sales process meant that customers were placed at prolonged and continued risk of receiving unsuitable advice.

In setting the level of the financial penalty the FCA accepted that there was no evidence of significant customer detriment and that, where customer detriment had been identified, the Firms had taken steps to compensate the customers. However, the Firms' position as leading providers of mortgage products to retail customers in the UK, the fact that every customer was at risk of not having received suitable advice and that the Firms were slow to recognise and address the magnitude of the problems were considered aggravating factors. This decision highlights the fact that the FCA will not limit the scope of its enforcement action, or the basis on which it assesses the appropriateness of a penalty, to failings initially identified within a firm. It will also take account of the ability of the firm (including its governance structure and internal processes) to take prompt and effective action to address those failings.

Further bank fined for transaction reporting failings: 21 August 2014

Investment bank Deutsche Bank AG ("Deutsche") has been fined £4,718,000 for transaction reporting failures which spanned a just over five year period between November 2007 and April 2013, resulting in breaches of the rules in SUP. The breaches were identified following a query raised by the FCA in February 2013, when the regulator spotted an anomaly in Deutsche's CFD Equity Swaps transaction reports. Having asked Deutsche to validate its transaction reports, the bank informed the FCA the following month that a coding issue in its transaction reporting system had reversed the buy/sell indicator for all its CFD Equity Swaps. Consequently, all reports relating to this product between November 2007 and April 2013 had been inaccurately reported. The bank then engaged consultants to undertake a thorough review of the controls across its product types, systems and flows, followed by a wider review of its transaction reporting processes and control framework. In October 2013, having already agreed to implement the recommendations arising out of the two reviews, two senior executives gave attestations to the FCA in relation to the compliance of Deutsche's reports with SUP 17 and the effectiveness of the bank's controls and policies in this area more generally.

As the period of the breaches spanned the operation of the both the FCA's old and new fining policy, the regulator used both methodologies when setting the fine. In applying its new fining policy, the FCA followed the precedent established in the Plus 500 Ltd decision, of attributing a value of £1 to each reportable transaction executed in breach after March 2010 (when the new policy was introduced) and using this as the relevant revenue figure at Step Two. Although the FCA recognised that Deutsche had taken a number of steps promptly to mitigate the situation and had wholly co-operated with the FCA, this was not sufficient to avoid a 25% increase in the Step Two figure as a result of aggravating factors. In particular, the FCA was unhappy that the bank had failed to heed warnings about its expectations of firms as regards transaction reporting included in a number of communications and high-profile enforcement actions during the period of the breaches. In addition, Deutsche had also been issued with a private warning in June 2010 in relation to similar SUP 17 breaches. The bank did receive a 30% discount for early settlement.

As far as the FCA is concerned, there can be no real excuse for firms failing to take on board messages as to conduct contained in both its own communications and enforcement action. The regulator can and will expect these lessons to be applied to both relevant and related business areas within firms, and has consistently increased the fines of those who fail to do this. Given its role in enabling the FCA to tackle market abuse and insider dealing, which allows it to fulfil its strategic objective of protecting the integrity of the market, it is unsuprising that the regulator places significant importance on the accuracy of transaction reporting. This final notice also highlights the importance of ensuring that changes required as a result of new legislation are delivered effectively; a large proportion of Deutsche's issues arose out of its execution of the first MiFID in 2007. Care must be taken in incorporating the requirements of MiFID II/MiFIR into firms' systems and controls in this area. The final notice also indicates that, as most issues relating to systems and controls are reserved by EU instrument to home state regulators (which in the case of Deutsche is the German regulator BaFin), the FCA will not be taking any action in respect of Deutsche's systems and controls. This is an interesting example of both the very real risks of multiple fines in connection with the same breaches faced by firms with operations across a number of jurisdictions, as well as the interplay between European regulators.

Insurance firm fined for failing to treat customers fairly: 7 August 2014

Insurance company Stonebridge International Insurance Limited ("Stonebridge") has been fined £8.3m for breaches of Principles 3 (systems and controls) and 6 (treating customers fairly) in connection with the telephone sales, by various intermediary firms, of personal accident, accidental death and accidental cash plan insurance products (together, the "Products") between April 2011 and December 2012. The decision illustrates many of the weaknesses in terms of consumer outcomes the FCA has expressly indicated will no longer be acceptable. Stonebridge, which underwrote the Products, targeted sales efforts at middle to low income individuals without a degree or professional qualification. Sales to such an ostensibly "vulnerable" subsection of consumers should have incorporated added safeguards in order to ensure that they remained "fair", in accordance with Principle 6. However, the FCA found deficiencies in the training materials designed by Stonebridge. The firm also failed to monitor adequately calls made by its intermediaries, during which their sales staff were encouraged to make use of cancellation rights to secure sales, but then allowed customer services staff to present barriers to cancellation should customers attempt to exercise these rights. An incentive scheme which failed to guard against the risk that it might precipitate mis-selling was also in place. The Principle 3 breaches surrounded Stonebridge's failure to provide adequate oversight of the firms to whom they outsourced sales and customer services work in connection with the Products. These failures included failing to identify weaknesses in the information provided at the point of sale and employing an inadequate governance structure, which did not ensure that outsourcing companies had adequate controls to prevent mis-selling.

The final notice details a number of specific failings in the areas outlined above and should be considered required reading for all retail firms. These suggest that, despite the considerable attention paid to retail sales by the FCA, elements of the retail sector remain unable to put in place procedures to ensure good consumer outcomes in this area. Firms need only review FCA Director of Enforcement and Financial Crime Tracey McDermott's speech last summer (on which we report further here) to see just how seriously the FCA, including its enforcement team, takes its obligations to ensure that customers' interests are placed at the heart of business planning and decision making. As this decision proves, the consequences of failing to appreciate this can be severe. In response to the FCA's concerns, Stonebridge has agreed to voluntarily stop distributing the Products, replaced its executive management team, comprehensively revised its governance structure and Operating Board membership and improved both its product design and contractual arrangements with outsourcing companies. It has also conducted a past business review and intends to offer compensation to anyone suffering loss as a result of the failings. Whilst sufficient in this case to mitigate the fine imposed by the regulator, these steps will have consumed a considerable amount of both management time and the firm's own resources. In addition, the resulting penalty is the second largest insurance, and the sixth biggest retail, fine levied by the FCA to date. With penalties under the post-2010 fining policy based upon a percentage of sales revenue (calculated according to the seriousness of the breach), coupled with the FCA's clear determination to improve consumer experiences, the potential for substantial fines arising out of retail failings has never been higher.

Tribunal prohibits further individual on the basis of findings in High Court litigation: 6 August 2014

In the second case of its type this year, the Upper Tribunal has accepted findings made by a High Court judge during civil proceedings as the basis for a prohibition order against an approved person. The RDC had decided to prohibit insurance broker Stephen Allen following arguments from the FCA that he had secretly added a fee to premiums charged to a client and diverted funds due to his employer to himself. Mr Allen referred that decision to the Upper Tribunal. The FCA's case before the RDC had been based upon the evidence of a Mr Webster. In the course of preparing for the Tribunal hearing, Mr Allen sent to the FCA a redacted copy of the judgment in an unrelated claim he had brought against a firm for breach of contract. This severely discredited Mr Webster, who had appeared as a witness. Having obtained an unredacted copy of the full judgment, however, it became clear to the FCA that the High Court judge in question had also concluded that Mr Allen had knowingly advanced an untrue case, had produced at least one forged document and had colluded with Mr Webster in advancing the forged case.

Its initial case (based on the evidence of Mr Webster) now undermined, the FCA applied for and was granted permission to amend its case to argue that the court's conclusions in relation to Mr Allen's conduct in bringing his civil claim were sufficient to merit a finding that he was no longer a fit and proper person. In addition, even if Mr Allen were able to establish a compelling reason why the judge had in fact come to the wrong conclusion, his attempt to mislead the regulator by forwarding a redacted copy of the final judgment, which concealed criticisms made of his own conduct, was sufficient evidence of his lack of fitness and propriety. Despite Mr Allen's attempt to argue that the judge had been wrong and that his remarks had no real foundation, the Tribunal agreed with the FCA on both points.

This decision is indicative of a trend within the FCA towards taking an increasingly wide view of conduct when applying the FIT test. This case, and that of Anthony Verrier which concluded earlier this year, demonstrate that the FCA is prepared to rely upon the findings of judges in civil proceedings as the basis of prohibition orders. The Tribunal also prohibited David Hobbs on the basis of his conduct during its investigation into allegations that he had committed market abuse, notwithstanding the fact that it acquitted him of the actual offence. It is clear that the FCA's purview now extends well beyond simply an individual's conduct in the workplace. This more "holistic" approach is likely to extend further once the new Senior Persons Regime comes into force next year.

The FCA's ability to rely upon entirely different arguments to support their contention that Mr Allen was no longer fit and proper before the Tribunal than those employed before the RDC demonstrates the flexibility afforded to both parties when bringing a case before the Tribunal. As this operates as a complete rehearing of the matter, both parties have the option of introducing new arguments or evidence in support of their case, provided that the "subject matter referred" remains the same. This case is a reminder that an element of risk is inherent, for both firms and individuals, in any decision to refer a matter to the Tribunal.

Upper Tribunal upholds FCA decision to fine former hedge fund executive: 30 July 2014

The Upper Tribunal has upheld the FCA's decision to fine a former hedge fund chief executive and prohibit him from performing any function in relation to any regulated activity having found that he deliberately misrepresented the position of a fund he managed, and sought to mislead investors, lenders and the then FSA, after the fund in question suffered catastrophic losses in the wake of the collapse of Lehman Brothers in 2008. Further background to the FCA's initial decision can be found here. The Tribunal found that Mr Micalizzi deliberately misrepresented his position to investors and failed to provide information about the true position even when it became clear that they had been initially misled. It also found that he attempted to mislead the FCA. The Tribunal upheld the imposition of a ban, but did reduce the financial penalty awarded from £3m to 2.7m.

Lloyds Bank plc and Bank of Scotland plc fined in relation to Repo rate and LIBOR misconduct: 28 July 2014

Lloyds Bank plc and Bank of Scotland plc (the "Firms") have been fined £105 million for breaches of Principles 3 (systems and controls) and 5 (market conduct) after the FCA concluded that they had made artificial submissions to two benchmark reference rates, the Repo Rate and LIBOR. The Firms were beneficiaries of the Special Liquidity Scheme ("SLS"), which was a temporary taxpayer-backed measure to improve the liquidity position of the US banking system during the financial crisis. The fees for drawing on the SLS were calculated by reference to the SLS Spread, which was the difference between the three-month GBP LIBOR and the three-month Repo Rate, subject to a minimum 20 basis point spread. The FCA found that the Firms sought to manipulate the Repo Rate and LIBOR in order to reduce as much as possible the fees they had to pay under the scheme.

The regulator considered that the Firms breached Principle 5 by failing to observe proper standards of market conduct in relation to their Repo Rate and LIBOR submissions. The Firms were found to have artificially inflated their three-month Repo Rate submissions on the days when the fees for drawing on the SLS were calculated. Similarly, the FCA found manipulation by the Firms of the GBP and JPY LIBOR submissions and manipulation from time to time of their USD LIBOR submissions. The Firms were assessed to have breached Principle 3 as the FCA did not find that they had implemented effective systems and controls to manage the desk's two conflicting roles of making Repo Rate and LIBOR submissions and managing their firm's participation in the SLS. In particular, the Firms were found to have failed to identify and manage this conflict of interest, implement adequate policies or procedures to manage the relevant desks, provide specific training to the traders in those roles and create systems and reports to monitor the traders' relevant activity.

The Firms' breaches were viewed by the FCA as "extremely serious". Manipulation of the Repo Rate would have reduced any fees payable by all other institutions that were drawing on the SLS because the Repo Rate set the fees for all institutions concerned. The FCA concluded that the Firms' misconduct gave rise to a risk that the published GBP, USD and JPY LIBOR rates would be manipulated, and undermined the integrity of those rates.

The FCA imposed very significant financial penalties on the Firms of £100m for their Repo Rate misconduct and £50m for their LIBOR misconduct. However, because the Firms agreed to settle at an early stage of the FCA's investigation, they qualified for a 30% discount under the FCA's executive settlement procedures, which reduced the final penalty to £105m.

EU: Recent Decisions

ECHR decision considers principle of double jeopardy in the context of regulatory proceedings

A recent judgment of the European Court of Human Rights (the "ECHR") has considered the application of the right to a fair trial and the double jeopardy rule, in the context of proceedings for market manipulation brought in Italy. In *Grande Stevens and Ors v Italy*, both administrative and criminal proceedings had been brought against two companies, Exor spa and its major shareholder Giovanni Agnelli & C. sas, together with their chairman, Mr Gabetti, and the Agnelli Group's lawyer Mr Grande Stevens (together, the "Applicants"), in connection with allegations of market manipulation in Italy in 2005. In 2006 Italian regulator CONSOB found that the Applicants had disseminated information capable of providing a false or misleading impression of financial instruments contrary to Italian law, and imposed administrative sanctions on the Applicants. The individuals were banned from managing and controlling companies listed on the stock exchange for certain periods. The Applicants were also subject to separate criminal proceedings in respect of the same conduct and convicted of a criminal offence. They subsequently issued proceedings in the ECHR claiming that the proceedings breached several of their human rights.

The ECHR agreed that there had been a breach of their right to a fair trial at Article 6(1). Their reasoning included the assertion that the criminal prosecution of the Applicants, in addition to administrative enforcement action, both in respect of the same conduct, breached the principle that no one should be liable to be tried or punished again in criminal proceedings under the jurisdiction of the same member state in respect of an offence for which he has already been acquitted or convicted (Article 4, Protocol No. 7). This conclusion appears to contradict the settled assumption across Europe that both criminal and administrative sanctions in respect of the same behaviour could be pursued where available. Indeed the Court of Justice of the European Union has ruled that the rule against double jeopardy would not preclude a member state from imposing a tax penalty and a criminal penalty in respect of the same conduct, provided the tax penalty was not also criminal in nature (*Aklagaren v Hans Akerberg Fransson*). Ongoing action against individuals by both the FCA and SFO for LIBOR related misconduct is a good example of the ways in which alleged regulatory breaches can attract both criminal and administrative sanctions. This decision potentially opens up the possibility of those facing criminal sanctions challenging any additional administrative sanction (or vice versa) which may be imposed in respect of the same conduct.

Hong Kong: News

SFC offers insights into firms' failings and its supervisory focus

In its first supervisory briefing earlier this month, the Securities and Futures Commission (the "SFC") offered valuable insights into its recent supervisory work, as well as areas of regulatory focus. The attendees, comprising over 200 senior executives from investment banks and regulatory practice advisers, were told about the SFC's findings and observations from its recent inspections of large licensed firms, where it found deficiencies and non-compliance in activities including client facilitation, short-selling, stock borrowing and lending, and transactions handling.

The key message from the SFC was the importance that it places on management responsibility. The SFC expects senior management to take ownership of regulatory issues and to set the tone from the top in terms of conduct and culture. Senior management is ultimately responsible for implementing proper controls, maintaining appropriate standards of conduct and adhering to proper procedures. The SFC suggested that one way of ensuring that a firm's systems and controls are sufficiently robust is by monitoring the effectiveness of the "three lines of defence", namely business, compliance and internal audit.

The SFC also highlighted its other expectations in relation to firms' conduct. Firms should be proactive, rather than reactive, when dealing with regulatory issues – this includes maintaining open lines of communication with the SFC, so that there are no "surprises" between firms and regulators. Regarding the

SFC's ongoing enforcement focus, it was confirmed that the current approach of pursuing criminal and disciplinary sanctions, as well as remedial outcomes against both firms and individuals, will continue. The SFC further pointed out that firms should not expect that an individual will escape liability simply because the employer firm agrees to compensate those who have been affected by misconduct – referring to past settlements agreed between the SFC and banks over the mis-selling of Lehman-related investment products. It was also revealed that the SFC will continue to focus on three key areas of supervision: electronic trading (including the operations of dark pools), anti-money laundering, and internal controls.

U.S.:News

New York's Highest Court Affirms the Separate Entity Rule*: Motorola Credit Corporation v. Standard Chartered Bank*

On October 23, 2014, the New York Court of Appeals released its highly anticipated decision in Motorola Credit Corporation v. Standard Chartered Bank. In an opinion that has important ramifications for international banks with New York branches, a 5-2 majority of the New York Court of Appeals – answering a question certified to it by the U.S. Court of Appeals for the Second Circuit – affirmed the long-standing separate entity rule and held that an international garnishee bank with a branch in New York cannot be ordered to restrain assets held in a foreign branch outside the United States. While the federal courts will ultimately decide how to resolve the Motorola case, the Court of Appeals' opinion confirms that, for New York restraining notices to have any effect on foreign branches of international banks, New York judgment creditors will need to obtain restraining orders in the jurisdiction in which the relevant bank account is located.

A note on the decision prepared by our New York Dispute Resolution team can be found here.

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