May 2013

Enforcement Watch
Issue 10

Mishcon de Reya

EDITOR'S NOTE

So, finally, the new regulatory architecture is in place, and the system is up and running. What changes will there be? It is true to say that there are structural changes, and that there are some new and concerning powers and provisions. However, more broadly as far as enforcement is concerned, the direction of travel looks like more of the same. Whilst the Enforcement Case Highlights section reports on cases concluded by the FSA, On the Horizon gives an indication of what we might expect to see from the new regulator. Watch this space.

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6 February 2013: RBS fined £87.5m for LIBOR misconduct

The FSA has handed out a fine of £87.5m to The Royal Bank of Scotland PLC for its role in the LIBOR scandal. RBS settled early and so qualified for a 30% penalty discount, without which the fine would have been an even more eye-watering £125m.

LIBOR's integrity is of course of fundamental importance to both UK and international financial markets. It is by far the most prevalent benchmark reference rate used in euro, US dollar and sterling over the counter interest rate derivatives contracts and exchange traded interest rate contracts. The notional amount outstanding of over the counter interest rate derivatives contracts in the first half of 2012 has been estimated as being as high as £315 trillion.

The LIBOR related misconduct at RBS was described by the FSA as "extremely serious". It occurred over a number of years and included the following breaches:

Breaches of Principle 5 (proper standards of market conduct):

- Making LIBOR submissions that inappropriately took into account RBS's derivatives trading positions, and also the impact on its money market trading books
- Allowing derivatives traders at times to act as substitute LIBOR submitters
- Colluding with other panel banks and with broker firms, including entering into some wash trades with brokers, the purpose of which the FSA concluded was to garner influence with brokers.

Breaches of Principles 3 (management and control):

- Failing to identify and manage the systemic risks of inappropriate submissions. RBS established a business model that sat derivatives traders next to LIBOR submitters and encouraged the two groups to communicate without restriction, despite the risk that derivatives traders could wrongly seek to influence RBS's LIBOR submissions.
- Having no systems, controls, training or policies governing the procedure for making LIBOR submissions until March 2011. In March 2011, RBS attested to the FSA that its systems and controls were adequate. However, this was not correct and its systems and controls were not adequate. (However, RBS did not deliberately mislead the FSA).
- Failing to manage the relevant business areas appropriately. For example at least two managers were aware that derivatives traders acted as substitute submitters but did not take any action to address the situation, and one manager himself made inappropriate submission requests.

Please click for Final Notice for The Royal Bank of Scotland PLC

Comment

Much has been written about the LIBOR affair by others, and so we limit our comments just to the following, which strike us of particular interest.

This is the third LIBOR fine.[1] All three cases were settled by the bank involved. This raises the important tactical issue of when may be the best time to settle relative to others. In some respects, there are a variety of reasons why settling first may be an advantage. For example, it allows the bank to portray itself in a particular light with the regulator, and it enables it better to set the agenda than if it follows the "precedent" of another bank. Indeed, there are areas of the law (more developed in the US than in the UK) that afford advantages to those who come first to the authorities. What is noticeable about the LIBOR cases, however, is that it was the bank that settled first in the UK (Barclays) for which the public's ire to date seems to have been greatest. Whether or not the FCA has the appetite to address from a penalty perspective the issue of the benefits of settling first, it is certainly something that firms will need to think carefully about in future matters.

Perhaps with its objective of "consumer protection in mind", the FSA was keen to point out that the direct impact of actual manipulation of the LIBOR fix on UK retail consumers is likely to be minimal.

The FSA said that the size and scale of its continuing investigations remained significant, including a number of significant cross-border investigations. Rumours of course abound of the others involved in the LIBOR affair. Further, no action has yet surfaced against individuals, and this remains an area to be watched. For example, whether it will be FCA disciplinary action that follows. Alternatively, it may be that the difficulties are perceived to be too large (see for example Enforcement Watch 8 "What is to come in relation to LIBOR") and the situation may instead be dealt with by the FCA challenging future applications for individual registration. Further, the SFO has been making belligerent noises about LIBOR. We shall have to wait and see what emerges on these.

The case is interesting as a further example of the problems that can arise on integrating new businesses. In this case, the FSA has pointed out that, in a complicated organisation where several legacy systems exist, it is essential that the organisation ensures its systems are correctly synchronised. (For another example of legacy issues causing enforcement difficulties, see Enforcement Watch 8 "11 September 2012: £9.5m Black Rock fine for client money breaches")

This is the second time during the calendar year 2012 that Bank of Scotland has been found by the FSA to have failed to comply with Principle 3. In June 2012, the FSA determined that Bank of Scotland had breached Principle 3 when the bank was found to have been guilty of very serious misconduct which contributed to the circumstances that led to the UK government having to inject taxpayer funding into HBOS (see Enforcement Watch 7 "9 March 2012 FSA censures Bank of Scotland for very serious misconduct")

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[1] The FSA fined Barclays Bank PLC £59.5m in June 2012 (see Enforcement Watch 8: Barclays receives largest ever fine imposed by the FSA, In December 2012, the FSA fined UBS £160m (see Enforcement Watch 9: UBS receives largest ever FSA fine). The FSA says that it considered RBS' misconduct relative to the above in determining the penalty.

8 February 2013: UBS fined £9.45m for suitability related failings in its sales of an AIG fund

UBS AG has received another fine from the FSA. The fine is a result of (i) failures in the sale of the AIG Enhanced Variable Rate Fund (which led to customers being exposed to an unacceptable risk of an unsuitable sale of the Fund between December 2003 and September 2008) and (ii) failures to deal properly with related client complaints. After taking account of the discount for early settlement, UBS was fined £9.45m.

The Fund was sold to high net worth customers and was invested in financial and money market instruments. However, unlike a standard money market fund, it sought to deliver an enhanced return by investing a material proportion of its assets in floating rate notes and securities that were primarily backed by UK residential and commercial mortgages with exposure at certain times to non-conforming UK residential mortgages. Despite this, UBS classified the Fund as a low risk product; and deemed it to be potentially suitable for all its customers regardless of their tolerance for risk.

During the financial crisis, the market value of some of the assets in the Fund fell below their book value and, immediately following the collapse of Lehman Brothers, AIG's share price fell sharply. A large number of investors sought to withdraw their investments and there was a run on the Fund. As a result, the Fund was suspended and customers were prevented from immediately withdrawing all of their investment. At that point in time, 565 UBS customers had approximately £816 million invested in the Fund.

A sample review by the FSA of sales of the Fund to 33 customers found that 19 were mis-sold and that there was a considerable risk that 12 of the remaining 14 may have been mis-sold. The FSA also reviewed 11 complaints made by these customers and found that all 11 had been assessed unfairly - albeit that the complaints had been thoroughly investigated and six had been upheld by UBS.

As a result, UBS breached Principle 9 (ensuring the suitability of its advice) and Principle 6 (treating customers fairly).

UBS's failings were serious and included the following:-

- Failing to carry out adequate due diligence on the Fund before selling it to customers, such that UBS had an inadequate understanding of the nature of the Fund's assets and its risks.

- Failing to ensure its advisers were provided with appropriate training about the Fund in order correctly to determine its suitability for customers. One adviser said he "*wasn't clear himself what was actually in* [the Fund]".

- Indicating to customers that the Fund was a cash fund that invested in money market instruments.

- Customers were not sent suitability reports when UBS sold the Fund and it failed to review past sales to ensure they were suitable.

– Failing to assess customer complaints relating to sales of the Fund fairly, despite conducting a thorough investigation of those complaints. For example, UBS employed a narrow complaints handling methodology.

Please click for the Final Notice for UBS AG

Comment

The FSA's credible deterrence agenda is well known. As part of that, the FSA has had a particular focus on suitability and on the wealth management industry. (See for example Enforcement Watch 3: "The FSA sends a tough message on suitability" and Enforcement Watch 5: "Dear CEO letter to wealth managers suggests action to come").

This latest UBS fine represents another example of the approach that the FSA is taking to such issues. Indeed, Tracey McDermott, director of enforcement and financial crime, trumpeted the Final Notice with the words "We have made our expectations in relation to the wealth management industry clear. UBS has paid the price for its failures and we will continue to take strong action against firms who fail to do the right thing for their customers."

Although the fine is substantial, the precise way in which it was determined remains unclear as the facts of this case occurred before the implementation of the FSA's new penalty setting regime in March 2010 which is in some respects more transparent (see Enforcement Watch 1: "Harsher Penalty Setting Introduced"). UBS received a 30% discount on the headline financial penalty figure of £13.5m for early settlement.

The fine is only part of the financial consequence for UBS. UBS agreed to conduct a redress programme in relation to customers who remained invested at the time of the Fund's suspension in September 2008. It is estimated that compensation will be in the region of £10 million.

The case is not the first in relation to the Fund in question. On 7 November 2011, the FSA fined Coutts £6.3m for failings relating to the sale of the AIG Fund (see Enforcement Watch 6 "Coutts fined £6.3m for AIG Fund sales failings").

27 March 2013: Prudential companies fined £30m and CEO censured for failures to inform regulator

Prudential PLC and The Prudential Assurance Company Ltd have received fines totalling £30m for failing to inform the FSA and the UKLA sufficiently early of plans to acquire AIA, a subsidiary of AIG. Prudential's Group Chief Executive has also been censured for being knowingly concerned in the FSA breach.

The facts are detailed and the cases were plainly hard fought. Suffice it to say for present purposes that the sanctions arose out of a failure to deal with the FSA/UKLA in an open and co-operative manner when the Prudential was seeking to acquire the Asian subsidiary early in the year 2010. The complaint relates to the fact that Prudential did not inform the regulators of the proposed acquisition until after news of the planned deal had been leaked to the media on 27 February 2010.

The FSA accepted that the respondents did consider their obligations when forming their assessment regarding notification of the proposed deal. In a nutshell, the FSA however expected disclosure well before 27 February 2010.

Interestingly, the FSA concluded that Prudential wrongly allowed its judgement to be overly influenced by its concern about the risk of leaks, which it believed was a key risk to the proposed deal going ahead. Prudential even considered that the FSA itself could become one of a number of parties which might be the cause of a leak. These concerns meant Prudential failed to give due weight to the importance of complying with its regulatory notification obligations.

Even though the FSA found that the breaches were neither deliberate nor reckless, the fines for the company were very heavy. The FSA determined that, for failing to deal with them and the UKLA in an open and co-operative manner, Prudential PLC contravened Listing Principle 6 for which it received a fine of £14m fine. Further, it determined that the Prudential Assurance Company Ltd had breached Principle 11 for which it was fined £16m. In addition, Tidjane Thiam (Group Chief Executive) was found to be knowingly concerned in the breach of Principle 11 and was publicly censured.

Please click for the Final Notice for Prudential PLC

Please click for the Final Notice for The Prudential Assurance Company Ltd

Please click for the Final Notice for Tidjane Thiam

Comment

The detailed reasons behind the findings are set out in the Final Notices and are beyond the scope of this publication. We confine ourselves to the following enforcement issues that readers may find of interest.

Interpreting how to be "open and co-operative"

Listing Principle 6 and FSA Principle 11 both impose a requirement to be open and co-operative. Principle 11 goes one step further and requires the firm to disclose anything of which the FSA would reasonably expect notice. Such broad principles create issues of uncertainty.

Prudential argued that these Principles were so broad and general as to require the FSA to construe them narrowly. They argued that a person must be able to reasonably predict at the time of the relevant omission whether the conduct would breach the relevant Principle. The FSA was having none of it. Rather unhelpfully, it found in essence that the requirements were clear and unambiguous, although necessarily broad, and that there was no necessity for a narrow construction. In similar vein, the FSA did not accept the argument that, in the absence of any clear guidance mandating notification at a particular point, the FSA needed to establish a clear reasonable necessity for regulatory purposes.

There is no hard edged division on when disclosure should be made. What is abundantly clear from the Final Notice is that the FSA will interpret the rules very widely. Firms and listed companies would do well to take a cautious line in considering their disclosure obligations.

Significance of the level of fines

The fines against the companies were very heavy. The companies argued that they were "unprecedented and grossly disproportionate". Further, they argued that they were flawed as a matter of law as they could not be to deter others from deliberately refraining to notify the FSA given that it was not alleged that the companies acted either act deliberately or recklessly[2]. Again, the FSA was having none of it. It found that the companies failed to give due weight to their regulatory obligations, and further that a deterrent effect was needed both in relation to the companies themselves and to others. The size of the fines shows how very seriously the FSA takes the issue of disclosure to it as regulator and to the UKLA.

Implications for individuals

In contrast to the heavy fines, Thiam received a censure. In some senses, the finding is somewhat illogical.

- the FSA found Thiam to be "knowingly concerned" in the Principle 11 breach, yet was clear that he was perfectly open with the Board. If that was the case, one would expect the Board all to be in the firing line, not one individual.
- If he was knowingly concerned with the breach, then it is difficult to reconcile the heavy fine for the companies with the relatively light sanction of public censure.

The sanction sits somewhat uneasily with the FSA's press release that the case sends a "clear message to all board members of their collective and individual responsibility". It is difficult to escape the conclusion that the FSA must have been disappointed by the sanction imposed, further that the pursuit of Thiam and the attendant press release illustrates the FSA's/FCA's increasing desire to hold individuals responsible.

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[2] The facts of this case occurred before the implementation of the FSA's more transparent penalty regime in March 2010 (see Enforcement Watch 1: "Harsher Penalty Setting Introduced"), and the precise way in which the level of fines were determined is not entirely clear from the content of the Final Notices.

28 March 2013: EFG Private Bank handed £4.2m fine for lax anti-money laundering controls

A penalty of £4.2m has been imposed on EFG Private Bank Ltd because of its serious failures, over more than three years, to take reasonable care to establish and maintain effective anti-money laundering controls for high risk customers.

EFG provides private banking and wealth management services to high net worth individuals, a large proportion of whom reside in overseas jurisdictions, including countries recognised as posing an abnormally high risk of money laundering to the Firms/institutions dealing with their citizens. In January 2011, the FSA visited EFG as part of a thematic review of firms facing a higher money laundering threat. The FSA says that what it found at EFG gave it serious cause for concern in terms of compliance with the Money Laundering Regulations 2007 ("the 2007 Regulations") and FSA Handbook. In summary, the FSA's concern was that there was a systemic failure to properly document compliance with the Firm's (generally compliant) anti-money laundering procedures. By way of examples:

- In 17 out of 36 sample customer files reviewed by the FSA, EFG's own processes had revealed adverse information about the customer, including allegations of fraud and corruption. However, there was no evidence to demonstrate how EFG had sought to mitigate the money-laundering risk posed.
- EFG's processes revealed that criminal allegations had been made against 13 of those 17 customers. Whilst EFG had concluded in each case that the allegations were unfounded or politically motivated and on that basis had taken on the relevant customer, there was no documented trail as to how that view had been reached.
- In addition to failures at the "take on" stage, EFG failed properly to monitor client relationships or to apply enhanced monitoring of certain higher risk customers (as required by the 2007 Regulations).

The FSA found that the failures of EFG constituted a negligent breach of Principle 3 of the FSA Principles for Businesses (a firm must organise its affairs responsibly and with adequate risk management systems). In addition, it found breaches of SYSC 6.1.1R and SYSC 6.3.1R, which relate to devising and implementing anti-money laundering and financial crime procedures.

Please click for the Final Notice for EFG Private Bank Ltd

Comment

There is perhaps not a great deal new to take from the EFG Final Notice. At the least, it reinforces a continued commitment to tackle money laundering failings (see Enforcement Watch 5 "AML enforcement cases on the agenda"). It also reinforces that many enforcement cases come out of thematic reviews. With the arrival of the new regulator and its new approach towards early protection, it is a trend that we consider will increase.

In terms of the £4.2m penalty, as most of the misconduct occurred before the introduction of the new penalty regime, there is little transparency on just how the figure was arrived at. However, it seems likely that the need for a "deterrent effect" was to the fore.

In addition to the legal provisions in the Handbook and the 2007 Regulations, firms handling customers' money should ensure they are familiar with the FSA's guide to preventing financial crime introduced in 2011, which includes guidance on dealings with high risk and PEP customers. Firms that accept business from high risk customers must have systems, controls and practices to manage the associated risk. The perhaps somewhat obvious lesson from this case is that those systems and controls must also be properly implemented on the ground.

We stated in Enforcement Watch 7 that there appeared to be other money laundering cases going through the system. It is notable that last year the FSA fined Coutts the sum of £8.75m and Habib Bank AG Zurich £525,000 for similar shortcomings (see Enforcement Watch 7: "Coutts and Habib substantial fines for anti-money laundering failings"). Like Coutts and Habib, EFG cooperated and settled with the FSA at an early stage of the investigation.

10 May 2013: JP Morgan wealth management division fined £3m for failures in suitability processes

JP Morgan International Bank (JPMIB) is a wealth management firm within the JPMorgan Group. Although the overwhelming majority of its clients are classified as retail, a large proportion are in fact financially sophisticated.

As we have previously reported (see Enforcement Watch 8 "Wealth Managers very much on the FSA radar"), the FSA has been conducting a thematic review into the wealth management sector with a particular focus on the suitability of advice. As part of this review, JPMIB was visited during 2010 and 2011. The (then) FSA identified concerns and required JPMIB to appoint a skilled person under s.166 FSMA, to review the adequacy and effectiveness of its systems. In essence, the skilled person determined that whilst there were flaws in JPMIB's systems (summarised below) none of the 25 client files reviewed in fact contained unsuitable advice. The failures in JPMIB's systems were in practice compensated for by the knowledge and record keeping of those running the client files as well as the level of sophistication of its clients. JPMIB was found to be in breach of Principle 3 (management and control) and SYSC 9.1.1R (record keeping). Whilst the absence of any impact on JPMIB clients was taken into account in setting the level of penalty, this did not prevent a penalty being imposed based on 5% of JPMIB's profits in the Relevant Period (around two years from January 2010). The deficiencies in the JPMIB systems included:

- Gaps in the recorded suitability information, such as clients' financial circumstances and ability to bear loss. Information was either not documented or not updated.
- Issues with the electronic information management system (Argus), which prevented certain information being entered and did not require key fields to be completed.
- Inadequate staff training regarding the need to obtain and record suitability information.
- Inadequacies in the suitability reports sent to clients.
- Insufficient information being provided to JPMIB's management, which prevented them from identifying the systemic issues noted above.

Please click for the Final Notice for JP Morgan International Bank Limited

Comment

This was a case of failure of record keeping, rather than of failure of suitability. Indeed, a review of some 1416 client files, reviewed by a third party that JPMIB was required to instruct, found only one instance of unsuitable advice. Nevertheless, the regulator was clearly concerned and handed down a fine of just over £3m.

Apart from showing the real focus of the FCA on wealth managers, what is perhaps most interesting about the case is the help it gives in understanding the FCA's thinking on penalty setting. This was a case where penalty was set according to the new penalty setting regime (see Enforcement Watch 1 "Harsher penalty setting introduced"). Under that regime, there is a five step process.

- There is a starting point which can be (as it was here) based on a percentage of relevant revenue. There are five levels of relevant percentage depending on the seriousness of the breach, with level 1 being the least serious. Relevant factors are impact of the breach, nature of the breach, and whether the breach was deliberate or reckless. The JPMIB breaches were found to be of a level 2 seriousness. This appears to have recognised the serious nature of the breaches, but that the impact of them was low and that they were not committed either deliberately or recklessly.
- One adjustment to that figure can be made according to aggravating and mitigating factors. In this case, the aggravating factors were essentially that the FSA had heightened awareness around wealth management issues and that the FSA had previously fined another member of the group (although not relating to retail investment advice). However, the FCA adjusted the figure down by 10%. It did this due to the "very high level of co-operation", the prompt and considerable steps taken to resolve the issues and the extensive past business review. This shows the very real credit the FCA will give in appropriate cases for positive behaviour.

The fine was then reduced to just over £3m for early settlement.

FCA reveals procedure on early publication of Warning Notices

Under the Financial Services Act 2012, the FCA now has power to publish such information about a Warning Notice as it considers appropriate. This is a controversial power that we regard as carrying great risks for subjects of enforcement action.

In Enforcement Watch 9, we reported on the FSA's consultation on the procedure for publishing such information (see Enforcement Watch 9 "FSA consults on procedure for publishing information about Warning Notices"). In March 2013, the FSA published the results of the consultation and its response.

Like us, respondents to the consultation agreed that the RDC (rather than FCA enforcement staff) is the appropriate decision maker in respect of the decision to publish details of a Warning Notice.

Respondents felt that the proposed seven day notice period before publication would not give subjects sufficient time to respond to the RDC's decision, suggesting that periods of 14 or 28 days would be more appropriate. In response to the consultation, the period to respond to the RDC has been extended in the normal case from seven to 14 days, with a provision to allow for consideration of a further extension if requested within the first seven days. Whilst we welcome the extension of time, there still remain areas of concern. For example, subjects will not normally be permitted to give their response in person. Further, the rules have no provision for a right of comment as to any revised wording proposed by the RDC following a challenge by a subject.

Additional wording has also been added to make clear that decisions regarding publication are to be made by the Chairman of the RDC panel which took the decision to publish the Warning Notice itself or, if not available, the Chairman or Deputy Chairman of the RDC.

The intended consequence of this new power is said to be increased transparency in the enforcement process at a much earlier stage than is the case currently. At this stage, we cannot know how aggressively the FCA, with the RDC, will approach this new power or how receptive the RDC will be to representations made by subjects. The potential unfairness to subjects remains clear.

The FSA has consulted separately in respect of its policy and the practicalities of publishing Warning Notices. That consultation remains open until June 2013 and we deal with this further in this issue (see "Consultation on how the power to publish Warning Notices details will be used").

Please click for the Policy Statement

Consultation on how the power to publish Warning Notices details will be used

We have commented over a period of time on the progress of the controversial proposals for publishing details of Warning Notices. The power is now in force, and the issue is now how it will be used. This comment piece relates to the March 2013 consultation on the approach that the FCA proposes to take to publication[3].

The consultation paper was published by the FSA in March 2013. It sets out proposed changes to section 6 of the Enforcement Guide which deals with the matter. The consultation closes on 18 June 2013.

Under s.391(1ZB) FSMA, the FCA has power to publish details of Warning Notices in relation to certain types of proceedings. However, it is not permitted to do so where publication would be unfair to a subject, would prejudice the interests of consumers or would be detrimental to the stability of the UK financial system.

The FCA's default position is unsurprisingly that it will publish details of a Warning Notice. Interesting aspects of the proposals for exercise of the power are:

on unfairness:

- the suggestion is that
  - a negative impact on reputation will not be sufficient to meet the criterion of unfairness as this is an inevitable consequence of publication.
  - subjects will instead need to provide *"clear and convincing"* evidence of how the unfairness will arise and how they could suffer a *"disproportionate level of damage."*
- Examples of such evidence are given, such as
  - that publication would result in deterioration of a serious illness or the health of a direct family member would be affected.
  - Evidence of loss leading to bankruptcy, insolvency or staff redundancies may also be sufficient to show unfairness but this is likely only to be relevant to smaller firms.
- We have on many occasions set out our thoughts on publication relating to Warning Notices. Whilst Parliament did not adopt all that the FSA had lobbied for on the topic (see Enforcement Watch 6 "FSA makes its views known on early publication of Warning Notices"), the publication of details is still potentially hazardous. A restrictive approach to unfairness such as the FCA looks to want to adopt, may cause real issues to the targets of FCA action.

on removal from the FCA website:

- where the Warning Notice does not result in a Decision Notice or a Final Notice, the proposal is not that the Warning Notice statement is removed (at least not within six years), but rather that, with consent, a discontinuation notice is published.
- It is difficult to see the justification for this approach. If the FCA took action that was then discontinued, a respondent would feel

[3] The FCA has already determined the relevant procedure (see elsewhere in this edition "FCA reveals procedure on early publication of Warning Notices").

rightly aggrieved that the detils of the initial allegations remained on show.

on sanction:

- the power to publish does not apply to proposals to prohibit
- the FCA says it does not propose to publish details of proposed sanctions eg level of fine
- given that any prohibition proposal we have ever seen has always carried with it also a proposed fine, the net result is that details will be published of conduct where a prohibition is sought. Unless the FCA publishes at the highest level of generality (and even possibly also then), it will likely be very easy for readers to work out who the FCA is proposing to prohibit.

Please click for the Consultation Paper

FCA Enforcement in Business Plan 2013/2014

On 25 March 2013, the FCA published its first Business Plan. The Business Plan is a rather dense document, setting out in some detail how the FCA intends to operate in the following 12 months.

As regards enforcement, although no particular surprise, it is worth stating that the FCA declares early on that it is committed to a credible deterrence strategy through its enforcement actions. This means that it will use its enforcement powers to take action against firms and individuals who abuse the system and to deter others from doing so. We pick out below some brief highlights that may be particularly interesting to those who are looking at where Enforcement's actions or emphasis may lie in the coming year:

- The FCA has trumpeted its product intervention approach for some time now. It plans to carry out thematic reviews of firms' product governance processes across wholesale and retail markets and says it will take tough action if standards are not adequate. We have commented in the past on how thematic reviews frequently give rise to enforcement action.

- Wealth management has been a focus of the regulator for some period now (see elsewhere in this edition "UBS fined £9.45m for suitability related failings in its sales of an AIG fund", "JP Morgan wealth management division fined £3m for failures in suitability processes"). The FCA says it will remain a focus.

- In 2013/14, the FCA also intends to review the management of conflicts of interest in the asset management sector. This follows on from the FSA findings of an initial review communicated to firms through a "Dear CEO" letter in November 2012.

- When discussing "Product Design and Oversight: Fund fee structure", the FCA says it will undertake a project that will highlight the behaviours and practices of asset management firms in relation to charging structures that harm consumers.

- On "Financial Incentives", the FCA talks of the guidance the FSA published in 2012 on the risks to consumers from financial incentives, after its thematic work showed that most incentive schemes are likely to cause mis-selling and that firms are not managing this properly. The FCA says it will take action against individual firms that are not managing the risks from their incentive schemes.

- In terms of financial promotions, the FCA now of course has enhanced powers. It says it will adopt a more streamlined and robust approach to firms that consistently produce promotions that can mislead, confuse or be unfair to consumers. It says that may involve greater use of supervisory and enforcement powers.

- News seeped out earlier this month of the FCA's investigations in relation to Transition Management (TM). The FCA says in the Business Plan that there is evidence that the level of transparency and market conduct among TM participants is not to the standard it requires. It goes on to say that it will undertake a project to review practices across the main TM industry participants to assess whether customers are being treated fairly.

- Client Assets remains a real focus area for the regulator. The FCA says that its supervisory work shows that a number of firms have inadequate records and ineffective segregation of client assets. Having taken action against a number of firms for client asset failures, the FCA threatens to take tough action and impose fines on those firms that still do not have adequate arrangements in place.

- Market abuse remains a continuing area of focus. Here, key enforcement priorities include: removing from the industry the firms or individuals who do not meet the FCA standards; continuing to pursue aggressively the firms or individuals who abuse UK markets by using its criminal and civil powers. It says that "taking actions against individuals is a key part of our credible deterrence strategy." One particular aspect of the FSA strategy that we have previously seen relates both to Suspicious Transaction reports and Transaction Reporting. The FCA commits to this, saying that it will take action where necessary to ensure that firms and individuals comply with their reporting obligations.

- Although not strictly speaking enforcement, we have previously commented on the FSA approach to firms' authorisations and individual approvals. The approach we have seen the FSA take to these in the last couple of years has been far more robust, with the potential to achieve the same impact as a prohibition. From the Business Plan, it seems this is a continuing focus for the FCA. Interestingly, related to this as regards individuals, the FCA says it wants to ensure that the accountability of Approved Persons are clearly defined by firms and understood by the FCA. The FCA seems to be particularly focussed on SIF accountability. It also says that firms should expect to see increased enforcement action against Approved Persons who breach the FCA rules as a result.

Please click for the Business Plan

The FCA's proposed use of temporary product intervention rules (TPIRs)

As trailed in Enforcement Watch 9"The FCA's proposed use of temporary product intervention rules", in March this year the then FSA published a Policy Statement regarding the use of the FCA's new and approach-defining power to bring into force short term rules (temporary product intervention rules (TPIR's)) without any consultation (limited to a maximum period of 12 months).

One of the main criticisms made by respondents to the consultation was the continuing lack of clarity as to when and how the power will be used. Set out in its broadest terms, the power can be used where the FCA identifies a threat to its statutory objectives and where prompt action is required. However, respondents noted the lack of clarity on the key tests that would be applied by the FCA in deciding whether and when to exercise that power. In response, the FSA noted that the statutory threshold for the power was deliberately low to give flexibility to the FCA and that it was not helpful in the policy statement to speculate on what the circumstances of their use may be. The FSA also noted that TPIR's are just one of the full range of regulatory tools available to it, including resolution through supervisory action. Whilst this gives an indication that TPIRs will not ordinarily be the FCA's first point of call, it is not at all clear that they will be a measure of last resort either.

In the circumstances, it is not difficult to see how firms might have concerns about the cost of product development, or the risks of being first to market, without clarity on whether there may be an intervention. Whilst most respondents to the consultation endorsed the need for the new power in order to prevent consumer detriment, there was unsurprisingly also a strong sentiment communicated to the FSA that the impact of the power would inevitably be to supress innovation by Firms. One issue arising out of this for the FCA is how consistent its approach is with its "competition objective". The suggestion is that the FCA is fairly sensitive to this issue.

The FSA also reported that some respondents were concerned that the proposed communication of TPIR's to both the industry and consumers would not be sufficient, both in terms of the lead-up to a TPIR and its promulgation. In response, the FSA stated that it envisaged engaging with firms through the usual supervision process prior to issuing a TPIR – but clearly that will not always be appropriate or possible. In terms of publication, the FSA clarified that website publication would be the minimum level of communication. It reminded firms that it was their responsibility to keep up to speed with the latest regulatory changes. Some respondents sought imposition of a minimum lead time to the introduction of a TPIR, giving the industry an opportunity to take action before a TPIR comes into force. Given the purpose of the new power, this was (perhaps unsurprisingly) not accepted.

Whilst the new statement of policy is clearly useful, the FCA has given itself considerable flexibility to use its new power when it sees fit. As a practical first step, firms will need to take care to monitor this area and put in place mechanisms to catch, interpret and react to TPIR's as and when they are issued. As we have previously commented, depending on how TPIRs are used in practice, TPIRs are open to the challenge of judicial review by those bold enough to take such a step. That said, there is clearly a risk that any judicial review, even if successful, will come too late to reverse the harm done by the TPIR.
Please click for the Policy Statement

Is punishing individuals how the FCA intends to achieve real deterrence?

Everybody remembers Hector Sants' comment that people should be frightened of the FSA.

Perhaps recognising that this is not the kind of relationship the FCA should be seen to have with the regulated community, Martin Wheatley (the FCA Chief Executive) recently used rather different language to describe the FCA's approach. In a press conference on 21 March 2013, he said that people would not hear the "be afraid" words of the FSA. The FCA wanted, he said, to get back to having a discussion with the CEOs of firms.

That's all well and good; a regulator's relationship with its members should not be defined by fear. However, whether or not you call it a relationship defined by fear, the FCA is openly looking to further the goal of credible deterrence. One way that it will do so is by holding individuals more to account.

In that vein, it was in the very same press conference that Wheatley argued that heavy fines would not change the behaviour of institutions, as ultimately, these are just passed on to shareholders. He said that it was not until management were held to account that there would be changes in firms. Indeed, credible deterrence is an approach that remains central to the FCA's pursuit of enforcement. To achieve this, it says that it will pursue more cases against individuals and hold members of senior management accountable for their actions.

The timing of Martin Wheatley's comments are interesting. They came just a week before the FSA fined the Prudential a substantial amount of money and censured its CEO, Tidjane Thiam (see elsewhere in this edition "Prudential companies fined £30m and CEO censured for failures to inform regulator"). For all that the FSA insisted that the Thiam Notice should send a clear message to all board members of their collective and individual responsibility for the decisions they make on behalf of their companies, it was difficult to avoid the impression that the FSA were disappointed by only achieving a censure. Maybe Wheatley's comments about individuals one week earlier were laying the groundwork for the FCA's desired direction of travel on punishment of individuals. We expect to see a greater emphasis on the punishment of individuals in future.

FCA looks at IT failures at RBS

In April, the FCA announced that it had commenced an enforcement investigation into the IT failures at RBS Group (which include NatWest and Ulster Bank) which affected the Bank's customers (particularly those banking with Ulster Bank) in June and July 2012. We await to see the outcome of this. In light of Martin Wheatley's comments that the management of firms need to be held to account (see elsewhere in this edition "Is punishing individuals how the FCA intends to achieve real deterrence?"), what may be particularly interesting is what the result of any enforcement action will be for those relevant individuals with senior management posts.

Requests for assistance from overseas regulators

Following a request under the Freedom of Information Act, the FCA has disclosed to the Financial Times that in 2012 it received 857 requests for assistance from foreign regulators. By country, the largest number of requests came from the US (248 requests) with France being in second place (152 requests). The overall number of requests is down from the 1023 received in 2011. As the FT note, the spike in that year was (no doubt) the result of multiple investigations into LIBOR fixing. Nevertheless, the figures for 2012 demonstrate that, if nothing else, London (and hence the FSA) often finds itself involved in regulatory investigations commenced in other jurisdictions. What is less clear is the level of active involvement of the FSA in the foreign investigations to which these requests relate.

U.S. Government Actively Pursues Violations Of Foreign Corrupt Practices Act

The United States Department of Justice ("DoJ") has continued its active pursuit of violations of the Foreign Corrupt Practices Act ("FCPA"). In the first four months of 2013, the DoJ announced four actions against individuals and corporations for violations of or assisting in the violation of the FCPA.

Details of the first two cases, on April 5 and April 16, are outside the scope of this publication as they do not involve the investment industry, nor the United States Securities and Exchange Commission ("SEC"). Nevertheless, they provide a useful indicator for possible future SEC action, with both cases involving the unsealing of charges against individuals.

See details at:

(http://www.justice.gov/opa/pr/2013/April/13-crm-388.html).

(http://www.justice.gov/opa/pr/2013/April/13-crm-434.html).

The SEC was, however, involved in the following two cases, including its first published use of a non-prosecution agreement in an FCPA case.

On April 16, 2013, the DoJ announced a non-prosecution agreement with Parker Drilling Company, a Houston, Texas-based, publicly traded company, to resolve charges that it authorized a $1.25 million payment to an intermediary it knew would be used to improperly influence Nigerian government officials. The intermediary, Panalpina World Transport (Nigeria) Limited, sought to avoid Nigeria's customs law with regard to Parker Drilling's drilling rigs, as well as a $3.8 million fine which Nigeria levied against Parker Drilling. As part of the non-prosecution agreement Parker Drilling agreed to pay $11.76 million. Parker Drilling also settled related charges brought by the SEC, agreeing to pay $4.09 million in disgorgement and prejudgment interest. The DoJ noted that it took account of Parker Drilling's cooperation, including its "extensive, multi-year investigation into the charged conduct."

Additional information is available at (http://www.justice.gov/opa/pr/2013/April/13-crm-431.html).

On April 22, 2013, the DoJ announced a non-prosecution agreement with Ralph Lauren Corporation, a New York based apparel company, to resolve charges of FCPA violations for bribing Argentinean government officials. The agreement recounts that Ralph Lauren's Argentinean subsidiary bribed customs officials over a five-year period in order to clear customs, avoid paperwork, and sometimes to avoid inspection entirely. Ralph Lauren agreed to pay an $882,000 penalty, cooperate with the DoJ, and to implement enhanced compliance procedures to prevent and detect FCPA violations. In a companion proceeding, the SEC announced a separate non-prosecution agreement with Ralph Lauren requiring the company to pay $734,846 in disgorgement and prejudgment interest. It is noteworthy that the DoJ made a special acknowledgment of Ralph Lauren's "extensive, thorough, and timely cooperation."

Additional information is available at (http://www.justice.gov/opa/pr/2013/April/13-crm-456.html).

Comment

The four cases show the DoJ's continued use of non-prosecution agreements. They also evidence an increase in government focus on individuals for FCPA violations. Additionally, the DoJ continues to positively credit the cooperation of its targets. While the benefits of cooperation for a corporation may be a lower fine and the option of a non-prosecution agreement instead of criminal charges, for individuals the benefit may be significantly greater, including a reduced sentence, that can possibly eliminate prison time.

Investigation Into Interest Rate Rigging Expanded To ICAP And ISDAfix

As authorities continue to investigate and prosecute those responsible for rigging LIBOR, the United States Commodity Futures Trading Commission ("CFTC") has begun probing ICAP, the largest interdealer broker in the world and entity responsible for managing the ISDAfix benchmark rate.[4]

The ISDAfix benchmark rate represents the interest rate at which fifteen of the world's largest banks say they would buy and sell a benchmark swap with a notional value of $50 million. The banks included in the rate are Bank of America Corp., Barclays, BNP Paribas SA, Citigroup Inc., Credit Suisse AG, Deutsche Bank AG, Goldman Sachs Group Inc., HSBC Holdings Plc, JPMorgan Chase & Co., Mizuho Financial Group Inc., Morgan Stanley, Nomura Holdings Inc., Royal Bank of Scotland, UBS, and Wells Fargo & Co. The rate is calculated daily at 11am in New York, and is included in a daily report on money-market rates from the U.S. Federal Reserve. According to news reports, concern about the ISDAfix rate was first raised by Martin Wheatley (now chief executive of the UK's new regulator, the Financial Conduct Authority) in a report concerning LIBOR. The CFTC has now issued subpoenas to ICAP and the fifteen other banks involved in setting the ISDAfix rate.

ICAP receives commissions based on the sizes of the trades it completes. According to ICAP's annual report, in 2012 it had an average of $1.4 trillion of transactions on its systems each day. One area of reported concern is with the manual entry of prices onto ICAP's electronic screen known as 19901. Because, it is said, ICAP tells its dealers not to enter trades into the system until a transaction is complete, the current market price listed on the screen is skewed. Additionally, at least one former ICAP broker has reported that because the entry of this data is manual, brokers may cause manipulation of the ISDAfix rate by failing to input data following the completion of a trade.

Comment

It is likely that the ISDAfix rate will not be the last inter-bank rate to receive attention by governmental authorities as they continue to investigate the improper behavior of banks and traders. Although it is still too early to tell whether any of the banks involved will face penalties for improper behavior, in light of the historic settlements that have already been reached with banks implicated in the LIBOR scandal, it is likely that additional significant settlements and fines will be forthcoming if government authorities discover actionable wrongdoing and malfeasance.

[4] It appears that ICAP was already being investigated by the U.K.'s Financial Services Authority for involvement in the LIBOR rigging scandal, according to a Financial Times report in January this year. The U.K.'s Financial Conduct Authority has reportedly joined the CFTC in investigating the ISDAfix rate.

JPMorgan Chase Faces Lawsuit Over Credit Card Collection Activities

On May 9, 2013, the State of California filed a lawsuit against JPMorgan Chase for allegedly engaging in fraudulent and unlawful debt-collection practices with respect to approximately 100,000 California credit card holders. According to the lawsuit, JPMorgan illegally "robo-signed" documents - meaning it electronically signed documents without reviewing them for accuracy or completeness - and failed to inform credit card holders that it was filing suit, despite claiming that it had provided the legally-required notification. This latter practice is known as "sewer service." Using these improper tactics, the lawsuit alleges, JPMorgan was able to file thousands of lawsuits on a monthly basis between January 2008 and April 2011. On one day alone JPMorgan apparently filed some 469 new actions against credit card holders. In addition to the State of California's action, the U.S. Office of the Comptroller of the Currency - one of JP Morgan's regulators - is reportedly preparing to file an enforcement action against JPMorgan for its credit card debt collection practices.

Additional information is available at:
http://www.latimes.com/business/money/la-fi-mo-california-ag-files-suit-against-jpmorgan-chase-alleging-debtcollection-abuses-20130509,0,6695376.story and
http://dealbook.nytimes.com/2013/05/09/california-sues-jpmorgan-chase-over-credit-card-cases/?ref=business.

Comment

California's lawsuit shows that state governmental authorities continue to investigate and prosecute banks for improper behavior. This case is notable because it shows authorities are expanding their banking oversight beyond improper mortgages activity and into other areas where enforcement and consumer protection has been historically lax.

New SEC Chairman Will Be Aggressive, and Appears To Change The Commission's Focus

On April 10, Mary Jo White was sworn-in as the 31st Chairman of the U.S. Securities and Exchange Commission ("SEC"). Ms. White is the first former federal prosecutor to hold the position. She has also been a white-collar defense attorney at a major New York law firm.

During her confirmation process, Ms. White pledged to oversee a "bold and unrelenting" enforcement program at the SEC, to focus on high-frequency and automated trading, and to explore the decrease in accounting fraud cases pursued by the SEC in recent years. Evidence of Ms. White carrying through on her promise can already be seen - (i) on May 1 news broke that the SEC had circulated a 500-page draft of new reforms for the money market fund industry, and (ii) on May 7 Ms. White stated that the SEC was reviewing the existing practice of allowing settlements without admission of guilt.

Beyond this, it also appears that the SEC has changed its view point, now seeing itself as one regulator amongst a sea of national authorities. For example, in her first month as Chairman, Ms. White met with regulators from Canada, China, Europe, Japan, Mexico, Singapore, Switzerland, and Australia. Similarly, on May 1, in her first formal speech as Chairman, Ms. White stated that "a defining fact of life at the SEC today is that we are not alone in the global regulatory space." Indeed, on May 1 the SEC unanimously voted to propose new rules for cross-border security-based swap transactions which would bring the SEC's rules more in-line with the regulations of other, non-U.S. regulatory authorities.

Additional information on these recent events can be found at: http://www.reuters.com/article/2013/05/07/us-sec-money-funds-idUSBRE94615H20130507; http://www.bloomberg.com/news/2013-05-07/white-says-sec-settlements-without-guilt-admissions-under-review.html; http://www.bloomberg.com/news/2013-04-18/sec-to-move-past-financial-crisis-cases-under-new-chairman-white.html; http://www.investmentnews.com/article/20130503/FREE/130509960#; http://www.sec.gov/news/press/2013/2013-77.htm.

Comment

Ms. White's promise to lead a "bold and unrelenting" enforcement program portends the continued active prosecution of violations of securities laws. Although an active SEC is cause for businesses to keep up their guard, the agency is not likely to be entirely unforgiving; indeed, recent enforcement actions have shown appreciation for cooperation in the form of smaller fines and the use of non-prosecution agreements.

Similarly, Ms. White's recognition of and apparent focus on the international nature of the regulatory environment may prove to have both benefits and drawbacks for businesses. On the one hand, changes in U.S. rules to comport with the rules of non-U.S. authorities should facilitate cross-border international businesses and provide more certainty as to applicable regulations. On the other hand, increased international cooperation will likely mean increased scrutiny of foreign operations and prosecutions brought concurrently by international authorities.