The summer months have seen the publication of final rules to implement the Senior Managers and Certification Regimes and the Conduct Rules, updated referral criteria for determining the appropriateness of enforcement action in any given circumstances and the search for a new Chief Executive of the FCA. In a period during which fewer enforcement notices were issued, the Co-operative Bank plc Final Notices were notable for the decision by the PRA and FCA not to fine the Co-op for breaches of the Principles for Businesses and listing rules. Nonetheless, the sanctions imposed by the FCA on another Rabobank trader for LIBOR fraud, and senior executives of TailorMade Independent and Catalyst Investment Group for failings impacting retail customers, suggest that the regulators will continue to take a robust approach to enforcement going forward. The 14-year sentence of Tom Hayes marks another success in the long-running investigations into benchmark misconduct and the judgment of the High Court in the Da Vinci Invest Limited case, the first case where the FCA has applied to the court to impose a financial penalty on a person for market abuse, highlights the continued importance of market abuse as a priority area for the FCA.

UK: News

Trader convicted for LIBOR manipulation: 3 August 2015

On 3 August 2015, the Serious Fraud Office (“SFO”) announced in a press release that Tom Hayes, a former derivatives trader at UBS and Citigroup, had been found guilty of conspiring to manipulate the Yen LIBOR rate and sentenced at Southwark Crown Court to 14 years in prison. Mr Hayes is the first person to be convicted by a jury on charges relating to LIBOR misconduct, and was found guilty of all eight counts of conspiracy to defraud.

The offences took place between the periods August 2006 to December 2009 and December 2009 to September 2010, whilst he was an employee at UBS and Citigroup respectively. The jury heard how, during this time, Mr Hayes asked fellow employees, rival traders and brokers to move Yen LIBOR submissions up or down to suit his trading needs, often offering to reward those who colluded with him.

Lord Justice Cooke, who presided over the criminal trial, summed up his misconduct in his sentencing remarks:
“You succumbed to the temptation, as a regulated trader, in an unregulated activity, because you could, to seek to skew Yen LIBOR submissions with a view to changing the published rate from what it otherwise would be, in order to gain an advantage for your bank’s trading profit, with the concomitant benefits which would come to you as the result of trading success, in the shape of status, seniority and remuneration, particularly by way of bonus.”

Cooke LJ made it clear that the conduct of Mr Hayes had to “be marked out as dishonest and wrong and a message sent to the world of banking accordingly”. He noted how important the reputation of LIBOR was to the City as a financial centre and the UK’s banking industry, stating that the activities in which Mr Hayes “played a leading part” jeopardised that reputation and the trust placed on it.

The 14-year sentence handed down to Mr Hayes reflects the seriousness of the offences together with, amongst other things, the potential losses involved, the sophisticated and pre-mediated nature of the fraud and the efforts made to coerce others to join in the conspiracy. Cooke LJ acknowledged that the scale of losses caused to counterparties could not be measured, but said he had no doubt that they “ran into millions of USD”. The SFO press release also noted the impact that LIBOR manipulation might have on the public, given the range of contracts, including loans, savings rates and mortgages, tied to the benchmark.

Cooke LJ also emphasised to Mr Hayes that “[t]he fact that others were doing the same as you is no excuse, nor is the fact that your immediate managers saw the benefit of what you were doing and condoned it and embraced it, if not encouraged it.”

Some of those alleged to be Mr Hayes’ co-conspirators will face trial from 21 September 2015 and a separate trial of individuals charged with manipulating US LIBOR begins on 11 January 2016.

**FCA seeks new Chief Executive: 17 July 2015**

On 17 July 2015, the FCA announced that Martin Wheatley would stand down as Chief Executive with effect from 12 September 2015. Mr Wheatley is expected to continue acting as an adviser to the FCA Board until 31 January 2016, focusing his efforts on the implementation of the Fair and Effective Markets Review (“FEMR”), which he co-chaired.

The FCA’s current Director of Supervision – Investment, Wholesale & Specialists, Tracey McDermott, is the FCA’s Acting Chief Executive until a permanent placement can be found. Media commentary suggests that potential candidates to replace Mr Wheatley include internal candidates, civil servants and senior individuals from overseas regulators.
**UK: Policy and Practice**

**FCA and PRA publish second set of final rules and forms to implement the SMCR for banks: 7 July 2015**

On 7 July 2015, the PRA and FCA published the second set of final rules (the "Final Rules") to implement the Senior Managers and Certification Regimes and new Conduct Rules ("SMCR"), which apply to banks, building societies, credit unions and PRA-designated investment firms ("Relevant Firms"). The SMCR also applies, in modified form, to the UK branches of overseas banks.

The final PRA and FCA rules to implement the SMCR were set out in the PRA Policy Statement 16/15 and the FCA Consultation Paper 15/22 respectively. These papers were accompanied by further PRA publications: (i) Supervisory Statement 28/15, setting out the PRA’s expectations of firms in relation to the new regimes; (ii) a Statement of Policy on the PRA’s power to impose conditions and time limits on approval to perform a Senior Management Function; and (iii) forms to be used by the Relevant Firms. Near final rules on the SMCR’s application in relation to incoming branches of non-UK firms were later published on 13 August 2015 in the FCA Feedback Statement 15/3, “Strengthening accountability in banking: UK branches of foreign banks – Feedback on FCA CP15/10”, and the PRA Policy Statement PS20/15, “Strengthening individual accountability in banking: UK branches of non-EEA banks”.

In Chapter 6 of CP 15/22, the FCA also consulted on an extension of the FCA Certification Regime to cover a wide range of wholesale traders (including all those currently registered as CF30s) and certain staff involved in the deployment and monitoring of algorithmic trading systems. The consultation closed on 7 September 2015 and new rules will be announced later this year. Particular concerns have been expressed regarding the proposed removal of the “30 day rule”, on which many banks rely as a means of not registering overseas staff visiting the UK.

Further details concerning the Final Rules can be found in our client alerts on this topic, “FCA and PRA final rules and forms to implement the Senior Managers and Certification Regimes and consultation on extension to wholesale market activities” and “Senior Managers and Certification Regime: UK branches of foreign banks – PRA and FCA final and “near-final” rules”, which are available on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

*We should have nothing to fear from high standards* - Getting Culture and Conduct Right: 10 July 2015

In a speech given at the Linklaters sponsored event, “Culture and Conduct: Implementing the FCA Agenda”, held on 10 July 2015, Martin Wheatley, the then Chief Executive of the FCA, delivered a speech on the importance of getting culture and conduct right. He referred to the publication of the FCA and PRA final rules on 7 July 2015, describing them as the “final major building block” of a regime aimed at enforcing greater accountability at all levels of the industry.
With the debate now moving away from policy to its practical implementation, Mr Wheatley’s speech focussed on the practicalities around how banks might meet some of the challenges under the new regime. He also sought to dispel some of the myths around the changes the regulator had made to the rules.

He discussed the three limbs of the SMCR: (i) the Senior Managers Regime; (ii) the Certification Regime; and (iii) the Conduct Rules. Amongst other things, he clarified that the Conduct Rules merely made explicit standards to which staff should already be adhering.

Addressing concerns regarding the Presumption of Responsibility under the incoming Senior Managers Regime, he reassured listeners that the presumption would be applied proportionately and that what the FCA considered to be reasonable steps would be determined according to the specific circumstances and facts known at the time; it would not be defined by what should have been done in hindsight. Examples of what the FCA might take into consideration in determining reasonable steps included whether Senior Managers: (i) could show that they had tested a particular control framework relating to a specific function; (ii) had considered whether the governance arrangements were appropriate; (iii) could show they had considered and implemented training requirements to people to whom they’d delegated; (iv) had clearly communicated to staff their roles and responsibilities; and (v) had sought to improve systems and processes as a result of lessons learned.

Mr Wheatley explained that the presumption did not prevent Senior Managers delegating tasks and activities where appropriate. It did, however, require them to delegate appropriately, providing necessary training to the delegate and maintaining an adequate degree of oversight. Individuals could not seek to wash their hands entirely of a particular responsibility through delegation.

Mr Wheatley concluded his speech with a summary of what the new rules were driving at – learning from the mistakes of the past, raising the bar in terms of standards and rebuilding trust in the industry. He ended by saying that “we should have nothing to fear from high standards”.

In October 2015, HM Treasury released a policy paper, “Senior Managers and Certification Regime: extension to all FSMA authorised persons”, which set out plans to remove the Presumption of Responsibility and replace it with a statutory duty of responsibility, and to extend the SMCR so as to apply it across the entire financial services sector. We have issued a client alert on these changes, which is available on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

FCA publishes new referral criteria for enforcement investigations (“Enforcement Referral Criteria”): 10 July 2015

Also on 10 July 2015, the FCA published updated Enforcement Referral Criteria setting out the process it uses when deciding whether to refer a firm or individual to its enforcement division for a formal investigation. This publication was made in response to one of the recommendations put forward in the December 2014 HM Treasury “Review of enforcement decision-making
at the financial services regulators: final report", which suggested that clearer criteria explaining the circumstances in which a matter will be referred to enforcement would assist in enhancing the transparency, fairness, effectiveness and speed of enforcement decision-making at the FCA and PRA.

In particular, the HM Treasury review identified several issues with enforcement investigations, including the fact that they were expensive, resource intensive and onerous for both the firms and individuals involved. This was compounded by a sense within the industry of arbitrariness around how cases were selected by the FCA, with some firms/individuals not being investigated despite engaging in the same practices that had led to enforcement action against other firms/individuals. The report suggested that the referral criteria should reflect the objectives of enforcement, including the public reinforcement of regulatory requirements in priority areas, but acknowledged that, due to limited resources, there may be instances where firms/individuals had to be held out as examples to others.

In a press release accompanying the updated Enforcement Referral Criteria, the FCA’s then acting director of enforcement and market oversight, Georgina Philippou, stated that the published criteria “will make our decision making process more transparent” and will provide firms and the public with “a clearer understanding of the questions we ask ourselves before we start a formal investigation”.

According to the revised criteria, the “overarching” question the FCA asks itself in deciding whether to appoint enforcement investigators, is whether an enforcement investigation is likely to further the FCA’s aims and statutory objectives. In determining this, the FCA considers:

- the strength of the evidence and the proportionality and impact of opening an investigation;
- what purpose or goal would be served if the FCA were to end up taking enforcement action in the case; and
- relevant factors to assess whether the purposes of enforcement action are likely to be met.

The revised Enforcement Referral Criteria are a little clearer than the previous criteria, and go some way to ensuring consistency in cases subject to FCA enforcement. The criteria include more references to potential action against individuals, identifying areas that individuals and firms might focus on to avoid enforcement. Despite this, and perhaps inevitably, the FCA criteria continue to afford the regulator with considerable discretion regarding which cases it accepts for enforcement.

Further information about the framework under which the FCA applies the referral criteria can be found here.
Wholesale Conduct Risk – Speech by Tracey McDermott: July 2015

In a speech given at the British Bankers’ Association Conference, “Wholesale Markets and Risk: FEMR and beyond”, Tracey McDermott, the Director of Supervision – Investment, Wholesale & Specialists at the FCA, discussed the FCA’s role and its expectations of the firms it regulates. The full text of the speech was published on the FCA website on 24 July 2015.

Ms McDermott focused on three areas: (i) the need for the FCA to work with the industry on solutions to rebuild reputation and embed cultural change; (ii) the need to get firms to ask themselves hard questions about how they identify and manage conduct risks; and (iii) how to create a system in which individuals, as well as firms, can be held accountable for their actions.

On the second point, she listed five questions that firms should ask themselves to get a sense of “what good looks like”, as set out below:

1. How do you identify the conduct risks inherent within your business?
2. Who is responsible for managing the conduct of your business?
3. What support mechanisms are in place to enable people to improve the conduct of their business or function?
4. How do the board and executive committees gain oversight of the conduct of the organisation?
5. Are there any perverse incentives or other activities that may undermine any strategies put in place to answer the first four questions?

On the third area of focus, Ms McDermott reiterated a number of points raised in Mr Wheatley’s speech at the Culture and Conduct event held earlier in July, emphasising that senior management “cannot delegate and forget” or “hide in labyrinthine structures where it is all too easy for everyone to say it was not me.” She acknowledged the challenges that would subsequently be faced by individuals and firms, particularly where they were being asked to “re-examine the behaviours that in many cases made them successful, and led to reward and promotion”.

Ms McDermott ended by highlighting the importance of getting individuals and firms to see how their actions played out in the wider context. Whilst regulators would assist by encouraging firms and helping share best practice, it was for individuals and firms to take responsibility for their own behaviour to ensure the wholesale markets, and with it, the UK economy, worked well for everyone.

FCA releases new complaints handling rules: 23 July 2015

In our December 2014 update, we reported on the outcome of a thematic review conducted by the FCA into how complaints handling in firms might be improved. The review involved 15 financial firms and resulted in a number of recommendations and proposed amendments to the FCA Rules. This was followed by the publication of a consultation (CP14/30) proposing changes to the rules on complaints handling and post sales telephone calls, together with
amendments required to implement the Alternative Dispute Resolution Directive.

On 23 July 2015, the FCA released a Policy Statement (PS15/19), reporting on the main issues arising from CP14/30 and setting out final rules on how complaints should be handled. It also included rules limiting the cost of telephone calls which consumers make to firms.

The new rules:

- increase, as of 30 June 2016, the time limit in which firms can handle complaints less formally (without sending a final response letter) from the close of the next business day to the close of three business days after the firm receives the complaint. Where a complaint has been resolved to the complainant’s satisfaction within this time, firms are required to send a written “summary resolution communication” (making clients aware of the FOS and their FOS rights);

- necessitate, from 30 June 2016, the reporting of all complaints, including those handled within the three-day window;

- from 26 October 2015, introduce rules to ensure firms provide only telephone numbers which cost customers no more than the ‘basic rate’ when calling about a contract already entered into with the firm (for example, to make changes to an existing account or policy), as well as to complain; and

- provide a new ‘complaints return’, requiring firms to send data to the FCA twice a year on the number of complaints received. Firms will need to report complaints data using the new complaints return for any reporting period ending on or after 30 June 2016.

In the statement, the FCA outlines its expectation that firms will “take all measures necessary to comply with [its] reporting rules” and warns that “consistently poor practice may be subject to supervisory or enforcement action”.¹

Provision of more detailed complaint data under the new rules will help the FCA select which firms to include in its thematic review; it could also lead the regulator to query which Senior Managers are responsible for products receiving high volumes of complaints. The increased reporting requirements will also help the FCA identify general trends in complaints in the market, helping it hone in on potential problem areas and pursue enforcement action more quickly.

Fines imposed on a number of firms in recent months for weaknesses in their complaints handling policies have already brought this issue to the attention of the boardroom.

¹ PS15/19, July 2015, page 12.
UK: Recent Decisions

FCA bans Rabobank trader following US conviction for LIBOR fraud: 30 July 2015

On 30 July 2015, the FCA published the Final Notice (dated 21 July 2015) issued on a former trader of Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank"), Lee Bruce Stewart, prohibiting him from performing any function related to any regulated activity carried on by any authorised or exempt person, or exempt professional firm. The prohibition follows Mr Stewart's conviction in the US for misconduct in relation to LIBOR. It also echoes the Final Notice dated 27 February 2015, in which another trader at Rabobank, Paul Robson, was similarly banned after being charged by the United States Department of Justice ("DOJ") with one count of conspiracy and 13 counts of wire fraud connected with the manipulation of JPY LIBOR rate between 2006 and 2011.

On 23 March 2015, Mr Stewart submitted a guilty plea after being pursued by the DOJ for one count of conspiracy to commit wire fraud and bank fraud relating to his attempts to manipulate US Dollar LIBOR between spring 2007 and his departure from Rabobank in 2009.

The FCA decided that the DOJ's indictment, which was contained in Annex B of the Final Notice, demonstrated Mr Stewart's lack of honesty and integrity and suggested that he was not a fit and proper person to perform the prohibited functions. Further information regarding the US conviction can be found in the DOJ press release dated 23 March 2015.

The seriousness of Mr Lee's misconduct was held by the FCA to have been aggravated by the fact that: (i) he was an experienced employee of Rabobank and an approved person, holding the CF30 (Customer) function; (ii) he was engaged in this improper activity over a prolonged period of time; and (iii) LIBOR is of central importance to the operation of the UK and worldwide financial markets and doubts in its integrity threatened confidence in those markets.

The action taken against these individuals follows the Final Notice issued on Rabobank on 29 October 2013, in which it was fined £105m, following a 30% stage 1 discount granted for early settlement, for its involvement in LIBOR misconduct. It serves as a sober reminder to individuals (and firms) that repercussions of the benchmark and FX investigations (which are still ongoing) will be felt for some time to come.

Catalyst senior management pay the price for misleading information provided to customers: 6 August 2015

On 6 August 2015, the Upper Tribunal released its decision in relation to references made by Timothy Roberts and Andrew Wilkins, senior executives of Catalyst Investment Group ("Catalyst") during the period relevant to the FCA's investigation, regarding Decision Notices issued by the FCA two years previously. The Tribunal's conclusions are significant in highlighting the
serious repercussions faced by individuals found to have misled retail customers, regardless of whether they had acted without integrity.

The background to the case concerned a Luxembourg entity, ARM Asset Backed Securities SA (“ARM”), which, between October 2007 and October 2009, issued bonds to the public in quarterly tranches. Catalyst was the primary distributor of ARM bonds in the UK and, in November 2007, became aware that ARM did not have a licence from the Luxembourg financial regulator, the Commission de Surveillance du Secteur Financier (“CSSF”), to continue issuing ARM bonds. This was a licence which ARM, and Mr Roberts in his role as director of ARM, had concluded it required.

Despite this, Catalyst continued to promote the ARM Bonds and received funds from pending investors, even after becoming aware in November 2009 that ARM had specifically been asked to defer from issuing further bonds by the CSSF. During the period relevant to the FCA’s investigation (November 2007 to May 2010), Catalyst also: (i) sent letters to its independent financial adviser clients in December 2009 and March 2010 which conveyed a misleading impression of ARM’s regulatory position, particularly regarding the licence application; and (ii) failed to reflect ARM’s true regulatory position in its financial promotions.

The Tribunal stated that as a result of Catalyst’s actions, UK retail customers were understood to have invested £17.1m in bonds which, ultimately, were not issued. Mr Roberts was found to have acted with a serious lack of integrity. His reference in relation to the prohibition and the withdrawal of authorisation was dismissed and the penalty of £450,000 upheld.

Mr Wilkins was found to have been “less blameworthy than Mr Roberts”. The Tribunal concluded that his actions had not demonstrated a lack of integrity, nor a reckless disregard to investors’ interests. Instead, he had adopted a more understandable (if nonetheless overly optimistic) view about the success of ARM’s application for the licence and, before the Regulatory Decisions Committee (the “RDC”) and the Tribunal, had “demonstrated a genuine recognition and understanding of the respects in which his conduct fell below the appropriate standards”, suggesting that he had learned from his mistakes. The Tribunal halved the penalty that the FCA proposed issuing against Mr Wilkins to £50,000 and questioned the suitability of the FCA’s proposed prohibition order, noting that it was a “draconian penalty” and was “likely to be more appropriate in a case where a lack of integrity is shown than a failure of competence or skill”. It clarified that it did not consider that Mr Wilkins was not fit and proper to perform either CF1 (director) or CF30 (customer advisor) controlled functions.

The Tribunal recognised that, where a reference was made to it in relation to a prohibition imposed by the RDC under section 56 FSMA (prohibition orders), it was required, under section 133(6) FSMA, either to dismiss the reference or to remit the matter to the FCA with such directions (if any) as the Tribunal considered appropriate for giving effect to its determination. Having clarified its position as regards Mr Wilkins, the Upper Tribunal remitted this aspect of the matter back to the FCA for decision.
Before reaching any decision on the matter, the FCA asserted that the Upper Tribunal had not made overall findings in relation to Mr Wilkins’ competence and capability. In response to this, the Upper Tribunal released additional reasons for its determination on 8 September 2015, which confirmed that the Upper Tribunal did not consider that Mr Wilkins lacked fitness and propriety on any basis alleged by the FCA. The position was summed up in the lines “we dismiss the allegation that Mr Wilkins is not fit and proper including the allegation of lack of competence. The burden of proof is on the authority to prove that he is not fit and proper and not competent. The Authority failed to satisfy the Tribunal in relation to that allegation”.

The FCA has subsequently confirmed in a press release that it would no longer be seeking a prohibition order in relation to Mr Wilkins.

Co-op bank avoids “substantial financial penalty” as public censure deemed proportionate response: 11 August 2015

On 11 August 2015, the FCA and PRA announced that the Co-operative Bank plc (the “Co-op Bank”) was guilty of serious failings meriting a “substantial financial penalty”, which, in the PRA’s view, would have amounted to £121.86m before application of the 30% stage 1 discount (interestingly, the FCA did not say what its penalty would have been). This was one of the few joint enforcement investigations by the FCA and PRA, with both regulators ultimately deciding that exceptional circumstances meant that a public censure, and not a fine, was the appropriate and proportionate response. The PRA and FCA news releases and Final Notices can be found here and here.

The PRA Final Notice

The PRA found that the Co-op Bank had breached Principles 3\(^2\) and 11\(^3\) of the Principles for Businesses between 22 July 2009 and 31 December 2013. Whilst the breach of Principle 11 was for the same reasons provided in the FCA Final Notice, as discussed below, the serious issues identified as being in breach of Principle 3 were unique to the PRA Final Notice. These issues related primarily to inadequacies in the Co-op Bank’s control framework across all three lines of defence:

- The first line of defence’s management oversight of the business was deemed inadequate and inappropriate, as shown by the failure of the business to: (i) consider risks and manage the business in line with risk appetite; (ii) identify and manage risks associated with the corporate loan book; and (iii) escalate key issues to the Board.

- The second line of defence (risk and compliance) was said to have been poorly structured and, along with the third line of defence, under resourced.

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\(\text{Principle 3 states that “} [\text{a} \text{ firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.”} \)\]

\(\text{Principle 11 states that “} [\text{a} \text{ firm must deal with its regulators in an open and cooperative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.”} \)\]
• The third line of defence (internal audit) was found to have had insufficient focus on high risk areas, and to have failed to pick up on key issues even when it did.

The culture within the Co-op Bank was seen by the PRA to have contributed to the breach of Principle 3, as a result of having prioritised short-term financial position over longer term sustainability.

In addition, the PRA found that the Co-op Bank had inadequate risk management framework policies and inadequate policies and procedures in relation to corporate lending and capital management. Finally, the PRA also found that the firm’s management information was not sufficiently forward-looking and failed to highlight the key issues sufficiently.

The FCA Final Notice

The failings set out in the FCA’s Final Notice took place between 25 April 2012 and 21 June 2013, when the Co-op Bank breached its obligation (under the FCA’s Listing Rule 1.3.3R) to take reasonable care to ensure that published information was not misleading, false or deceptive and Principle 11 of the FCA’s Principles for Businesses by failing to notify the FCA of intended changes to two senior positions (and the reasons for those changes).

The first of these breaches took place between 21 March 2013 and 17 June 2013. On 21 March 2013, the Co-op Bank published its 2012 Financial Statements for the year ending 31 December 2012. Despite showing a loss of £673.7m, the firm stated that it had sufficient surplus capital to meet the firm’s regulatory minimum requirements and that it could maintain adequate capitalisation at all times, even under the most severe stress scenarios. In fact, the Co-op Bank had been issued with revised capital requirements in January 2013 which it immediately could not meet. The FCA also found that there was no reasonable basis for asserting that the firm would have adequate capital in the most severe stress scenarios. Only on 17 June 2013 did the Co-op Bank announce that it had a £1.5 billion capital shortfall.

In further breach of its regulatory obligations relevant to the period from April 2012 to May 2013, the Co-op Bank was found not to have provided timely notification to the FCA or PRA of its intention to change the holders of two key senior positions and, during one conversation with the FCA, provided an incorrect assurance to questions relating to one of the position holders. The FCA and PRA said that they would expect to be notified of intended changes, together with the reasons for those changes, without delay to enable them to properly consider and assess the firm’s management.

Decision not to impose a financial penalty

By way of explanation for not fining the Co-op Bank for the above breaches, the FCA and PRA said that they had had regard to the seriousness of the breaches and the impact a financial penalty would have on the firm. The Co-op Bank was engaged in a turnaround plan aimed at ensuring it met its capital requirements on a sustainable basis, with adequate capital to withstand a severe stress. In the regulators’ view, it was important to prioritise
capital resourcing, ensuring the success of the plan and improving the firm’s resilience. A public censure alone was therefore appropriate and proportionate.

The press releases accompanying the Final Notices confirmed that investigations into senior individuals at the Co-op Bank during the relevant period were ongoing.

**FCA fines and bans former director of TailorMade Independent: 13 August 2015**

In a Final Notice dated 13 August 2015, the FCA issued a financial penalty of £165,900 against a former director of TailorMade Independent Limited ("TMI"), Robert Shaw. Mr Shaw was also stripped of his approval to perform the CF1 (director) controlled function at TMI and prohibited from performing any significant influence function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm. The fine reflected the 30% stage 1 discount for early settlement, but was greater than those deemed appropriate for two other ex-directors of TMI, Lloyd Pope and Peter Legerton, who were issued Final Notices earlier this year.

During the relevant period (22 January 2010 to 20 January 2013), Mr Shaw was found to have been in breach of Statement of Principle 7 of the FCA's Statements of Principle and Code of Practice for Approved Persons by failing to take reasonable steps to ensure that the business of the firm for which he was responsible met the relevant requirements and standards of the regulatory system. The breach stemmed from his failures to: (i) identify, disclose, manage and mitigate adequately a number of conflicts of interest arising from his role as director and shareholder of both TMI and an unregulated introducer, which received commissions for investments in the products it promoted (many of which were unregulated) and which referred work to TMI where individuals required advice on the most suitable self-investment pension plan (“SIPP”) to apply to their investment; and (ii) take reasonable steps to ensure that TMI assessed the suitability for its customers of investments underlying the SIPPs on which it provided advice.

The case highlights the FCA's willingness to impose stringent penalties on individuals, even where losses were not caused intentionally or recklessly and where external compliance and qualified internal advice had been sought, particularly where retail customers are concerned. It also emphasises the need for directors to monitor potential and existing conflicts of interest and to ensure that these are declared and managed appropriately.

**The Financial Conduct Authority v Da Vinci Invest Limited and ors, [2015] EWHC 2401 (Ch) - High Court ruling assessing necessary element of intent, burden of proof and level of liability in market abuse cases: 12 August 2015**

On 12 August 2015, an application made directly to the High Court by the FCA marked the first case in which the regulator invited the court to use its powers under section 129 FSMA to impose a financial penalty against the Defendants for market abuse, in addition to seeking a final injunction under...
section 381 FSMA to prevent such abuse continuing. The injunction was granted and the financial penalty imposed across the Defendants amounted to over £7m.

The Defendants being pursued by the FCA were an English company that operated from a branch in Switzerland, Da Vinci Invest Limited (“Da Vinci”); three traders resident in Hungary (the “Traders”); and a Seychelles company owned and controlled by the Traders that has since been struck off the register in the Seychelles, Mineworld Limited (“Mineworld”). The market manipulation in question related to the Traders’ use of a manipulative high-frequency trading strategy, known as “layering” and “spoofing”, in shares traded on the LSE and multi-lateral trading facilities (“MTFs”). The strategy had the effect of creating a false and misleading impression as to the supply and demand of relevant shares, which the Traders then took advantage of by trading on the other side of the order book before cancelling the orders which had created the false or misleading impression.4

The Traders were found by the court to have begun trading in this way on behalf of Da Vinci in 2010 and, so far as two of the Traders were concerned, on behalf of Mineworld in 2011. Their suspicious trading activity was reported to the FSA in late 2010 and early 2011, prompting the FSA to commence an investigation on 26 May 2011 and issue proceedings in mid-July 2011.

In considering the FCA’s application, the court raised a number of issues of relevance to Linklaters’ clients, some of which are set out below. The court:

- agreed with the FCA that the question of whether or not market abuse had occurred under section 118(5) FSMA was a purely objective test requiring no mental element, reiterating the conclusion in earlier cases that this was an effects based regime (see Winterflood Securities Limited v FSA [2010] EWCA Civ 423 and Swift Trade [2013] Lloyd’s LR (FC) 381);
- disagreed that the conduct could only be attributed to the company if it was undertaken by the company’s directing mind and will, and held that this issue should be determined by reference to usual principles of the law of agency;
- stated that liability for market abuse should also not be avoidable by the simple expedient of the company engaging traders to transact business on its behalf as independent contractors rather than as employees. The nature of the relationship between the company and the trader should make no difference, what counts is whether the behaviour in question occurs on behalf of the company;
- applied the Upper Tribunal decision in Hannam v FCA [2014] UKUT 0233 (TCC) in determining that the civil standard of proof on the balance of probabilities should be applied in market abuse cases, rather than the criminal standard.

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4 A more detailed description of the practice is provided at paragraph 22 of the judgment.
The FCA’s decision to make use of the court’s discretionary powers under section 129 FSMA, rather than adopt the usual approach of issuing a warning notice and progressing the case through the RDC, emphasises its focus on market abuse and determination to bring those involved in such misconduct to account, and to use all of its powers for this purpose. Despite taking four years to come to trial, the success of the claim may encourage the FCA to take the court route in similar cases, particularly those involving individuals operating outside the UK who are neither approved nor authorised by the FCA and against whom the pursuit of the usual regulatory disciplinary process may be more challenging.

A more detailed note on the High Court’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 High Court held dealing and disclosure provisions under OSCO constitutional: 5 August 2015

In the recent judgment, Interush Limited & anor v The Commissioner of Police, The Commissioner of Customs & Excise & Superintendent of Police (HCAL 167/2014, 5 August 2015), the Hong Kong Court of First Instance (“CFI”) dismissed an application for judicial review, in which the Applicants sought to challenge the constitutionality of sections 25 and 25A of the Organised and Serious Crimes Ordinance (“OSCO”). The CFI held that the provisions are not unconstitutional, and also dismissed the Applicants’ challenge of the propriety of the decision making process under section 25A(2)(a) (i.e. the “no consent regime”).

A note on the CFI’s findings in this case can be found on the Linklaters Client Knowledge Portal. If you are not yet a subscriber, please sign up now.

First disciplinary action against a dark pool operator

The Hong Kong financial regulators have taken a number of “first ever” enforcement actions in the past two months, amongst which was the Securities and Futures Commission (“SFC”) fining of an international securities firm HK$15m under a settlement agreement for failures in relation to the firm’s dark pool trading services.

The SFC found that, contrary to what was stated in its business plan for its licence application as well as representations to clients, i.e. that client orders would be matched and executed according to order price priority, all orders were in fact treated as having equal priority with allocations on a pro rata basis. The firm suspended the dark pool operations when it discovered the order priority issue; however, it did not inform the SFC until 21 months after the services were first suspended.

Further, the firm failed to notify the SFC of a change in its business plan – instead of obtaining client consent before orders were sent to the dark pool for matching, orders intended for execution on the Stock Exchange of Hong
Kong were automatically enabled on the dark pool without client consent. It also failed to maintain sufficient trade records relating to the dark pool, or coherently document the matching logic to explain the matched trades.

This disciplinary action highlights the importance that the SFC places on firms’ compliance with the statutory notification requirements, in addition to the SFC Code of Conduct and firms’ licensing conditions.

**SFC commenced first MMT proceedings against listed company and executives over late disclosure of inside information**

Following in the trend of “first ever” examples of its kind, the SFC has also commenced the first proceedings in the Market Misconduct Tribunal (“MMT”) against a listed company and its executives for failing to disclose inside information as soon as reasonably practicable, as required under the Securities and Futures Ordinance. This marks the first time the SFC has relied on the statutory disclosure regime since it came into force on 1 January 2013.

The SFC alleges that AcrossAsia Limited (“AcrossAsia”) had failed to disclose in a timely manner litigation with its subsidiary, and enforcement proceedings (including insolvency-related proceedings) by the subsidiary against AcrossAsia. The Chairman and CEO of AcrossAsia also face MMT proceedings for alleged reckless or negligent conduct in relation to the alleged late disclosure.

**U.S.: News**

**SEC Issues Interpretation of Definition of Dodd-Frank Whistleblower: 4 August 2015**

On 4 August 2015, the Securities and Exchange Commission (“SEC”) issued an interpretive rule to clarify the whistleblower rule it passed in response to the Dodd-Frank Act (“Dodd-Frank”). The SEC acknowledged ambiguities in the current whistleblower rule and made plain that full protections are afforded to internal whistleblowers. A whistleblower, therefore, need not report suspected wrongdoing to the SEC in order to be protected by the anti-retaliation provisions of Dodd-Frank. Indeed, according to the SEC, internal whistleblowing that is protected activity sufficient to state a claim under the Sarbanes-Oxley Act is also protected activity sufficient to state a claim under Dodd-Frank.

This clarification comes in response to a sharp split in judicial authority on the critical question of the protections afforded to internal whistleblowers. The Fifth Circuit held in *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013) that a Dodd-Frank whistleblower must report wrongdoing to the SEC to qualify for protection from retaliation. The Second Circuit has also struggled with the question of whether the SEC’s whistleblower rules under Dodd-Frank afford the same protections to internal whistleblowers, clearly divided over whether the *Asadi* ruling should apply to a former finance director at Neo@Ogilvy, who was dismissed after reporting suspected irregularities internally, but before taking his concerns to the SEC.
In a joint petition for rule-making, the Government Accountability Project (a whistleblower advocacy group) and former SEC enforcement official, Jordan Thomas, urged the SEC to clamp down on corporate attempts to impede or silence would-be whistleblowers. Such corporate attempts include employment agreements that require workers to give notice of external reports, to anonymously report such occurrences, and to limit the ability to seek independent counsel. This interpretive rule certainly serves as a step in the direction of increasing whistleblower protections.

SEC Administrative Court Judges “ Likely Unconstitutional” : 12 August 2015

The Securities and Exchange Commission (“SEC”) has suffered what could be a fatal blow to its administrative court when U.S. District Judge Richard Berman of the Southern District of New York called the controversial forum “likely unconstitutional” on 12 August 2015. In issuing a preliminary injunction in the SEC’s case against former Standard & Poor’s Ratings Services executive, Barbara Duka, Judge Berman lent credence to a growing number of critics who perceive the SEC’s in-house court as unfair and unconstitutional.

In his order, Judge Berman stated that Ms Duka was likely to succeed on her claims that the SEC violated the Appointments Clause of the U.S. Constitution because its administrative law judges are not hired by the agency’s commissioners themselves. He largely followed the reasoning of U.S. District Judge, Leigh Martin May of the Northern District of Georgia, who recently blocked two SEC cases – one against accused insider trader Charles Hill and the other against Atlanta-based investment adviser Gray Financial Group Inc. – on similar grounds. The SEC has appealed the Hill injunction to the Eleventh Circuit, which has refused to stay the injunction while the appeal is pending.

Judge Berman’s ruling, therefore, deals another blow to the SEC’s administrative courts, which the SEC began using more broadly following the Dodd-Frank Act. The SEC stands by the argument that the hiring of administrative law judges never violated the Appointments Clause because they are not “inferior officers” under the Constitution. Of course, if the agency gave in to the argument that its administrative law judges were hired in violation of the Constitution, it would have negative consequences for all of its pending cases.