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COMPLIANCE OFFICER BULLETIN

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

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FCA ENFORCEMENT ACTION: THEMES AND TRENDS

1. Introduction

"For 'tis the sport to have the engineer hoist with his own petard." So observed Hamlet in a metaphor that might easily have applied to the FCA in October 2014 following the publication of the Davis Review into the regulator's mishandling of its announcement of proposed supervisory work in the life insurance sector in April 2014. Ultimately, that Review concluded that while the FCA's strategy of providing an advance briefing to journalists was "well intentioned … [w]hen it went wrong, the FCA's reaction was seriously inadequate and fell short of the standards expected of those it regulates". While some regulated firms might be tempted to engage in a spot of *schadenfreude* when reading the Review's findings, a more constructive response might be to heed the omen that when even the regulator makes mistakes in connection with market standards, firms need to be especially careful to ensure that they understand the regulatory requirements to which they are subject if they wish to avoid enforcement action. As the selection of cases from the previous year demonstrates, there are still some common and persistent industry misunderstandings about various FCA rules, coupled with some examples of deliberate and flagrant disregard for applicable standards of behaviour.

As in previous years, the size of penalties continues to soar as the FCA seeks to make clear statements to the market that certain types of conduct or certain failings will be severely punished. From the former record of £474 million in fines for 2013, total

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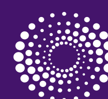

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FCA penalties imposed in 2014 reached an eye-watering £1.471 billion, bolstered in particular by fines imposed on major banks in connection with the attempted manipulation of foreign-exchange rates. Any firm or individual still tempted to engage in market misconduct should take notice, as there is a very real possibility that the next round of fines for similarly egregious activities will be significantly higher still.

The important decision of the Upper Tribunal in the case of Ian Hannam was also published in May 2014, giving further guidance on how to identify inside information and when a disclosure of such information may be considered to be made in the proper course of a person's employment. The lengthy and detailed decision was clearly intended to act as a guide for future FCA and Tribunal decisions in this area, so firms grappling with these complex issues would be well advised to read the Tribunal's reasoning and conclusions in full.

Aside from market conduct cases, the FCA has continued to impose a range of smaller, but nonetheless still significant, penalties against firms and individuals for the, by now familiar, range of regulatory failings, including failure to ensure proper protection for client assets, systems and controls failings, failure to ensure client communications are clear and fair, and failure to act with integrity. A notable trend over the past year has been a developing focus on how firms (and especially asset managers) address conflicts of interest, with two key decisions of the Upper Tribunal relating to Arch Financial Products and Angela Burns respectively setting out an important range of considerations in this area. More broadly, the continuing focus on conflicts, client communications and the general need to treat customers fairly feeds into the FCA's broader narrative about the importance of firms embedding the correct "culture" from top to bottom—indeed, many of the final notices during the period of review contain explicit references to that concept.

The FCA has continued to punish firms severely for breaches of its client assets and client money regime, with Barclays Bank Plc receiving the largest FCA penalty to date in this area (£37,745,000 after the settlement discount) for failing to apply these rules correctly in the context of certain custody relationships. The enforcement action against Pritchard Stockbrokers Ltd in October 2014 also emphasised that the FCA is willing to take action against individuals within a firm where they have engaged in reckless behaviour, but it is not necessary for there to be actual loss (as there was in the Pritchard case) for firms and individuals to be at risk of enforcement action. The persistent line of enforcement notices for firms' failure to ensure adequate protection and compliance in this regard continues to attest that this is a key FCA regulatory priority and it is likely to remain so when certain complex revised client money and client asset rules take effect in mid-2015.

Other significant penalties imposed by the FCA in the previous year have included penalties of £2,398,100 and £1,429,000 (both after a 30 per cent settlement discount) against Credit Suisse and Yorkshire Building Society respectively in June 2014 for failing to ensure that financial promotions in connection with structured deposit products were clear, fair, and not misleading. In August 2014, Deutsche Bank AG was fined £4,718,800 (again, after a 30 per cent settlement discount) for transaction reporting failures in connection with CFD equity swaps, while Yorkshire Building Society found itself fined for a second time in October 2014 (this time with a £4,135,600 penalty after the settlement discount) due to its failure to treat customers fairly when addressing mortgage arrears.

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In the context of criminal enforcement action, in addition to some successes in prosecuting market misconduct in 2014, the FCA also secured the conviction of Alex Hope in January 2015 for defrauding investors after he had earlier pleaded guilty to a charge of operating a collective investment scheme without authorisation. Mr Hope's co-defendant, Raj Von Badlo, had earlier pleaded guilty to charges of recklessly making false representations to investors and the unlawful promotion of a collective investment scheme. Both men had told investors that Mr Hope would use his expertise to trade investors' money on the foreign exchange markets, but in reality only 12 per cent of that money was ever invested and Mr Hope made heavy losses which he then attempted to hide by falsifying statements of trading accounts. In a clear warning about the consequences of such dishonest conduct, the court sentenced Mr Hope to seven years' imprisonment, while Mr Von Badlo received a two-year prison sentence. To underline the point that those breaching regulatory standards will not be allowed to profit personally, the FCA has also emphasised that confiscation orders are expected to follow in due course.

Between October 2014 and March 2015, the FCA also secured guilty pleas from Phillip Boakes in respect of a number of charges relating to fraudulent trading, using a forged instrument, and accepting deposits without authorisation. Mr Boakes had operated a fraudulent investment scheme through his company, CurrencyTrader Ltd, which was supposed to carry out foreign exchange spread betting activities on behalf of customers in order to generate guaranteed returns which were advertised as exceeding 20 per cent. Where returns were paid out, these were in fact funded from deposits paid by new customers through a "Ponzi scheme" arrangement. When the scheme eventually collapsed, the resulting loss to investors was over £2.5 million, with Mr Boakes's trading having led to a loss of almost £1 million and around £1.3 million having been used to fund his own personal lifestyle. In March 2015, Mr Boakes was sentenced to a total of 10 years' imprisonment, with the judge indicating that the sentence would have been 13–14 years but for his guilty pleas. Interestingly, the sentence also included one year's imprisonment to run concurrently with the other sentences for accepting deposits without authorisation, providing a relatively rare example of a criminal sanction for breach of the general prohibition against performing regulated activities without the regulator's permission.

The first, and to date only, PRA penalty was imposed in November 2014, finally giving an insight into the tone and content of a PRA enforcement action. It is perhaps unfortunate that this was a result of a joint investigation alongside the FCA into IT failings within The Royal Bank of Scotland group, as there is understandably a high degree of conformity between the resulting FCA and PRA final notices, thereby limiting the scope of the PRA to demonstrate how its ultimate approach to enforcement may differ.

In this issue, we consider a selection of the more interesting or important FCA enforcement cases that were published between March 1, 2014 and February 28, 2015 in order to identify the main themes and the resulting lessons for firms and individuals.

2. Market conduct

Criminal actions

Throughout 2014 and early 2015, the FCA has managed to build upon its previous successes in relation to market misconduct prosecutions, which form a central plank of its credible deterrence strategy.

Between September 10 and 15, 2014, the FCA secured confiscation orders against seven individuals following their earlier convictions in 2012 and 2013 for involvement in an insider dealing scheme. The scheme involved a print room manager at JP Morgan Cazenove, Ersin Mustafa, passing the seven defendants price-sensitive information in connection with proposed takeovers which they used to place spread bets. In total, the confiscation orders imposed required the disgorgement of over £3,249,000 from the defendants. In certain cases, the order against the relevant individual exceeded the amount of profit that was directly attributable to the instances of insider trading of which he was convicted. This was because the courts have powers under the Proceeds of Crime Act 2002, in appropriate cases, to assume that certain other property obtained by the defendant results from a broader "criminal lifestyle" and therefore can also be confiscated. In addition, two of the defendants, Richard Joseph and Neten Shah, were ordered to pay costs of £200,000 and £100,000 respectively.

In November 2014, Julian Rifat, a former trader at Moore Capital Management LLC, pleaded guilty to eight counts of insider dealing in connection with an insider dealing scheme also involving Paul Milson and Graeme Shelley, both of whom had previously pleaded guilty to related charges in March 2013 and March 2014 respectively. At the time of writing, Mr Rifat's sentence has yet to be announced. The scheme involved Mr Milsom, who was a senior equities trader at Legal & General Investment Management, and Mr Rifat providing price-sensitive information that they obtained in the course of their employment to Mr Shelley, who would then enter into contracts for differences or spread bets on the basis of that information. Mr Shelley would then divide the proceeds of the trades with Mr Milsom or Mr Rifat, as appropriate. The three men communicated by means of pre-paid mobile telephones to mask their activities and the profits arising from the trades were sometimes diverted via third parties.

More recently, in February 2015, Ryan Willmott, the former group reporting and financial planning manager for Logica Plc, pleaded guilty to three counts of insider dealing after placing a number of trades on the basis of inside information relating to a takeover offer for Logica by CGI Group, although at the time of writing, Mr Willmott's sentence has yet to be confirmed. Mr Willmott opened a trading account in the name of his girlfriend without her knowledge in an attempt to avoid detection while placing the relevant trades and also admitted disclosing inside information to a family friend who undertook transactions in Logica shares both for himself and on Mr Willmott's behalf.

As of March 1, 2015, insider dealing prosecutions against eight other individuals remained ongoing.

The FCA's determination to push for confiscation orders against those convicted of market misconduct demonstrates its desire to ensure that in addition to any custodial sentence that may be imposed, individuals are also unable to derive any lasting monetary benefit from their misconduct. By demonstrating that insider dealing, where detected, will ultimately be a fruitless pursuit for the individual concerned (and may actually end up costing that individual money), the FCA hopes to dissuade others from engaging in similar conduct.

Similarly, the FCA's successful prosecution of Mr Rifat relied in no small part on its willingness to engage in lengthy technical analysis of trading patterns and communications in order to build a strong case and secure a guilty plea. Firms and individuals should be absolutely clear that the mere fact that an insider dealing investigation may be technically complex and expensive will not deter the FCA from doggedly pursuing the relevant case in order to set a clear example to the wider market. It is also clear that in appropriate cases, the FCA will not hesitate to use the criminal law to punish misconduct, rather than restricting itself to the exercise of its civil enforcement powers.

Civil actions

With the bulk of the LIBOR-fixing penalties having been dispensed by the FCA in 2012 and 2013, one might have expected 2014 to be a quieter year in terms of civil fines for market misconduct, with the last firms to be fined in connection with the LIBOR scandal being Martin Brokers (UK) Ltd in May 2014 (£630,000, reduced from £3,600,000 due to the firm's inability to pay) and Lloyds Bank Plc and Bank of Scotland Plc in July 2014 (with a combined penalty of £105,000,000, reduced from £150,000,000 due to early settlement).

However, November 2014 saw the FCA engage in another round of significant penalties for market misconduct, this time in connection with manipulation of spot foreign exchange ("FX") rates. The resulting fines are significantly larger than even the LIBOR-related penalties, with the £233,814,000 penalty against UBS AG (reduced by 30 per cent from an original amount of £334,020,000 for early settlement) becoming the largest single fine ever issued by the FCA. Other banks that were subjected to similarly enormous fines included Citibank NA (£225,575,000), JP Morgan Chase Bank NA (£222,166,000), HSBC Bank Plc (£216,363,000), and The Royal Bank of Scotland Plc (£217,000,000).

In each of these cases, the FCA concluded that even though spot FX trading is not a regulated activity, it nonetheless had jurisdiction to take action for beach of Principle 3 of the Principles for Businesses, which requires firms to take reasonable care to organise and control their affairs responsibly and effectively. This is because Principle 3 is one of the few Principles that also applies to unregulated activities carried on by an authorised firm, although it only applies if those activities have, or might reasonably be regarded as likely to have, a negative effect on the integrity of the UK financial system or the ability of the firm to meet

certain threshold conditions for FCA authorisation. The FCA took the view that manipulation of the FX rate risked eroding confidence in the UK financial system as a whole and, therefore, that the conduct fell within the ambit of Principle 3. This is a salutary reminder of the very wide application of the Principles and of the fact that the regulator may choose to take action solely on the basis of a breach of a Principle if no other specific infraction of a regulatory rule can be identified.

Another important aspect of the FX penalties relates to the calculation of the final penalty amount. The FCA overtly stated that in order to achieve credible deterrence, it considered that the penalty imposed for FX-rigging must, as a minimum, exceed the largest penalty imposed in relation to LIBOR-rigging (which was the £200,000,000 (before discount) fine imposed on UBS AG in December 2012). The FCA therefore added an additional £225,000,000 to the basic amount of each penalty (i.e. prior to the application of any settlement discount) imposed on the banks in the FX scandal, arguing that continuing market misconduct suggested that previous penalties had been insufficient to prevent repeat offending.

2.1 Ian Hannam (Tribunal Decision: May 27, 2014; FCA Final Notice: July 17, 2014)

2.1.1 Penalty

The Upper Tribunal directed the FCA to impose a penalty of £450,000 on Mr Hannam in connection with two instances of market abuse resulting from Mr Hannam's disclosure of price-sensitive information in two emails in September and October 2008 otherwise than in the proper course of his employment.

2.1.2 Summary

In 2008, Mr Hannam was a senior broker at JP Morgan, which acted as corporate finance adviser to Heritage Oil Plc ("Heritage"), a company listed on the London Stock Exchange which specialised in oil and gas production. At the relevant time, Heritage was engaged in a number of exploratory drilling operations to find oil, including one in Uganda. During the relevant period, Mr Hannam was close friends with the CEO of Heritage, Anthony Buckingham.

In September 2008, Mr Hannam included the following paragraphs in an email to Dr Ashti Hawrami, the Minister for Oil in the Kurdish Regional Government:

> "I thought I would update you on discussions that have been going on with a potential acquirer of Tony Buckingham's business [i.e. Heritage]. Tony, advised by myself, has deferred engaging with the client until Thursday of next week although we know they are very excited about the recent drilling results of Heritage Oil and today's announcement by Tullow. I believe the offer will come in in the current difficult market conditions at £3.50–£4.00 per share. I'm not trying to force your hand, just wanted to make you aware of what is happening."

The reference to Tullow related to Tullow Oil Plc, another oil company which had been carrying out exploratory drilling operations in Uganda near to Heritage's own exploration sites. The reference to the "potential acquirer" was a reference to Perenco, a company that was considering whether to launch a takeover bid for Heritage and which had sent a formal written indication of interest to the company.

In October 2008, Mr Hannam sent another email to Dr Hawrami, which was also blind-copied to David Ishag, an adviser to a potential investor in Heritage. So far as is relevant, that email contained the following postscript:

> "PS—Tony [i.e. Mr Buckingham] has just found oil and it is looking good."

It was subsequently agreed by both Mr Hannam and the FCA that Heritage had not located "oil" in the sense of black oil and that only certain liquid hydrocarbons which might have indicated the presence of black oil had in fact been found.

The FCA argued that by sending these two emails, Mr Hannam had committed market abuse within the meaning of s.118(3) of the FSMA (i.e. that he was an insider who had disclosed information to another person (Dr Hawrami) otherwise than in the proper course of his employment, profession, or duties). This was despite the fact that the FCA conceded that Mr Hannam did not disclose the information with the intention that it would be used for the purposes of market abuse or insider dealing. Mr Hannam also made no personal profit from the disclosures.

The Tribunal analysed each of the constituent elements of the civil offence in s.118(3) of the FSMA in considerable detail. As regards the meaning of "inside information", the Tribunal noted that the statutory definition required the information to be: (a) precise; and (b) information which would, if it were generally available, be likely to have a significant effect on the price of qualifying investments (which would include the listed equity shares in Heritage) or related investments.

2.1.2.1 Precise information

Section 118C(5) of the FSMA states that information will be "precise" if:

(a) it indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may be reasonably be expected to occur; and

(b) it is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.

The Tribunal concluded that information could be precise without being wholly accurate because it could nonetheless convey a message to the recipient which confers an advantage on that recipient that is not available to other market participants. The Tribunal endorsed a highly fact-specific approach to determining whether any particular communication contained information that was precise for these purposes. The exact content of the statement and the extent of any inaccuracies will be fundamental in determining whether the statement indicates circumstances or events which actually exist or have occurred, or which may reasonably be expected (objectively) to come into existence or to occur, such that they convey a particular "message" to the recipient. For these purposes, circumstances could "reasonably be expected" to occur if there is a realistic prospect that they will come into existence (i.e. the chances of them doing so are more than merely fanciful). The Tribunal declined to approach the assessment of this issue on the basis of specific percentage probabilities.

In relation to the "possible effect … on the price", the Tribunal's view was that the information need only enable a conclusion to be drawn about the price movement in a particular direction; it was not necessary that the information should reveal the *extent* of that price moment. It was also not necessary that the information should enable the recipient to be certain that the price of the relevant investments would definitely move if the information were generally available to the public.

2.1.2.2 Likely to have a significant effect on price

Section 118C(2) of the FSMA requires that inside information must be information which, if generally available, would be *likely to have a significant effect* on the price of the relevant investments. Section 118C(6) of the FSMA then states that information would be likely to have a significant effect on price if, *and only if*, it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions. The question is how these two provisions should be interpreted together.

Previously, the Tribunal appeared to have stated in its earlier controversial decision in *Massey v FSA* that if information was of a kind that a reasonable investor would be likely to use as part of the basis of his investment decisions, it was not necessary that the information also be of a kind that would be likely to have a significant effect on the price of the relevant securities. The Tribunal in Mr Hannam's case disagreed with that conclusion, stating that it was not clear why the earlier Tribunal had expressed its decision in that way. In its view, the correct interpretation of the two provisions, read together, is that the reasonable investor is an investor who would take into account information which would be likely to have a significant effect on price, but would ignore information which would have no effect on price at all.

The Tribunal refused to specify a particular quantitative threshold for whether a particular effect on price was "significant". As to the meaning of "likely" in this context, the Tribunal rejected the argument that this should be interpreted as "more likely than not". Instead, it stated that information would be likely to have a significant effect on price if there was a real (rather than merely fanciful or *de minimis*) prospect of that information having such an effect on the price of the relevant investments.

2.1.2.3 Disclosure in the proper course of employment

Section 118(3) of the FSMA is clear that in order to commit the offence of improper disclosure, a person must disclose inside information otherwise than in the proper course of his employment. Mr Hannam

referred to guidance published by the FSA in MAR 1.4.5G that where disclosure of inside information is accompanied by the imposition of confidentiality requirements upon the person to whom the disclosure is made and that disclosure is reasonable and is made for the purpose of enabling a person to perform the proper functions of his employment, profession, or duties, this would constitute disclosure in the proper course of employment.

The Tribunal found that the ability to disclose inside information in the proper course of one's employment was an exception to the usual prohibition on disclosure which should be interpreted narrowly. It was not the case that every email sent in the course of a person's employment could be said to be sent in the *proper course* of that employment and the disclosure of inside information in circumstances where a person's employer and client would not consent to that disclosure could never be said to have been made in the proper course.

2.1.2.4 Application to the facts

In Mr Hannam's case, the Tribunal concluded that the email sent to Dr Hawrami in September 2008 contained inside information because it indicated that there was a reasonable prospect that an offer for Heritage could be forthcoming, notwithstanding that the speculation over an offer price of between £3.50 and £4.00 per share indicated some level of uncertainty.

The information was also specific because it would have enabled Dr Hawrami to draw a conclusion about the possible effect on the price of Heritage's shares (i.e. that it would increase as a result). It was not necessary that a bid would actually be forthcoming. The Tribunal concluded that a reasonable investor would use that information as the basis of his investment decisions and that since the rise in Heritage's share price was likely to be significant, the information was inside information.

In relation to the email sent in October 2008, the Tribunal found that even though Mr Hannam's belief that Heritage had found black oil was incorrect, nonetheless the statement in the postscript did indicate circumstances which existed (i.e. that there were in fact strong indicators of the presence of black oil, as well as Mr Hannam's opinion that this was a positive development). That information was likely to have led to a significant increase in Heritage's oil price if it had generally become known to the market. As a result, the postscript could also be classified as inside information.

The Tribunal concluded that the two emails sent by Mr Hannam in September and October 2008 represented disclosures of inside information made otherwise than in the proper course of Mr Hannam's employment. The information in the September email was made in breach of the provisions of the UK Takeover Code, which was a strong indication that the disclosure was not made in the proper course of Mr Hannam's duties.

In addition, Dr Hawrami had never been made subject to an obligation of confidentiality, although Mr Hannam claimed that there had been an "understanding of confidentiality" between him and Dr Hawrami. The Tribunal concluded that Mr Hannam's assertion of such an understanding was unreliable and a mere appreciation of the importance of confidentiality could not, on its own, satisfy that requirement. Furthermore, the disclosure of the information to Dr Hawrami could not be said to be reasonable, as required by the provisions of MAR 1.4.5G, because no confidentiality requirements had been imposed and the emails could not be shown to have been a proportionate method of achieving the purpose that Mr Hannam alleged he was pursuing, namely, to encourage potential counterparties dealing with Heritage to conclude significant commercial transactions, as specified in JP Morgan's corporate finance advisory mandate.

Mr Hannam also argued that even if the disclosure of the information had been otherwise than in the proper course of his employment, he could nonetheless still rely on the defence in s.123(2) of the FSMA because: (i) he believed on reasonable grounds that he was not engaging in market abuse; and (ii) there were reasonable grounds for the FCA to be satisfied that Mr Hannam did in fact have that belief.

The Tribunal identified that there were two possible grounds on which Mr Hannam could make such an assertion: (i) he reasonably believed that the information in the emails did not constitute inside information; or (ii) he reasonably believed that, while the emails did contain inside information, the disclosure was made in the proper course of his employment. The Tribunal rejected both these grounds.

First, Mr Hannam believed that the contents of both emails were true and it was difficult to argue that the communication of what he believed to be an accurate indication of a possible offer and its likely price

or of a finding of black oil could reasonably be considered to be anything other than inside information. Secondly, it was clear that Dr Hawrami did not know of the existence of a contemplated third-party offer for Heritage or of the existence of black oil at the relevant drilling site and therefore Mr Hannam could not reasonably have concluded that providing the information to Dr Hawrami would not constitute "disclosure" of that information. Thirdly, Mr Hannam knew that Dr Hawrami was not under a strict obligation of confidentiality and, in the absence of such restrictions, it was clearly not reasonable to conclude that the disclosure could be made in the proper course of Mr Hannam's employment.

2.1.3 Lessons to be learnt

- The decision in the *Hannam* case contains a very lengthy and detailed discussion of the tests for inside information and the improper disclosure offence in s.118(3) of the FSMA and should be required reading for any person who may be required to advise on these issues.
- It is important to note that the definition of "inside information" is also important for any issuer of securities that is subject to the FCA's Disclosure and Transparency Rules ("DTRs"), as those disclosure obligations specifically cross-refer to the definition of inside information in s.118C of the FSMA. The decision in Hannam will, therefore, also be relevant to any person who is required to advise on whether an issuer should disclose price-sensitive information to comply with the requirements in the DTRs.
- The Tribunal once again confirmed that the correct standard of proof for market abuse cases is the civil standard, notwithstanding that the FCA's power to impose penalties on firms and individuals has in the past sometimes been described as a "quasi-criminal" jurisdiction.
- It is clear that any person seeking to rely on the argument that the disclosure was made in the proper course of his employment (or indeed seeking to run the defence that he reasonably believed that this was the case) will need to ensure that the recipient of the information is subject to a clear and strict duty of confidentiality. Firms should ensure that their procedures for making individuals insiders clearly provide for adequate confidentiality undertakings to be given. A mere "understanding" of confidentiality which is not supported by a concrete regulatory and/or contractual duty is insufficient.
- The Tribunal concluded that an expression of opinion (even if it is inaccurate) could constitute information indicating that circumstances or events exist or may occur and, therefore, could meet the definition of inside information. The Tribunal gave the example of an expert opinion on the reserves of oil that could be extracted from a particular oil well. Even if such an opinion were wrong, the expression of that opinion would be a fact about circumstances reasonably expected to come into existence (i.e. the level of oil that could be extracted).
- Mr Hannam argued that the provision of inside information to a person who was already in possession of that information from some other source could not constitute "disclosure" for the purposes of the improper disclosure offence in s.118(3) of the FSMA. The Tribunal did not find it necessary to express a final opinion on this point, since it concluded that Dr Hawrami had not already been in possession of all of the information in any case. However, it indicated that it would be strange if a person who provided inside information to another person and who was not aware that the recipient already knew that information could argue that he had not "disclosed" it for market abuse purposes. Nonetheless, it also speculated that the position could potentially be different if the person providing the information knew for certain that the recipient was already in possession of it and the repetition of the information did not "significantly reinforce" the existing knowledge. In the absence of clarity in this area, individuals should proceed very cautiously and should avoid disclosure of inside information to any person (whether or not that person may already be in possession of it through other means), except where this is clearly in the proper course of the individual's employment, profession or duties.

2.2 Daniel Plunkett and Barclays Bank Plc (FCA Final Notices: May 23, 2014)

2.2.1 Penalty

The FCA imposed a penalty of £96,500 (reduced by 30 per cent from £136,600 for early settlement) on Mr Plunkett and subjected him to a prohibition order preventing him from performing any function in relation to any regulated activities carried on by an authorised or exempt person. The FCA found that

Mr Plunkett had failed to act with integrity and had failed to act in accordance with proper standards of market behaviour, in breach of Statements of Principle 1 and 3 of the Statements of Principle and Code of Practice for Approved Persons ("APER"), in connection with trading designed to manipulate the price of gold during the London gold fixing.

In addition, Barclays Bank Plc ("Barclays") was subject to a fine of £26,033,500 (reduced by 30 per cent from £37,190,800 due to early settlement) for breaching Principles 3 and 8 of the Principles for Businesses through its failure to implement adequate risk management systems and its failure to manage conflicts of interest fairly in connection with the London gold fixing process.

2.2.2 Summary

The London gold fixing takes place twice on each business day—once at 10.30 am and again at 3.00 pm—by way of a conference call between the five member banks of the gold fixing panel (which include Barclays). The fixing process essentially involves submissions by the panel banks which indicate whether they would be interested in buying or selling gold at the price announced, with subsequent adjustments to the proposed price until the supply and demand of gold between the panel members is matched exactly (or is almost exactly matched, subject to a small pro-rata adjustment between members).

On June 28, 2011, Barclays entered into a long-term option contract (the "Option") with a customer which was based on the gold fixing price. Under the terms of the option, if the price of gold at the gold fixing on June 28, 2012 exceeded US$1,558.96, the customer would receive a payment of 9 per cent of the notional amount of the option. An additional payment could fall due on a later date, depending again on the gold price at that date. The notional amount of the option was approximately US$43 million and the customer paid a premium of US$4.4 million to Barclays in return for the option being issued.

Mr Plunkett was a senior individual on the Precious Metals Desk within Barclays and held the CF30 (customer) controlled function. He was responsible for pricing and managing the risk associated with a number of products linked to the price of precious metals, including the Option. As a result, Mr Plunkett was familiar with the terms of the Option under which amounts could become payable to the customer.

During the gold fixing on June 28, 2012 (the date on which payment could become due to the customer if the gold price fixed above US$1,558.96), the proposed price had reached US$1,558.50 and was therefore hovering very close to the level that would trigger Barclays's obligation to make the payment. Mr Plunkett submitted a large sell order of between 100 and 150 bars of gold to Barclays's representative at the fixing. That sell order became part of Barclays's net trading position, resulting in Barclays making a declaration that it would be willing to sell 130 bars of gold at that price. The FCA alleged that Mr Plunkett's purpose in making this order was to increase the likelihood that the price of gold would fix at or below the proposed level of US$1,558.50, thereby avoiding the trigger for payment under the Option.

Once all declarations of interest had been made at the proposed price of US$1558.50, the level of gold selling was significantly larger than the level of buying, with a net selling position of 190 bars. At this point, it appeared that the price of gold at the fixing was, therefore, likely to fix below that level and therefore Mr Plunkett withdrew his entire sell order, thereby causing Barclays's representative to withdraw Barclays's entire selling submission of 130 bars.

A few minutes later, external events led to a sudden spike in the level of buying interest at the proposed price of US$1,558.50 which in turn led to an overall net buying position amongst panel members of 110 bars, suggesting that the final fixing price could increase above the proposed level. Mr Plunkett immediately placed another large selling order of 150 bars, leading to Barclays declaring itself to be a net seller of 100 bars. That submission brought the level of declared supply and demand amongst the panel members to sufficient equilibrium so that the price fixed at US$1,558.50. Barclays therefore avoided the payment that might otherwise have been due to the customer under the Option and Mr Plunkett's trading desk made a profit of US$1.75 million as a result. Shortly after the gold fixing had occurred, Mr Plunkett entered into an internal trade within Barclays to close the open position created by his large selling order of 150 bars of gold. This led to an immediate loss on his trading book of US$114,000.

The customer subsequently sought an explanation of what had happened to cause the price to fix at the relevant level during the gold fixing. Mr Plunkett did not disclose his own trading activities to the customer,

although he did subsequently disclose them to his manager and to Barclays's compliance department a few days later. When Barclays carried out an internal investigation, Mr Plunkett claimed that he had traded for reasons other than a desire to manipulate the price of the gold fixing and he maintained that position during questioning by the FCA. Barclays subsequently voluntarily repaid the customer the amount that would have been due if the gold price had exceeded the trigger level under the Option.

The FCA found that Mr Plunkett's trading on June 28, 2012 had clearly been carried out with the intention of fixing the price of gold below the trigger price for a payment under the Option. His conduct clearly fell below the standards of honesty and integrity expected of a person in the financial industry and he had put his own interests ahead of those of his customer. He had also risked the integrity of the UK financial markets by manipulating the gold fixing and had deliberately provided an untruthful account to the FCA during the course of its investigations. As a result, the FCA concluded that Mr Plunkett was clearly not a fit and proper person to continue to be involved in the provision of any regulated activities.

The FCA also found that Barclays had failed to create or implement policies that were adequate for the proper management of traders' participation in the gold fixing and had inadequate systems and controls for monitoring activity in connection with the fixing process. Barclays had not taken reasonable steps to mitigate the conflicts of interest that were posed by having individuals selling options to customers which referenced the gold fixing price while those same individuals could also contribute to Barclays's submissions during the fixing itself. In addition, there was inadequate training for members of the precious metals desk in order to identify these issues. The FCA found that training focused primarily on the mechanics of trading during the gold fixing and was not sufficiently tailored so as to provide adequate guidelines for traders' individual behaviour.

2.2.3 Lessons to be learnt

- This is another clear example that serious dishonesty will almost invariably result in an individual being made subject to a prohibition order so that (s)he can no longer work in the financial services industry.
- The fact that Mr Plunkett lied to his employer and to the FCA in the course of their investigations, and the fact that his conduct was deliberate, were both aggravating factors identified in the FCA's final notice. Even in the absence of any other dishonest conduct, the FCA and the Upper Tribunal have previously emphasised that deliberately deceiving the regulator will almost always be grounds for a prohibition order since it is in itself clear evidence of a lack of integrity.
- The significant fine against Barclays is a clear indication of the FCA's increasing intolerance for firms failing to ensure the proper oversight of their employees' activities and particularly for failing to address conflicts of interest properly. Firms should ensure that their employees are given clear training on required standards of conduct and that their policies and procedures give relevant, practical guidance and are reinforced by a sufficiently resourced compliance oversight function.

3. Failure to operate adequate systems and controls

3.1 The Royal Bank of Scotland Plc, National Westminster Bank Plc, and Ulster Bank Ltd (FCA and PRA Final Notices: November 19, 2014)

3.1.1 Penalty

The Royal Bank of Scotland Plc ("RBS"), National Westminster Bank Plc ("NatWest"), and Ulster Bank Ltd ("Ulster") (together, the "RBS Group") were subject to a combined FCA penalty of £42,000,000 and a combined PRA penalty of £14,000,000 for breach of Principle 3 of the Principles for Businesses due to the failure to operate adequate systems and controls to mitigate the risk of disruption caused by IT failure in June and July 2012. Both of these penalties were reduced by 30 per cent (from original amounts of £60,000,000 and £20,000,000 respectively) for early settlement.

3.1.2 Summary

The RBS Group relied on "batch scheduling" software to process the large numbers of transactions involving their clients' accounts that occurred during the day. Each evening, the software automatically

coordinated the order in which individual updates to the accounts were processed so as to ensure that deposits, withdrawals, scheduled payments and other account activity were applied in the correct sequence.

On June 17, 2012, an RBS Group IT technician updated the software for the batch scheduling systems used by NatWest and Ulster by installing a new software version. When the scheduler subsequently began to process batches of the account updates in the evening of June 18, the system performed more slowly than usual, leading to certain batch failures whereby some customers' accounts were not updated. These failed batches had to be entered into the update system manually to correct the problem.

On June 19, to avoid a repeat of these difficulties, RBS Group's Technology Services department decided to uninstall the latest version of the batch scheduler and revert to the previous version. However, this caused an unexpected software compatibility problem due to a software patch that had been contained in the later version of the scheduling software. In turn, this led to a large number of unprocessed batches building up within the system. RBS Group's technical staff were able to resolve the backlog of updates for NatWest accounts by intervening manually, but by June 20 this left batches relating to Ulster's customers from the previous day still unprocessed. The backlog then began to build steadily, causing further IT difficulties as batches from multiple days built up.

RBS operated a separate batch scheduler, but RBS accounts were still affected because updates to those accounts also relied upon information supplied from NatWest and Ulster, whose accounts were no longer being properly updated.

The RBS Group's technicians were able to restore RBS's and NatWest's batch scheduling systems to an acceptable level of functionality by June 25, 2012, although some manual updates were still required. However, Ulster's batch scheduling system was not fully operational again until July 10, 2012.

Throughout this period, the IT failures within the RBS Group led, amongst other things, to the following consequences:

- Some RBS Group customers found that incorrect account balances were displayed when using ATM machines, leading to some customers' accounts becoming overdrawn because credits to the account had not been applied and other customers being unable to withdraw cash at all.
- Online accounts were sometimes unavailable and both online and telephone accounts suffered from incorrect account balances, preventing certain transactions.
- Point of sale transactions involving debit cards were affected because the transaction amount was sometimes being checked against an incorrect account balance which could lead to authorisation being declined. The RBS Group put in place a "stand-in" limit for customers of up to £200, but this did not fully mitigate the problem.

In total, at least 6.5 million customers of the RBS Group were affected, leading to the RBS Group having to pay £70.3 million in redress to its UK customers and £460,000 in redress to other consumers who were not its customers.

Separately, the PRA stated that it had become involved in the investigation because the IT failure could have affected the stability of the wider UK financial system as third parties were also adversely affected. It stressed that banks must have proper systems in place to prevent operational failures which would affect their core business and their ability to continue providing critical financial services.

3.1.3 Lessons to be learnt

- The FCA and PRA are increasingly becoming concerned about the stability and security of firms' IT systems as these are frequently central to a firm's ability to continue providing services to its customers effectively. In the case of large institutions, these systems may also have a wider systemic importance in the general financial markets, increasing the likelihood that any resulting penalty will be more severe due to the potential wider range of harm that such a failure could cause.
- The FCA concluded that the RBS Group had a limited understanding of IT operational risk and that its "three lines of defence" (Technology Services, Business Services, and Group Internal Audit) did not take sufficient care to control IT risks responsibly or effectively. It is important that firms do not treat IT

issues as solely the responsibility of a back-office technical team. The FCA expects that there will be proper oversight of IT systems and that a firm's management should understand the risks that may be posed by potential IT failures and should ensure that adequate resources are allocated to mitigating such risks properly.

3.2 Invesco Asset Management Ltd and Invesco Fund Managers Ltd (FCA Final Notice: April 24, 2014)

3.2.1 Penalty

Invesco Asset Management Ltd ("IAML") and Invesco Fund Managers Ltd ("IFML") were subject to a joint financial penalty of £18,643,000 (reduced by 30 per cent from £26,632,900 for early settlement) for breaching Principles 3 and 7 of the Principles for Businesses by failing to operate adequate systems and controls to ensure compliance with investment limits, to record trades in a timely manner and to ensure funds were valued accurately and trades were fairly allocated as between funds.

3.2.2 Summary

Between May 2008 and November 2012, IAML and IFML were responsible for managing, amongst others, a range of retail funds with combined assets under management of approximately £47 billion. IFML was the authorised corporate director of the relevant authorised funds, but it had delegated its portfolio management responsibilities to IAML, although it remained responsible for the funds' compliance with the applicable FSA rules. Both firms were authorised by the FSA during the relevant period.

IAML entered into a number of trades during the period which caused the funds to breach certain applicable investment restrictions set out in the Collective Investment Schemes ("COLL") sourcebook. The purpose of those restrictions is to ensure that authorised funds are subject to the requirement to invest so as to ensure a prudent spread of risk, but IAML's trading activities meant that these limits were breached on 33 different occasions in relation to investments funds which, in aggregate, represented more than £35 billion of assets under management. Some of these breaches resulted from unavoidable price increases in listed securities held by the funds, but these were then exacerbated by further purchases of those securities, rather than the funds reducing their exposure.

A number of the funds used derivatives which introduced a total of approximately £1 billion of leverage into the funds. IFML and IAML failed to make adequate disclosure of the risks associated with the use of such derivatives to investors, meaning that investors may have invested their money without a full appreciation of the level of risk that they were assuming.

As the relevant funds were UCITS funds, from February 2012 onwards, IFML was responsible for producing a Key Investor Information Document ("KIID") in relation to each fund, explaining the essential characteristics of that fund. Prior to that date, the firm was required to produce a simplified prospectus in relation to those funds instead. In the FCA's view, investors were likely to rely on the simplified prospectus or KIID when making decisions about whether to invest in the fund and, therefore, it was vital that the document was clear, fair, and not misleading, and also complied with the specific rules relating to its format and content. Although the full fund prospectuses referred to the possibility of the funds using derivatives, the simplified prospectuses issued by IFML did not make any reference to the use of such instruments when setting out the classes of permitted investments and therefore omitted important information. The KIIDs for the relevant funds did refer to the possible use of derivatives, but the FCA found that they did not do so in a balanced way because the language used suggested that derivatives would reduce the fund's overall risk and did not refer to the downside risks involved. The FCA also concluded that inadequate risk disclosures could have meant that IFML and IAML gained an unfair competitive advantage over other fund managers because they may have attracted investors who would not otherwise have invested if the disclosures had been complete.

Between May 2008 and May 2012, IFML and IAML also failed to ensure that a number of trades in their fixed income business were recorded in a timely manner, thereby resulting in the risk that the funds may have been priced inaccurately because the trades were not included in their net asset value calculation. In addition, the firms failed to ensure that there were adequate controls in place to ensure that partially

executed bulk trades were allocated fairly between funds. The manual system used by IFML and IAML meant that there were insufficient records to monitor how fund managers had allocated such trades or their basis for doing so, leading to the risk that investors in certain funds could have been disadvantaged.

3.2.3 Lessons to be learnt

- IAML and IFML's failings are clear evidence of how inaccurate record keeping can lead to a number of other serious failings. In the present case, such failures were responsible for funds being incorrectly valued and for the possibility that investors were ultimately misled. Firms should not underestimate the importance of investing in systems and controls to ensure that data is correctly captured to allow proper monitoring of their business activities.
- The FCA is increasingly beginning to consider how regulatory failures may also have an impact on its competition objective. In the present case, it expressed concern that misleading disclosures by an investment manager may lead to an unfair advantage in the marketplace as investors may choose that manager over competitors on the basis of incorrect information. The FCA may therefore conclude that a firm's activities may have the effect of both harming its clients and distorting the market more generally.
- The present case is also a clear demonstration of the importance that the FCA places on the accuracy of disclosures to investors or clients. In addition to the potential civil (and in certain cases, criminal) liability that may exist under statute for misleading statements, firms face large potential penalties if their marketing materials are not clear and balanced and risks are not properly highlighted.

4. Failure to provide adequate protection for client money or assets

4.1 Barclays Bank Plc (FCA Final Notice: September 23, 2014)

4.1.1 Penalty

Barclays Bank Plc ("Barclays") was fined £37,745,000 (reduced by 30 per cent from the original penalty of £53,921,619 for early settlement) for breaching Principles 3 and 10 of the Principles for Businesses through its failure to take reasonable care to establish adequate and effective controls in relation to the ongoing operation and monitoring of external custody accounts at third party sub-custodians and its failure to arrange adequate protection for custody assets in respect of which it acted as custodian or sub-custodian. Barclays was also found to have breached a number of specific requirements in the Client Assets sourcebook ("CASS").

4.1.2 Summary

Barclays's failings took place between November 2007 and January 2012 in connection with its provision of custody services to a mix of professional clients, eligible counterparties, and certain subsidiaries (the "Affiliates") within the Barclays corporate group.

During that period, it was common for the Affiliates to request that Barclays open custody accounts under its existing agreements with third party sub-custodians in order that the Affiliates could hold their own assets, and those of their clients, within such accounts. In a number of cases, Barclays's custody records did not record that the particular custody accounts had been opened under its agreement with the relevant sub-custodians and, therefore, that it was the entity responsible for the assets that had been deposited within the accounts (i.e. it was acting as a custodian in connection with the assets of Affiliates and as a sub-custodian in connection with the assets belonging to the clients of those Affiliates). Due to this oversight, Barclays did not perform internal or external reconciliations in relation to those accounts, although the Affiliates did maintain their own records in relation to the relevant assets and carried out regular reconciliations.

In June 2011, Barclays's external advisers concluded that its lack of records in respect of the accounts used by the Affiliates and its failure to undertake regular reconciliations was in breach of the requirements in CASS. Barclays subsequently notified the FCA of this and began a remediation programme, although it took over eight months to identify the relevant accounts that were affected due to poor internal record keeping. The affected accounts were located in 21 different jurisdictions, containing in aggregate approximately £13.5 billion of assets belonging to the Affiliates and £2.7 billion of assets belonging to the clients of Affiliates.

During the course of the FCA's investigation, additional weaknesses were identified in relation to Barclays's custody arrangements, including a failure to ensure that documented custody agreements were in place in connection with certain custody accounts and a failure to obtain letters from the third-party sub-custodians acknowledging that those custodians had no lien or right of set-off over the assets held in the accounts. As a result, there was a risk that the sub-custodians would have sought to assert rights to the custody assets in the event of Barclays's insolvency. In addition, the FCA identified that Barclays's conventions for naming the custody accounts led to names that were often misleading, with certain account names failing to identify either Barclays or the underlying Affiliate. Barclays had also submitted inaccurate monthly Client Money and Asset Returns to the FSA during the relevant period.

4.1.3 Lessons to be learnt

- The Barclays final notice specifically states that the FCA considered that it was important to continue sending a "strong message" to the industry that compliance with the CASS rules is a fundamental obligation. It should come as no surprise that enforcement actions for CASS breaches continue to be a regular occurrence. The FCA is determined to demonstrate that this is a key regulatory priority.
- The plethora of enforcement actions in the last few years against firms for breach of the CASS requirements, as well as a previous enforcement action against a subsidiary of Barclays for a breach of those rules, were cited as an aggravating factor in the determination of the final penalty, leading to a 20 per cent uplift in the final amount. This is a clear demonstration that any firms making similar mistakes in the future should expect a large penalty in furtherance of the FCA's objective of credible deterrence.
- Although Barclays's failings did not lead to any actual losses for the Affiliates or their underlying clients and there was no suggestion that Barclays was ever at risk of insolvency during the relevant period, the FCA continues to take the view that the theoretical risk of such losses is sufficient to justify very large penalties. Therefore, firms need to ensure that they comply with the specific regulatory rules and cannot merely satisfy themselves that in practice there may be little actual risk to their clients' money or assets.
- Firms must ensure that they understand the legal and regulatory effect of their custody or client money arrangements and the capacity in which they are acting in any given circumstance. Barclays's failure to appreciate that it was acting in the capacity of custodian or sub-custodian in relation to the assets of the Affiliates and their clients led to a lack of understanding about the particular rules with which it was required to comply.

4.2 Pritchard Stockbrokers Ltd (In Special Administration), David Gillespie, and David Welsby (FCA Final Notices: October 9, 2014)

4.2.1 Penalty

Pritchard Stockbrokers Ltd (In Special Administration) ("Pritchard") was subject to a statement of censure for breaching Principles 1, 2 and 10 of the Principles for Businesses in connection with its reckless failure to provide adequate protection for client money for which it was responsible. The FCA indicated that were it not for Pritchard's financial position, it would have imposed a financial penalty of £4,932,600 on the firm.

Mr Gillespie was subject to a financial penalty of £10,500 (after a 30 per cent settlement discount) for breach of Statements of Principle 1 and 6 of APER. The FCA indicated that this would have been a penalty of £144,000 (reduced to £100,800 for early settlement), but for evidence that Mr Gillespie would have suffered serious financial hardship as a result. In addition, his approval to perform the CF1 (Director) controlled function at Pritchard was withdrawn and he was subjected to a prohibition order preventing him from performing any function in relation to any regulated activity carried on by an authorised person or exempt person.

Mr Welsby was fined £14,000 (after a 30 per cent settlement discount) for breaching Statement of Principle 1 of APER, although the FCA indicated that this would have been a penalty of £72,000 (reduced to £50,400 for early settlement), but for evidence that this would have resulted in financial hardship. In

addition, Mr Welsby's approval to perform the CF1 (Director) controlled function at Pritchard was also withdrawn and he was subjected to a prohibition order preventing him from performing any function in relation to any regulated activity carried on by an authorised person or exempt person.

4.2.2 Summary

Between July 2010 and February 2012, Pritchard provided stockbroking and wealth management services to over 11,000 customers and managed in excess of £26 million on behalf of its clients. During that period, Mr Gillespie was the managing director of Pritchard (holding the CF1 (Director) and CF3 (Chief Executive) functions) and was also responsible for the CASS operational oversight (CF10a) function. Mr Welsby acted as the finance director and was therefore approved to perform the CF1 function.

Since 2009, Pritchard had been experiencing financial difficulties and this had resulted in it using certain client money to meet its ongoing business expenses, in clear breach of the then FSA's rules. Thereafter, Pritchard's daily client money reconciliations almost invariably showed a client money shortfall, which eventually reached over £2.6 million. The CASS rules required Pritchard to transfer an amount from its own funds to the client account to cover the shortfall or, if this was not possible, to notify the FSA immediately that a client money shortfall had been identified. However, instead of making this notification, Pritchard merely made a record of the amount that it was unable to cover, first in manuscript and later in electronic form.

When interviewed about the situation, Mr Gillespie stated that Pritchard had put in place a support facility from an offshore third party which was designed to cover the resulting client money shortfall. The offshore facility was described as being a sum held by a UK law firm in an escrow account on behalf of an offshore company which would be available to Pritchard on demand. The FCA found that even if such a sum had existed, the CASS rules do not permit a firm to hold client money in an escrow account of a law firm and, therefore, the relevant amount could not properly have been classified as client money for the purposes of Pritchard's required client money reconciliations.

However, the FCA also found that there was, in any case, no credible evidence that the offshore facility actually existed, at least in the form that Mr Gillespie contended. Pritchard was unable to provide any contractual documentation demonstrating the existence of the sum and had apparently relied on verbal assurances provided by a third party (who was a director of one of Pritchard's trading counterparties) to Mr Gillespie. Mr Gillespie had then convinced Mr Welsby that those assurances were sufficient. The absence of any legally binding written documents led the FCA to conclude that Mr Gillespie had no proper basis for his (in any case, erroneous) belief that the client money shortfall had been adequately covered during the period and, therefore, had acted recklessly. The FCA also found evidence of correspondence between Mr Gillespie and a solicitor acting for the overseas third party which indicated that the release of any funds in the future was subject to certain conditions, although Mr Gillespie had not informed Mr Welsby that this was the case.

The FCA concluded that Mr Gillespie had accepted the CF10a function without properly understanding the duties that the role entailed or the rules relating to the correct treatment of client money. In addition, he had incorrectly provided an attestation to the FSA in June 2010 that Pritchard was in full compliance with its obligations under the CASS rules.

The FCA found that in the course of acting as Pritchard's finance director, Mr Welsby had been reckless in accepting Mr Gillespie's assurances and failing to seek verification that the offshore facility existed and was unconditionally available and that it properly qualified for inclusion in the client money calculation. As a consequence of Mr Welsby's failings, client money continued to be used to pay Pritchard's business expenses in violation of the rules in CASS.

Ultimately, Pritchard was placed into special administration following an intervention by the FSA, leading to a final client money shortfall of approximately £3 million. In turn, this resulted in the Financial Services Compensation Scheme having to compensate Pritchard's clients, although certain customers could not be fully compensated because their losses exceeded the maximum permitted claim amount under the scheme.

4.2.3 Lessons to be learnt

- Although Mr Gillespie's failings were obvious and egregious in nature, the case also demonstrates that other individuals performing important functions within a firm need to take appropriate steps to ensure that they fully understand the firm's operations in so far as these fall within their area of responsibility, rather than relying only upon assurances from other senior individuals. The extent to which an individual may be found blameworthy for failing to identify and challenge false assurances from a senior colleague may be a question of degree depending upon the specific facts of the situation, but in the instant case Mr Welsby was responsible for the firm's overall financial situation and should have investigated the position in relation to the offshore facility in further detail.
- The FCA is increasingly using attestations as a preliminary form of "self-policing" to force firms to assess their own compliance with the regulatory rules and then to use those attestations in future enforcement actions where there has been a breach. In the present case, the fact that Mr Gillespie had incorrectly attested to the FSA that Pritchard was complying with the CASS rules was clearly viewed as an aggravating factor. Accordingly, firms should be aware that attestations should not be made lightly, as an inaccurate attestation may seriously exacerbate the penalty imposed for any relevant regulatory breach that is subsequently identified.
- It is critical that any person who is approved to carry out a controlled function fully understands the nature of his or her duties and the relevant regulatory requirements. The FCA found that Mr Gillespie had accepted the CF10a role without appreciating the resulting responsibilities and accordingly had failed to exercise the due care, skill, and diligence required when carrying out the CASS oversight function. An individual should take appointment to a controlled function seriously, particularly because of the FCA's increasing focus on identifying personal responsibility amongst individuals whose responsibilities include oversight of the business areas in which failings have occurred.
- Although the FCA had not alleged that either Mr Gillespie or Mr Welsby had acted dishonestly, their failures were serious enough to constitute recklessness, which, in turn, formed the basis of a finding that both men had failed to act with integrity. Since a finding that an individual lacks integrity will almost inevitably lead to the FCA making that person subject to a prohibition order, it is important to note that a reckless disregard for compliance with regulatory requirements can easily lead to the end of a person's career in the financial services industry (see also the Arch Financial Products case below).

5. Failure to manage conflicts of interest fairly

5.1 Sesame Ltd (FCA Final Notice: October 29, 2014)

5.1.1 Penalty

Sesame Ltd ("Sesame") was fined £1,598,000 (reduced by 30 per cent from an original penalty of £2,282,902 due to early settlement) for failing to manage a conflict of interest between its commercial interests and its customers' best interests fairly, thereby breaching Principle 8 of the Principles for Businesses and certain requirements in the Conduct of Business sourcebook ("COBS").

5.1.2 Summary

In 2006, the then FSA began its Retail Distribution Review ("RDR"), which was an examination of the retail investment market with a particular focus on the quality of investment advice that was received by consumers. The findings from the RDR led to a range of new rules that firms were required to implement by the end of 2012, including a ban on commission payments from product providers to financial advisers (except in very limited circumstances). The purpose of that ban was to remove any conscious or unconscious incentive on the part of financial advisers to recommend certain products which would result in a payment from the provider to the adviser, but which might be unsuitable for the relevant customer.

Sesame is the UK's largest network of financial advisers and provides advice to retail customers in relation to a range of investment products. Other companies within Sesame's group provide other services to investment product providers, including marketing services, IT development, and data and research products.

In July 2012, Sesame decided to restructure its business so that its advisers would only provide advice on a restricted basis, rather than on an independent basis (i.e. its investment advice would relate only to a limited range of pre-selected investment products and not to a broader population of products identified through a survey of the wider market). In order to determine the restricted range of products in relation to which Sesame would provide investment advice, Sesame undertook a selection process by requesting information from certain product providers who already purchased services provided by other members of the Sesame group. A subsequent invitation to tender requested information from the selected providers about whether, and to what extent, they were prepared to purchase additional services from Sesame's affiliates. Sesame also indicated to certain product providers during the tendering process that if they wished to gain a place on the panel of products in relation to which Sesame would provide investment advice, they were expected to purchase additional services worth at least £250,000 from the Sesame group.

The FCA found that by operating a "pay-to-play" arrangement of this type, Sesame had prioritised its own commercial interests over those of its customers and had failed to manage the resulting conflict of interests in any way and certainly not to the standard of fairness required by the FCA rules. The serious effects of that conflict were exacerbated because a product provider's appointment to Sesame's panel lasted for five years, meaning that if the product was unsuitable for Sesame's retail customer base, it would nonetheless continue to be included in the range of products in relation to which Sesame would provide investment advice for a considerable period. Sesame also failed to disclose to its customers that other members of the Sesame group were receiving payments from some of the providers of products that formed part of its product panel, preventing those customers from considering whether Sesame's advice could have been adversely influenced by such payments.

5.1.3 Lessons to be learnt

- The FCA is increasingly focusing on conflicts of interest across all market areas and on whether firms are addressing conflicts fairly so as to avoid detriment to their customers. Although the RDR is a specific example of an initiative designed to address certain conflicts that were previously embedded in the structure of the retail investment advice market, the Sesame case is a more general reminder that firms need to consider the effect of their commercial arrangements carefully to ensure that they do not create significant risks of conflicts or that if they do, adequate steps are taken to mitigate these.
- The FCA referred, in the Sesame final notice, to previous publications of the FSA giving guidance on the specific requirements of the RDR and highlighting certain concerns, as well as specific concerns that the FSA had made clear to Sesame during the course of an earlier thematic review. These, coupled with previous enforcement action against Sesame, led the FCA to increase the size of the penalty by 40 per cent. Again, this is a clear reminder that where the FCA has previously taken steps to alert the industry to the importance of specific regulatory requirements, firms which do not heed that advice and continue to fall below the required standards should expect to be penalised severely.

5.2 Arch Financial Products LLP, Robin Farrell, and Robert Addison (Tribunal Decision: January 19, 2015)

5.2.1 Penalty

The Upper Tribunal directed the FCA to publish a statement of censure in respect of Arch Financial Products LLP ("AFP") relating to its contravention of Principles 1, 3 and 8 of the Principles for Businesses and connected rules in the COBS and Senior Management Arrangements, Systems and Controls ("SYSC") sourcebooks. These contraventions related to failures to ensure the fair management of conflicts of interest between the firm and funds that it managed and between the different funds themselves. The Tribunal also stated that it would have directed the FCA to impose a £9 million penalty on AFP had it not been for the firm's financial position at the time of the decision.

In addition, the Tribunal directed that Mr Farrell be subject to a financial penalty of £650,000 and that Mr Addison be subject to a financial penalty of £200,000, with both individuals also being made subject to prohibition orders preventing them from performing any function in relation to any regulated activity carried on by any authorised or exempt person. These penalties were the result of Mr Farrell and Mr Addison breaching Statements of Principle 1 and 7 of APER by failing to take reasonable steps to ensure

AFP's compliance with applicable regulatory requirements and failing to act with integrity in connection with the operation of certain investment funds.

5.2.2 Summary

The decision in respect of AFP, Mr Farrell and Mr Addison is the latest in the long-running line of cases and regulatory decisions in connection with the operation and eventual suspension of the CF Arch Cru Diversified Funds and the CF Arch Cru Investment Funds (together, the "UK Funds") between 2006 and 2009. Mr Farrell acted as the chief executive of AFP throughout that period, while Mr Addison acted as the firm's chief operating officer and compliance officer.

The UK Funds were both UK non-UCITS retail schemes ("NURSs") constituted as open-ended investment companies ("OEICs") in respect of which Capita Financial Managers Ltd ("Capita") acted as the authorised corporate director. Capita had delegated the management of the funds' investment portfolios to AFP, granting AFP complete discretion over the UK Funds' investments, subject to compliance with the applicable FSA rules and the specific requirements relating to OEICs and NURSs.

In mid-2006, AFP became interested in a new fund structure in Guernsey whereby a closed-ended investment fund could be established as a company with a number of individual cells, each having separate legal personality and pursuing separate investment objectives. The shares in these individual cells could be listed on the Channel Islands Stock Exchange ("CISX") and therefore could qualify as "transferable securities" for the purposes of the eligible investments restrictions applicable to a NURS. This was advantageous because the NURS regime normally permitted only very limited investment in other investment funds as these are usually considered to be high risk, illiquid investments, but investment in shares of a listed, closed-ended fund meeting the definition of "transferable securities" was essentially treated as equivalent to investing in liquid equities listed on the Main Market of the London Stock Exchange. As a result, such investment was not subject to an investment cap, save in respect of concentration rules which prevented investment of more than 10 per cent of the NURS's assets in a single issuer. However, since each separate cell in the Guernsey funds had separate legal personality, each could be treated as a separate issuer for these purposes. The NURS restrictions did not stipulate that the issuer of the eligible transferable securities itself had to invest in particular types of assets, thereby allowing the NURS to take indirect exposure to high risk, illiquid alternative investment classes in which it was not permitted to invest directly.

In order to take advantage of this, AFP established a Guernsey cell company in late 2006 which operated a number of separate cells (the "Guernsey Cells"), with AFP acting as the investment manager for each cell. Two individuals, Mr Radford and Mr Meader, were appointed as the directors of the Guernsey company.

In early 2007, AFP adopted an investment strategy whereby the UK Funds would invest predominantly in the Guernsey Cells in order to gain exposure to particular new alternative asset classes. AFP effectively treated the Guernsey Cells as investment vehicles that represented extensions of the UK Funds, rather than viewing them as legally separate funds in their own right. This was despite the fact that certain Guernsey Cells, being listed on the CISX, had attracted direct external investors who were unconnected with the UK Funds and therefore it should have been clear that there could not have been a complete alignment of interests between the various entities. The Tribunal found that this approach had led AFP to adopt a number of decisions where there were clear conflicts of interest between the UK Funds and the Guernsey Cells and/or between AFP and both sets of funds. In particular, these included the following:

- AFP made an investment of approximately £1.17 million on behalf of the Guernsey Cells in AFP's parent company, AGL, followed shortly thereafter by a decision that the Guernsey Cells would pay approximately £500,000 to buy further shares in AGL from Mr Farrell personally. No independent valuation was carried out to support the price paid for either investment.

  There was a clear conflict of interest between AFP and Mr Farrell's interests in securing the highest possible price to maximise the amount AGL and Mr Farrell received and the Guernsey Cells' interests in the lowest possible price for the same investment.

- Five Guernsey Cells made a series of debt and equity investments in Cru Investment Management Ltd, which was an entity with whom AFP had entered into a distribution agreement under which Cru's

network of IFAs would introduce investors to investment products that AFP offered. In relation to the equity investments, the Guernsey Cells subscribed for new shares in Cru a few months after Cru's directors had initially acquired shares in the company. The subscription price paid by the Guernsey Cells was many multiples of the price previously paid by the Cru directors.

There was an obvious conflict in this situation through AFP's relationship with Cru, particularly because the Tribunal noted that the two businesses were, in effect, mutually dependent because the distribution agreement was a major asset for both. There was, therefore, a clear risk that AFP might, deliberately or unconsciously, choose to favour Cru's interests over those of the Guernsey Cells on whose behalf it invested in Cru.

- AFP entered into agreements on behalf of a number of the Guernsey Cells whereby the Guernsey Cells lent approximately £20.2 million to a company called Lonscale that was set up by an associate of Mr Farrell, which in turn used the money to acquire a separate business. AFP acted as Lonscale's corporate finance adviser in connection with the acquisition and was remunerated through a conditional fee arrangement that meant that AFP would be paid only if the acquisition completed.

There was a clear risk that AFP's judgement could be unduly influenced by its desire to ensure that the Lonscale transaction completed in order to receive the fees, whereas it was in the interests of the Guernsey Cells to secure the best possible terms for the loans.

- AFP decided to invest the funds of a number of Guernsey Cells in a property company, Nice, in which AGL was also making an investment. The Guernsey Cells purchased a 15 per cent interest in Nice for £3.75 million and paid a further £0.75 million for a 15 per cent investment in another vehicle associated with Nice. The valuation of the Nice shares used to calculate the subscription price was agreed between Nice and AGL. Shareholders in AGL transferred 2 per cent of their shareholdings in exchange for the issuance to AGL of a 5 per cent interest in Nice and a 5 per cent interest in the associated vehicle. AGL's nominee company paid £1 for an issue of equity warrants in respect of Nice's shares. AGL and Nice also entered into an advisory agreement whereby they would both share property advisory fees arising from certain properties that were managed by Nice. A few months later, Mr Farrell became a director of Nice and also assumed the role of chairman of the company. Shortly afterwards, another of the Guernsey Cells provided a £1.5 million debt facility to Nice, while the warrants purchased by AGL's nominee were sold to two of the Guernsey Cells for £50,000. Six months later, two of the Guernsey Cells that had not previously invested in Nice (Cells PF3 and RE3) entered into two loan agreements with the company for £1.1 million in total in order to assist Nice when it ran into financial difficulties.

There were a number of obvious conflicts inherent in these arrangements. First, since other entities in AFP's group were investing in Nice alongside the Guernsey Cells, there was a clear risk that the AFP entities would obtain better terms than the Guernsey Cells on whose behalf AFP was acting as agent. There was a serious risk inherent in the fact that it was AGL that had agreed the valuation price for the Guernsey Cells' subscription for Nice shares, whereas AGL had not paid the same cash amount, but had instead acquired an interest in Nice in exchange for its own shares. Secondly, the sale of the warrants by AGL's nominee company to the Guernsey Cells involved a direct conflict whereby it was in AGL's interest to maximise the sale price, whereas the interest of the Guernsey Cells was clearly to acquire the warrants on the best possible terms. There was only a period of around six months between the purchase of the warrants by AGL's nominee company for £1 and their onwards sale to the two Guernsey Cells for £50,000. Thirdly, there was a conflict between certain of the Guernsey Cells, since the purpose of the loans made by Cells PF3 and RE3 was to provide funds to Nice in order to help protect the value of the prior equity investments made by the other Guernsey Cells. Since AGL also held shares in Nice, it also benefited from the provision of that funding. There was an obvious risk that it might not be in Cell PF3 and RE3's interests to make such a loan or, at least, to make such a loan on the terms agreed.

In connection with these transactions, the Tribunal identified a significant number of failings attributable to AFP, Mr Farrell and Mr Addison, including the following:

- Mr Farrell chaired AFP's investment committee and was the dominant decision maker. This meant that the committee did not act as a proper check on whether particular transactions were in the best interests of the UK Funds or the Guernsey Cells.

- There were conflicts of interest embedded throughout the structure of AFP's business. For example, the investment committee was approving transactions on behalf of the UK Funds and Guernsey Cells where AFP had a direct financial interest in the outcome of the particular investment decisions. Mr Farrell also had personal interests in the outcome of certain decisions.
- AFP's compliance manual was generic and did not give specific guidance in relation to the types of conflicts of interest that might arise in the context of AFP's business or how to manage those appropriately. AFP's conflicts of interest policy throughout most of the period was a framework document which largely contained "high level standards". AFP relied heavily on an "independence policy", which required staff members to disregard any material conflict of interest when giving advice or taking decisions, but failed to give any guidance on what this meant in practice.
- There was a lack of clear records of any disclosures in connection with conflicts of interest and there was no centralised system for recording the existence of conflicts or the action taken in connection with them.
- AFP, Mr Farrell and Mr Addison sought to rely on the fact that the transactions entered into on behalf of the Guernsey Cells had been disclosed to, and approved by, Mr Radford and Mr Meader in their capacities as the directors of the Guernsey cell company. However, the Tribunal noted that Mr Radford and Mr Meader were frequently provided with limited information at a very late stage in the negotiations of the proposed transactions (or were not provided with key information at all) and therefore their consent to the transactions could not be considered to be *fully informed*.
- AFP had failed to put in place proper systems to ensure that the investments in the CISX-listed Guernsey Cells on behalf of the UK Funds were not made on the basis of non-public material information about the Guernsey Cells (e.g. in relation to their NAV models) that was available within AFP. External investors who had invested in the Guernsey Cells directly through the CISX did not have access to such information and accordingly risked being disadvantaged.

5.2.3 Lessons to be learnt

- The FCA is taking a much more active interest in the management of conflicts of interest across the industry and a particular area of focus is asset managers and their funds. Firms need to ensure that they operate clear and robust arrangements to identify potential conflicts and to take all reasonable steps required to mitigate them.
- The Tribunal found that Mr Farrell and Mr Addison had been reckless in connection with their breaches of the relevant regulatory requirements. It confirmed that in this context, the correct test for recklessness was whether:
  - Mr Farrell or Mr Addison were subjectively aware that there was an unacceptable risk that the conflict of interest in question would not be managed fairly if they failed to take further steps to mitigate it; and
  - the unacceptable risk was one which would have been obvious to a reasonable person in Mr Farrell or Mr Addison's position and having Mr Farrell or Mr Addison's level of experience.
- The Tribunal found, in accordance with its previous decisions against other individuals, that a finding that an individual had been reckless was a basis for finding that that person lacked integrity. It was not necessary to conclude that the person had been dishonest in order to support such a finding. This is important because a finding that an individual lacks integrity will almost inevitably support the imposition of a prohibition order against that person (as was ultimately the case with Mr Farrell and Mr Addison). This means that senior individuals within firms who consciously close their minds to unacceptable risks in connection with ongoing regulatory compliance risk being banned from the financial services industry for life.
- Properly drafted and practical conflicts of interest policies and broader compliance manuals are key for ensuring effective compliance within an organisation. It is particularly important in this context that the advice contained in such documents gives specific examples of the types of situations that will occur in the context of the particular business, as high-level generic wording is unlikely to be of much practical utility when a real life decision must be taken.

- The involvement of a client (or the client's representatives) in the decision-making process will not necessarily prevent a finding that any conflict of interest was not properly addressed if the firm has not made full disclosure of all the relevant facts to the client. While consent to the transaction may sometimes be a defence (subject to the applicability of other regulatory rules), that consent must be fully informed in order to be effective.
- The Tribunal also confirmed that while as a matter of general law it may be possible to modify the fiduciary duties owed by a firm to its client under the firm's terms of business, this is subject in all cases to the mandatory regulatory rules imposed on the firm by the FCA Handbook. AFP, Mr Farrell and Mr Addison could not, therefore, rely on terms in the documentation given to investors in the UK Funds and Guernsey Cells which were inconsistent with those regulatory duties.
- Certain of the transactions could have been concluded without breaching regulatory requirements if AFP had taken other steps such as reliance on external valuations from arm's-length professional advisers, proper arm's-length negotiation of terms, and full and complete disclosure to the Guernsey directors. However, in the absence of taking such steps as were necessary to mitigate the relevant conflicts, the only correct course of action was for AFP to decline to carry out the relevant transactions.

5.3 Angela Burns (Upper Tribunal Decision: December 15, 2014)

5.3.1 Penalty

The Upper Tribunal concluded that Ms Burns was not a fit and proper person to continue to be approved for the CF2 (Non-Executive Director) function due to her breach of Statement of Principle 1 of APER by failing to act with integrity in connection with her failure to disclose certain conflicts of interest while acting as a non-executive director of two FCA-regulated firms.

The Tribunal also directed Ms Burns and the FCA to agree on further sanctions and indicated that, in the absence of such agreement, it would decide the appropriate sanctions at a future time.

5.3.2 Summary

Ms Burns was an investment consultant who specialised in investment analysis and fund management and who had a particular focus on advising clients on the possibility of their entry into the UK financial market. Between 2009 and 2010, Ms Burns acted as the non-executive director of two UK mutual societies, Marine and General Mutual Life Assurance Society ("MGM") and Teachers Assurance ("Teachers").

In 2006, Ms Burns had been retained by Vanguard, a US fund manager, to write a report outlining the possibility of its entry into the UK market, in exchange for which she was paid £30,000. After the report was completed, Ms Burns indicated that she would be interested in working with Vanguard in the future if it ever sought to implement the recommendations in her report. She had further contacts with Vanguard in 2008 which led to her presenting a more detailed consultancy proposal in September that year.

Between December 2006 and October 2008, Ms Burns was employed by Pearl Group Management Services Ltd ("Pearl") to provide advice on fund structuring, but she was dismissed on redundancy grounds and subsequently brought an unsuccessful claim against Pearl in an employment tribunal.

In December 2008, MGM indicated that it wished to appoint Ms Burns as a non-executive director and as chair of its investment committee. She did not inform MGM of her previous employment with Pearl and nor did she include this in her application for approval for the CF2 controlled function that was subsequently sent to the FSA. This was despite the fact that the form clearly required her to provide a full employment history for the five years preceding the date of the application and also specifically asked if she had ever been dismissed from any employment. Ms Burns was subsequently approved to take up the CF2 function in January 2009. The Tribunal concluded that Ms Burns had no convincing explanation for these omissions, other than that she considered that disclosing her dispute with Pearl would harm her chances of being appointed by MGM. Ms Burns also argued that she had provided a prospectus to MGM which made clear the details of her previous involvement at Pearl and that it had been MGM's responsibility to confirm the accuracy of the data on the form. The Tribunal rejected that argument, noting that Ms Burns had signed the declaration at the bottom of the form and was therefore also responsible for the accuracy of its content.

In early February 2009, MGM was considering launching a new investment product and Vanguard was identified as one potential fund manager. MGM's executive director asked Ms Burns whether she had any contacts at Vanguard and encouraged her to set up a meeting. Ms Burns disclosed to the executive director that she had previously worked for Vanguard and stated that Vanguard was not a current client (both of which were technically correct). However, she did not disclose that she was actively seeking work from Vanguard at that time by virtue of the consultancy proposal that she had put forward in 2008. While the FCA had alleged that Ms Burns was in breach of her duty of disclosure at this point, the Tribunal found that at that stage, no duty of disclosure had arisen solely as a result of her previous contacts with Vanguard.

However, in late February 2009, Ms Burns emailed a contact at Vanguard from the email address of her personal consultancy firm, drawing attention to her position as chair of the investment committee at MGM and then attempting to solicit work for her own account by referring to her report on Vanguard's possible entry into the UK market. In particular, she asked Vanguard whether it had considered possible candidates to act as non-executive directors on the board of its UK subsidiary and put herself forward as a possible candidate who could "support your business growth and development here".

MGM's board of directors convened the following day to consider possible fund managers. Vanguard was put forward as one possible option, but Ms Burns did not disclose that she had been soliciting work for herself with Vanguard the day before by referring to her role as a non-executive director of MGM. On the following day, Ms Burns emailed a separate contact at Vanguard from her address at her personal consultancy firm and again repeated that she was a non-executive director at MGM and was available to perform the same role for Vanguard in the future. Vanguard responded by informing Ms Burns that non-executive roles would be filled by senior managers within Vanguard and therefore that her services were not currently required. Ms Burns subsequently argued that at the relevant time, there was a very real possibility that MGM and Vanguard would not engage with each other. The Tribunal found that this was looking at the issue from the wrong perspective. The correct question was whether there was a real possibility that there *would* be negotiations between the two firms. It therefore concluded that her email had already created a conflict of interest by actively seeking paid work from Vanguard on her own account while also being aware that there was a strong possibility that Vanguard would be asked to pitch for the position of MGM's fund manager. There was a very real possibility that this could have interfered with her judgement on the issue and, therefore, she should have disclosed the conflict to MGM.

The Tribunal accepted that if Vanguard had not been an active potential candidate for appointment as MGM's investment manager, it would not have been improper for Ms Burns to solicit a role at Vanguard by referring to her experience as a non-executive director at MGM. However, given that Vanguard was clearly a live candidate at the relevant time, the only way that the solicitation could have been rendered proper was to disclose in advance to MGM that she intended to make a proposal on her own account to Vanguard and to receive MGM's consent to doing so.

Separately, in late 2009 Teachers began to search for a new non-executive director. Ms Burns submitted a CV which briefly referred to her involvement with Vanguard and when she was called to an interview, she explained the nature of that relationship in further detail. She had also discussed the role at Teachers with certain board members at MGM who had concluded that the position would not conflict with her duties at MGM because Teachers and MGM were active in different markets. Mr Burns was again required to seek FSA approval for the CF2 function and again failed to disclose her employment at Pearl. Ms Burns subsequently argued that Teachers had incorrectly used the long-form application for her CF2 approval when only a short-form application was necessary because Ms Burns was already approved for the CF2 function at MGM. The short-form application would not have required a career history and therefore Ms Burns argued that the omission in the erroneously selected long-form version was not material. The Tribunal rejected this, noting that even if the long-form version was not strictly required, Ms Burns had still signed a false declaration in connection with the content of that form.

In June 2010, Teachers confirmed Ms Burns's appointment as a non-executive director by way of a letter of appointment which also stated that if she became aware of any conflicts of interest, she had to inform Teachers's chairman and company secretary.

In August 2010, Teachers was also considering appointing Vanguard as a fund manager and Ms Burns

became involved in discussions about whether Vanguard should be appointed and, if so, how this should happen. In November 2010, Ms Burns emailed the managing director of Vanguard's international operations stating that Vanguard would shortly be presenting a proposal to Teachers and that she was the chair of Teachers's investment committee. She also referred to her role on MGM's investment committee and Vanguard's appointment as MGM's manager. Ms Burns then stated that she would be "delighted to help secure new institutional mandates for Vanguard UK" and that "[g]iven that my [non-executive] positions have facilitated potentially some £1bn of new assets to your new enterprise, I feel it appropriate to reprise our earlier discussions. We had discussed previously both the prospect of my receiving 1 [basis point] for new monies secured, on an ad valorem basis, and my becoming a [non-executive director] of your Dublin funds. The MGM Advantage mandate would amount to £35k pa, with the TA mandate taking it to £110k pa".

Ms Burns's counsel conceded before the Tribunal that it would not have been unreasonable for Vanguard to interpret the final sentence as a direct request for payment for Ms Burns's involvement in having secured Vanguard's appointment as MGM's investment manager and for the future appointment of Vanguard as Teachers's manager. However, Ms Burns claimed that this was not what she intended and she was merely using these as illustrations of how she could bring future benefits to Vanguard, albeit that her email was poorly phrased. While the Tribunal accepted her evidence on this point, it also concluded that her solicitation of future paid benefits from Vanguard created a clear conflict of interest with her involvement on Teachers's investment committee given that Vanguard was still a live candidate for the Teachers appointment. Again, the only way to avoid such a conflict was advance disclosure of her proposal to Teachers in order to obtain its informed consent to her solicitation.

Vanguard's managing director was surprised by the content of Ms Burns's November 2010 email and sought legal advice. Vanguard subsequently withdrew from the tender process to be appointed as Teachers's investment manager and emailed Ms Burns, stating that it did not pay third parties for securing new funds and that there had apparently been a misunderstanding. The FSA then began its investigation into Ms Burns's conduct, following which she resigned as a non-executive director of both MGM and Teachers.

The Tribunal concluded that while Ms Burns had not been consciously aware of any wrongdoing, she had been reckless in failing to consider the conflicts of interest created by her behaviour and had fallen below the standards expected of an approved person. In considering whether she remained a fit and proper person, the Tribunal found that some of Ms Burns's evidence had been untruthful and her failure to respect proper standards was clear from her willingness to omit important details from her CV and her approved person applications to the FSA in order to further her own personal gain. The Tribunal therefore concluded that she was not a fit and proper person to continue to hold the CF2 function.

5.3.3 Lessons to be learnt

- This case is an important reminder about the need for directors and other persons acting as agents of a firm to consider and identify any conflicts between their personal interests and those of the firm and to take appropriate action. The key question that should be asked is whether there is a *real possibility of a conflict* in any given situation. It is important to note that the analysis may also change as situations evolve, for example, as it becomes clear that a business relationship is becoming more likely or that a transaction is more likely to occur.
- The Tribunal's decision confirms that it is not necessarily illegitimate for directors or other agents of a firm to refer to their role and experience at that firm in order to further their own personal interests, but this needs to be considered very carefully in the context of the particular situation. In particular, such references should not give rise to any implication that the relevant individual may be able to procure an improper advantage by virtue of his or her existing position.
- Where directors or agents are seeking to undertake business on their own account with a counterparty or potential counterparty of the firm, they will need to analyse whether this gives rise to any potential conflict in the context of their existing role and the duties that they owe to the firm. If there is any conflict or potential conflict, this should be clearly disclosed to the firm and consent to proceed with

the personal proposal should be sought and clearly documented in writing in accordance with the firm's conflicts of interest policy.

- Firms and individuals must take great care when providing information to the FCA or another regulator to ensure that disclosures are accurate and complete. This is particularly the case where the relevant form requires a declaration of truthfulness, but it is not limited to that situation. A person cannot argue that inaccurate information that was provided was not strictly required by the terms of the form or the relevant regulatory rule under which the disclosure was made. If a person becomes aware that inaccurate information has been provided to the FCA, the FCA must be notified immediately.

5.4 Aviva Investors Global Services Ltd (FCA Final Notice: February 24, 2015)

5.4.1 Penalty

The FCA fined Aviva Investors Global Services Ltd ("Aviva") £17,607,000 (reduced by 30 per cent from £25,152,900) for breaching Principles 3 and 8 of the Principles for Businesses by failing to organise and control its affairs effectively and failing to manage conflicts of interest fairly in connection with the management of certain funds in its fixed income business.

Aviva also paid £132,000,000 in redress to eight funds which it found could have been adversely impacted by its failure to manage conflicts of interest fairly.

5.4.2 Summary

Between August 2005 and June 2013, Aviva operated "side-by-side management" arrangements whereby the same fixed-income traders managed a number of funds which paid differing levels of performance fees. The fees payable often differed according to the type of funds being managed. Hedge funds tended to pay larger performance fees, while some "long-only" funds paid lower performance fees or did not pay such fees at all. These differing levels of fees created an incentive for the relevant traders to favour the funds that paid higher amounts to Aviva, creating obvious conflicts of interest between different funds. Aviva had noted that its side-by-side management arrangements gave rise to conflicts of interest issues, but the FCA found that it had failed to implement sufficiently robust systems and controls to ensure that these risks were adequately mitigated and that funds were treated fairly.

Individual traders were able to choose the individual financial instruments in which they traded on behalf of the funds they managed, provided that those instruments were permitted under the mandate given to Aviva. Aviva operated a policy whereby traders were supposed to allocate trades to specific funds either at the time of, or immediately after, an order had been executed, but Aviva's systems allowed traders to delay undertaking that allocation during the trading day. Trades were only flagged where the execution and subsequent allocation of the trade occurred on different days and inadequate record-keeping systems meant that traders could mis-report the time that a transaction was executed. As a result, traders could monitor the intra-day performance of the relevant financial instrument before assigning it to a fund. If the financial instrument performed favourably throughout the remainder of the day after execution of the order, the trader had an incentive to allocate the trade to a fund which paid a higher performance fee; in contrast, if the instrument suffered an adverse price movement, there would be a greater benefit to Aviva in allocating the trade to a fund with lower or no performance fees, thereby protecting the investment performance of higher paying funds.

The FCA found that Aviva's compliance department acted as an ineffective first line of defence against these unfair practices because it was inadequately resourced and lacked the experience and assertiveness to challenge the traders' activities. In addition, a series of structural reforms within Aviva had led to unclear lines of reporting and accountability and a lack of understanding about which individuals had oversight responsibility for others. Senior managers received limited management information which was often out of date, further limiting their ability to understand and monitor the traders' activities.

Aviva's Internal Audit department had identified a number of issues that resulted from the side-by-side management arrangements, but there was an unclear process within Aviva about how to ensure that audit issues were properly actioned and closed. As a result, the relevant failures were not remedied until the end of the relevant period.

Aviva subsequently ended the use of side-by-side management arrangements in its fixed income business in June 2013 and segregated dealing activities from investment decisions on all its fixed income desks at that time. It also carried out an exercise to identify and compensate any adversely affected funds.

5.4.3 Lessons to be learnt

- Asset managers that do not operate arrangements whereby investment decisions and the execution and allocation of resulting trades to clients are segregated should review their policies and procedures carefully to ensure that any resulting conflicts of interest are adequately identified and mitigated.
- The final notice against Aviva again refers to the firm's culture and the fact that Aviva's fixed income business was focused on performance, viewing compliance with regulatory requirements as an unnecessary hindrance rather than an integral part of the business. The FCA was particularly critical of Aviva's reliance on a "culture of assumed trust rather than control", emphasising that firms need to have adequately resourced, assertive compliance departments and clearly defined management oversight of their business activities.
- In calculating the fine payable by Aviva, the FCA applied an extremely unusual 40 per cent discount to part of the penalty in recognition of Aviva's "exceptional" cooperation and open manner in dealing with the FCA. This highlights the potential benefits that may result from extensive cooperation with the regulator, but firms and their advisers will need to weigh the possibility of such benefits carefully against any risks involved in adopting a much more open approach (e.g. loss of privilege over voluntarily disclosed communications with legal advisers).

6. Mis-selling of financial products

6.1 Stonebridge International Insurance Ltd (FCA Final Notice: August 7, 2014)

6.1.1 Penalty

Stonebridge International Insurance Ltd ("Stonebridge") was fined £8,373,600 (reduced by 30 per cent from £11,962,317) for breaching Principles 3 and 6 of the Principles for Businesses as a result of its failure to ensure that customers were treated fairly in connection with the sale of certain personal insurance products.

6.1.2 Summary

Between April 2011 and December 2012, Stonebridge sold a range of personal protection insurance products, comprising certain personal injury and accidental death plans, through various intermediaries with whom Stonebridge had contracted to carry out sales and customer services in the UK and across the EU.

The products were sold by the intermediaries making unsolicited sales calls to customers whose details were provided by various business partners of Stonebridge, such as catalogue companies or online retailers. The sales executives employed by the intermediaries used a series of scripts and call flow documents that were produced by Stonebridge for the purpose of providing information about the policies, discussing payment options and identifying the applicable exclusions and limitations in the policy coverage. In particular, customers were informed that if they cancelled the policy at any time during the first 30 days, any premiums paid would be refunded and there would be no cancellation charge.

However, in early 2012 the FSA conducted a review of a sample of recorded sales calls carried out by Stonebridge's intermediaries and identified a number of concerns. Stonebridge sought professional advice from a law firm and subsequently developed an action plan in conjunction with the FSA to remedy the relevant issues. In July 2012 Stonebridge conducted another review of the sales calls at its own initiative and concluded that there were still widespread failings. After the FSA was informed of these findings, it required Stonebridge to carry out a skilled person review of its sales, which identified, amongst others, the following deficiencies:

- Customers were frequently not provided with appropriate information at the point of sale. For example, the sales scripts directed the sales executive to ask the customer if (s)he had a family. If the customer confirmed that this was the case, the sales executive was directed to offer the customer a policy covering the customer's entire family without referring to the possibility of a cheaper policy that would provide single cover for the customer only.

- Information about the scope of the cover provided by different policies and the associated benefits, or the applicable exclusions and limitations, was often explained incorrectly, preventing customers from making an informed decision about whether the products were appropriate for their needs. Some customers were incorrectly told that certain accidents or events would be covered by the relevant policies when this was not the case.
- Certain calls were not carried out in a clear, fair, and balanced manner. The sales executive sometimes provided information too quickly, leading to a significant risk that the customer was unable to understand the policy and therefore could not properly determine whether the product was, in fact, suitable.
- At the stage in the call when the customer was deciding on the payment method to use, the sales executive frequently failed to explain that if the customer chose to pay for the policy through one of Stonebridge's business partners (e.g. through the customer's account with a catalogue company), there could be additional charges such as interest payable on that balance to the business partner. This information was often only provided at the end of the sales call (after the decision about the payment method had already been made) in accordance with the flawed sales scripts. In some cases, the sales executive actually encouraged the customer to make payment through the business partner's account by stating that this would be more convenient for the customer. The failure to explain these potential charges clearly meant that the customer was unable to assess the affordability of the product properly.
- Sales executives were encouraged to refer to the customer's cancellation rights in order to sell the insurance policies and had wide discretion in the scripts as to when, and how frequently, they should do this. However, when customers subsequently sought to cancel their policies, the sales executive was encouraged to overcome the customer's objections and frequently put additional barriers in the way of cancellation. For example, customers were sometimes unjustifiably asked to answer a large number of "data protection" questions before the cancellation process could be initiated. In other instances, the sales executive continued to question the customer's decision throughout the call in order to dissuade the customer from exercising the cancellation rights. Sales personnel received rewards if they successfully retained customers.
- Insufficient management information was provided to Stonebridge's management to facilitate monitoring of the activities of sales intermediaries in order to ensure that customers were treated fairly. Executive committees frequently failed to provide sufficient challenge or oversight of sales activities.

6.1.3 Lessons to be learnt

- As with previous mis-selling cases, the Stonebridge case exhibits a number of common failings contributing to an overall sales culture which in turn leads to a failure to treat customers fairly. By prioritising sales and customer retention at the expense of the fair presentation of key information that is required for the customer to make a fully informed choice about the product on offer, firms put themselves at risk of enforcement action.
- In accordance with the FCA's increasing focus on identifying and reinforcing management responsibility for the firm's activities, it is crucial that firms design reporting systems so that key management information is properly escalated to individuals or committees with responsibility for supervising sales activities. Firms should take care to design proper sales sampling techniques and to identify any negative trends (such as customer complaints in relation to particular product lines or localised in particular geographic areas) which may indicate that the required standards are not being met.
- Proper training of sales advisers and careful design of sales tools (such as telephone scripts or flowcharts) is essential to avoid poor practice becoming embedded in a firm's wider culture.

6.2 The Royal Bank of Scotland Plc and National Westminster Bank Plc (FCA Final Notice: August 27, 2014)

6.2.1 Penalty

The Royal Bank of Scotland Plc ("RBS") and National Westminster Bank Plc ("NatWest") were subject to a combined penalty of £14,474,600 (reduced by 30 per cent from £20,678,000 due to early settlement) for breaching Principles 2 and 9 of the Principles for Businesses and certain provisions of the Mortgages and Home Finance Conduct of Business sourcebook ("MCOB") through their failure to ensure the suitability of mortgage advice provided to retail customers.

6.2.2 Summary

In late 2011, the FSA carried out a review of the quality of mortgage advice provided by RBS and NatWest and raised a number of concerns about whether the sales process complied with the MCOB rules and whether sufficient information was being recorded on customer files to evidence that the mortgage was suitable for the customer. The firms responded to the FSA in mid-2012, stating that the relevant issues had been fully addressed, but in late 2012 the group internal audit function within RBS and NatWest's group identified that the steps taken by the firms to address the failings had in fact been insufficient and breaches of the relevant regulatory rules were ongoing. This view was confirmed by two separate reports produced by independent consultants engaged by the firms that were published in January and May 2013.

The FCA's subsequent investigation found that a significant number of compliance failings by RBS and NatWest between June 2011 and March 2013 had led to an unacceptable risk that customers would not receive suitable mortgage advice. During that period, both firms sold mortgages either through customers having face-to-face meetings with mortgage advisers in branches or by advised telephone sales, although the in-branch sales constituted the majority of mortgages sold. Both firms shared the same group systems and processes in connection with mortgage sales.

In each case, the mortgage adviser would work through a series of step-by-step displays on a computer which guided the sales process (although the precise steps might vary depending upon the particular mortgage product being sold). Mortgage advisers were provided with an intranet document called the "Mortgage Sales Guide" ("MSG"), but otherwise had no other guidance to assist them with the sales process. The MSG was over 200 pages long and rather than being a clear, step-by-step guide to the process, it was essentially a collection of different guidelines and procedures. Some of the content of the MSG was subsequently identified as not being fully compliant with the MCOB rules during the relevant period. Particular problems with the MSG and the general sales process included:

- The fact-finding process which formed the basis of the mortgage advice provided was inherently flawed, as mortgage advisers were given very little guidance (except for a small number of basic issues) about which questions they needed to ask the customer. The training provided to mortgage advisers merely noted that the adviser needed to formulate a range of relevant questions prior to the interview.
- In addition, the IT system used by the mortgage adviser had very limited space to record the results of the fact-finding process so that only a maximum of 500 characters could be recorded in the text box. The contents of that text box were automatically transferred to the suitability letter provided to the client. The suitability letter was intended both to set out the basis of the advice provided to the customer and to record the content of the customer interview, but the severe limit on the information that could be recorded undermined both these purposes. This meant that suitability letters were frequently unclear or inaccurate, omitting key information that the customer had provided during the interview.
- In some cases, mortgage advisers gave clearly inappropriate advice. For example, in a mystery shopping exercise carried out by RBS and NatWest, it was discovered that certain advisers were providing customers with their own predictions for future changes in the Bank of England's interest rate which was clearly inappropriate given that the advisers had no basis on which to make such forecasts. The FCA noted that this entailed a very high risk that the resulting advice would be unsuitable and that the customer would choose a mortgage in reliance upon that prediction. In another case, the sales adviser inaccurately recorded on the fact-finding record that the customer had confirmed that a mortgage product would remain affordable after the customer retired when in fact no such confirmation had been given.

- There was no clear process for determining if the relevant customer could afford the mortgage product that the adviser recommended because the customer's individual budget and future spending commitments were not properly taken into account. RBS and NatWest relied heavily on comparisons with average expenditure data from the Office of National Statistics which, while relevant, could not be a substitute for the particular customer's own personal circumstances.
- Both firms became aware that they were not providing proper advice to customers who wished to take out a mortgage to consolidate their existing debts. As a result, from February 2012, customers who indicated that they wished to consolidate debts would only be sold mortgages on a non-advised basis. However, the lack of clear policies in this area meant that some mortgage advisers failed to collect sufficient information from the customer to determine whether (s)he was seeking to consolidate debts, meaning that advice continued to be provided to some customers in this situation.
- Both firms did not specifically advise on the term of the mortgage and simply deferred to the customer's preference in that regard. While the FCA acknowledged that the customer's preference was important, a firm that was making an advised mortgage sale still had a responsibility to ensure that the term was appropriate for the particular customer in the circumstances.

In addition to these failings, the FCA concluded that monitoring of mortgage sales had been inadequate and was hindered by a lack of documentary evidence in the sales files. The key performance indicators used to monitor individual advisers initially gave insufficient weight to certain aspects of the sales process and some process failures did not result in an adverse score if they were remedied within a particular time period. The FCA also noted that there was unclear accountability within RBS and NatWest's group about which executives were responsible for oversight of the mortgage sales process.

RBS and NatWest subsequently carried out a customer contact exercise, writing to customers who may have been affected by the regulatory breaches to invite them to raise any concerns in connection with the advice that they received.

6.2.3 Lessons to be learnt

- The FCA noted that RBS and NatWest had provided an attestation to the FSA in July 2012 which confirmed that they were making the necessary changes to the mortgage sales process following concerns raised by the FSA at the end of 2011. While the FCA found that the firms had not been deliberately misleading when providing that confirmation, it nonetheless considered that this should be classified as an aggravating factor when calculating the final penalty, since it was clear that the deficiencies had not, in fact, been satisfactorily resolved. This again demonstrates that attestations should not be made without careful prior verification of the facts.
- The failings in connection with advised mortgage sales were exacerbated by poor systems and controls and inadequate resourcing of the compliance function which was unable to provide proper oversight of the advisers' activities. As levels of activity grow and/or as the complexity of business activities increases, firms need to ensure that they continue to allocate sufficient funding and management time to compliance and oversight functions to ensure that adherence to regulatory requirements is not compromised.
- Record keeping and requirements for evidence should not be treated as a low priority. Many of the criticisms levelled against RBS and NatWest related to the fact that customer files failed to record important information. The recording of interactions with customers is a key part of a firm's ability to demonstrate to the FCA how it complies with the regulatory requirements to which it is subject.

6.3 Chase de Vere International Financial Advisers Ltd (FCA Final Notice: November 5, 2014)

6.3.1 Penalty

Chase de Vere International Financial Advisers Ltd ("CDV") was fined £560,000 (reduced by 30 per cent from £800,000 for early settlement) for breaching Principles 3 and 7 of the Principles for Businesses and certain applicable rules in COBS and SYSC in connection with advised sales of certain traded life policy instruments ("TLPIs").

CDV also made payments of an unspecified amount to its customers and to the Financial Services Compensation Scheme as part of a redress exercise in connection with the sales of the TLPI products.

6.3.2 Summary

CDV was a firm that acted as an independent financial adviser across the UK, specialising in providing advice to retail customers through a team of telephone and in-branch advisers. Between August 2005 and June 2009, CDV advised over 2,800 customers to invest in over 3,800 TLPI products issued by Luxembourg special purpose vehicles ("SPVs") controlled by Keydata, an authorised product provider. The Keydata products were corporate bonds issued by the SPVs, but the amounts payable under those bonds were to be generated by the SPVs investing in US life insurance policies (i.e. life insurance policies which were predominantly based on US citizens). The SPVs would pay the premiums due under those policies and, in return, would receive the maturity payment when the relevant individuals died.

In the marketing materials that Keydata provided to CDV, the following points were made about the TLPI products:

- The products did not offer a capital guarantee, so potentially the entire investment was at risk.
- The predicted performance of the TLPI products depended upon the accuracy of Keydata's complex actuarial modelling. External changes beyond Keydata's control (e.g. improvements in healthcare) could render that model materially inaccurate by affecting the predicted dates on which the underlying insurance policies would mature.
- The TLPI products issued by the Keydata SPVs had fixed maturity dates (e.g. five years from the date of issuance). This meant that each SPV was contractually bound to pay the full amounts due under the bonds on that date, even if the underlying insurance policies had not yet matured to provide funding for that payment.
- The life insurance policies backing the TLPI products were not liquid assets in the same way as listed shares. If it became necessary to sell an insurance policy prior to its maturity date to fund payments under the TLPI products, there was a risk that this would only be possible at a reduced value.
- The TLPI products involved investment in a single alternative asset class.
- Since the SPVs issuing the TLPI products were based in Luxembourg, customers would not be covered by the UK Financial Services Compensation Scheme if the SPVs defaulted on their payment obligations.

When CDV first considered approving the Keydata TLPI products for inclusion in the "product panels" on which it would provide advice to customers, CDV's research team noted that the product was novel and therefore referred the product to the firm's Advice Suitability Group ("ASG") for approval. There was no formal meeting of the ASG, but the product was approved through an email exchange between ASG members who determined that it was a tax-efficient product offering a high rate of return and the risks involved in the products were not considered to be "huge". One member of the ASG did inform the research team that he had concerns that the product literature provided to CDV's customers which explained the TLPI products did not clearly explain how the investment worked. However, there was no evidence that this concern was subsequently acted upon or that it was escalated to any other ASG members.

For each subsequent tranche of Keydata TLPI products, CDV did not carry out the entire approval process again. Instead, the features of the new tranche were compared against those of the tranche that was approved in the original decision and any differences were then discussed with Keydata. This meant that the substantive decision to approve the Keydata products using the TLPI structure was never revisited.

CDV did not normally impose direct limits on the sale of individual investment products which had been admitted on to its "product panels", although advisers were subject to an overall asset allocation model set by CDV which broadly indicated how assets should be distributed between broad asset classes (cash, fixed interest, commercial property and equities). Each CDV adviser therefore had discretion to decide whether a particular product falling within one of those broad asset classes was suitable for the particular customer in the relevant circumstances. However, certain products were directly subject to additional limitations, including specific concentration limits and attitude-to-risk ("ATR") limits. For investments that were considered to constitute "alternative investments", there was a concentration limit of 15 per cent of the customer's portfolio and the customer had to have an ATR of at least 6 out of 10. However, CDV did not consider that the Keydata TLPI products were alternative investments and therefore they were not subject to these more stringent direct restrictions throughout the majority of the relevant period.

Prior to June 2006, CDV's research team had drafted standard wording in relation to the Keydata TLPI products which was approved by the compliance department and was then designed to be included in the suitability reports that were given to customers. Advisers were not, however, required to use that standard wording and could include their own product descriptions or risk disclosures.

However, in early 2006 CDV's compliance team indicated that it did not have sufficient resources to review the wording produced by the research team and advisers were increasingly using their own bespoke wording anyway. As a result, CDV took the decision in June 2006 to cease providing the standard wording. Some CDV advisers were concerned by this decision and identified the risks to CDV's senior management, but it was not until October 2008 that approved standard wording was once again provided. The FCA reviewed a number of CDV's customer suitability reports relating to the Keydata TLPI products dating from before October 1, 2008 and found that certain of these omitted key risk disclosures (such as a clear statement that the customer's capital was at risk) or included inaccurate factual statements (such as a statement that although the capital was not guaranteed, it was "protected" when in fact no element of capital protection was offered by the TLPI product).

The FCA concluded that throughout the period, CDV had failed to put in place adequate systems and controls to ensure that it understood the risks that the Keydata TLPI products posed to its customers or to ensure that the information on those products provided by CDV's advisers was fair, clear and not misleading.

6.3.3 Lessons to be learnt

- It is essential that a firm's compliance department is fully involved in the production of marketing and information materials that are provided to clients in order to ensure that any materials do not breach the FCA's rules. Leaving individual advisers or sales executives to generate their own wording may lead to inconsistency and inaccurate or misleading explanations of product features or risks.
- Firms must ensure that they understand the products that they are selling, the risks inherent in those products and the types of client for which those products are likely to be suitable.
- It is also important to ensure proper documentation of decision-making processes in connection with product approvals so that any conclusions can be properly justified to the FCA if they are subject to review at a future date. An informal email exchange such as that which took place between the members of CDV's ASG is unlikely to be considered sufficiently rigorous for these purposes.

Issue 126—The Client Money and Assets Regime

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On July 12, 2013 the Financial Conduct Authority ("FCA") published its much-anticipated Consultation Paper (CP13/5) covering its root-and-branch review of the client money and client assets regime for investment business. In doing so, the FCA published one of the most controversial Consultation Papers that the industry had seen in a very long time. The Consultation attracted a very large number of responses and a lot of protest against some of the provisions. The following year, in June 2014, the FCA published its feedback and final rules, which did not look all that different from the proposals in the Consultation Paper, although some concessions were made. The proposals have resulted in material changes to the client money and assets regime in the UK and are likely to have far-reaching consequences, the full extent of which in many cases is still yet to be ascertained.

The FCA (and its predecessor regulator, the Financial Services Authority ("FSA")) undertook its review of the current client assets regime, largely due to the collapse of Lehman Brothers and later, MF Global. Some of the proposals are intended to bring the client money and assets rules into line with requirements in the European Markets Infrastructure Regulation ("EMIR"). Some changes have already been made to the regime to reflect EMIR, but the proposed changes go further. At the same time, there is change afoot more widely, as the Markets in Financial Instruments Directive II ("MiFID II") covers client assets, although the FCA's new rules are ahead of the proposals in many respects.

Both the Consultation Paper and the Policy Statement are substantial, not so much in their physical length, but in terms of the vast amount of ground that they cover. Much of it is difficult to follow as, in many cases, the commentary does not match the rules provided; and some of it is contradictory. This edition of Compliance Officer Bulletin will look at the new Rules and their implications. It will also look at the changes coming from Europe and their likely consequences.

COMPLIANCE OFFICER BULLETIN

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