Baker McKenzie.

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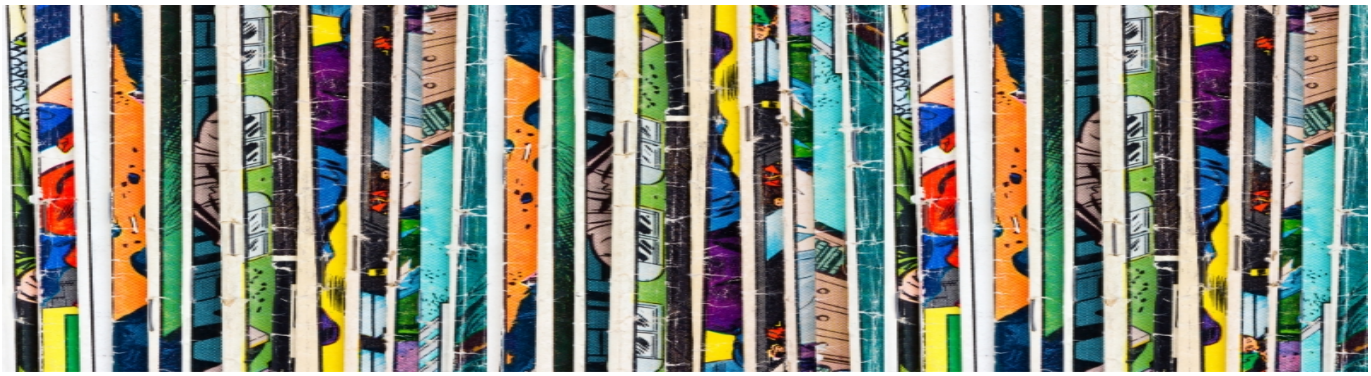

Financial Services - News on Enforcement & Cases

Welcome to this edition of News on Enforcement and Cases produced by Baker McKenzie's Financial Services Regulatory Group. This publication provides a non-exhaustive guide to enforcement actions plus cases, speeches, policy & rulemaking over the preceding month.

Commentary

Approach to enforcement

A headline development last month was the publication of the Financial Conduct Authority's paper detailing its Approach to Enforcement. This had been promised in the FCA's "Mission" statement on which it consulted last year. While this new paper does not contain any changes to enforcement, the conduct regulator seeks to explain how its approach fits with the Mission Statement. In particular, how the FCA: (i) seeks to address harm to its regulatory objectives; (ii) decides when to use statutory powers to investigate; and (iii) where appropriate, arrives at a decision to take civil, criminal and/or disciplinary action. The paper emphasises that when someone is referred for investigation, this does not mean the FCA has already decided that wrong-doing has taken place. A consultation on the question of "whether the paper sets out the approach clearly?" runs until 21 June. There is also an accompanying paper on the FCA's Approach to Supervision (an Approach to Authorisation paper was published in December last year). Of probably greatest interest, the FCA is reviewing its penalties policy in the Decision Procedure and Penalties Manual (DEPP) and a consultation is due later this year. The policy is unlikely to be relaxed. What's more, hard on its heels, is a review of the Enforcement Guide with a consultation expected in 2019.

Culture, values and behaviours

One might wonder why it took the FCA so long to prohibit, Paul Flowers, the former Chair of the Co-op Bank who stepped down almost five years ago. To be fair, a criminal prosecution for the possession of illegal drugs may have prevented earlier action. While the conclusion that Mr Flowers lacked the fitness and propriety required to work in the financial services industry is unsurprising, the FCA's Final Notice and its summary of reasons is helpful to anyone seeking to understand the FCA's expectations of senior management. This is especially important with the extension of the Senior Managers Regime to most financial services firms next year. In its Final Notice, the FCA quotes approvingly of the Financial Reporting Council's Guidance on Board Effectiveness, for example: "*The chairman should demonstrate the highest standards of integrity and probity, and set clear expectations concerning the company's culture, values and behaviours, and the style and tone of board discussions.*" This is a high bar. The Final Notice was followed by publication of the FCA's discussion paper on transforming culture in financial services and a speech by FCA, chief executive, Andrew Bailey. According to Mr Bailey, rules and supervision help "*create the right incentives and… provide tools to diagnose the key characteristics*" of the "right" culture. Senior Managers

should take note that the FCA will "*prompt and persuade*."

Unauthorised collective investment schemes

Last month saw the FCA secure two further successes in its campaign against unauthorised collective investment schemes (CIS). In the High Court, it obtained orders for restitution against Capital Alternatives Ltd for unlawfully establishing, arranging, operating and promoting such a scheme. The CIS involved persuading over 2,000 individuals to invest almost £17 million in rice farm harvests in Sierra Leone and in carbon credits to be generated from land in Sierra Leone, Brazil and Australia. The High Court had previously found that the schemes were a CIS under section 235 of the Financial Services and Markets Act 2000 (FSMA) for which FCA authorisation was required. A number of other issues remained to be decided. The High Court was satisfied to the civil standard, that the defendants had made misleading statements to investors contrary to section 397 FSMA (now replaced by Part 7 of the Financial Services Act 2012). Moreover, that "arranging deals" in investments (under Article 25 of the Regulated Activities Order) had, potentially, a very wide meaning. In order to make a restitution order, there had to have been a breach of a relevant requirement. The Court held that this included breaches of the general prohibition, financial promotion restriction and the breaches of section 397. This case demonstrates, as does the recent Supreme Court judgment in *Asset Land Investment Plc v FCA* [2016] UKSC 17, that the courts are taking are an expansive view of the legislation on CIS in order to protect consumers. The second development last month involving unauthorised CIS operators took place in the criminal courts. The operator of an unlawful CIS, Alex Hope, was sentenced to 18 months' imprisonment in the Crown Court for perverting the course of justice. He had breached a restraint order by failing to return investors' money. This sentence serves as a reminder that the FCA, which brought the application, has the resources to enforce the courts' orders.

FCA & PRA Published Statutory Notices (Final & Decision)			
Firm / individual	**Subject matter**	**Rule / Sanction**	**Summary**
FCA Final Notice to Paul Flowers NB: HM Treasury has directed that there is an investigation of the prudential regulation of the Co-operative Bank between 2008-13.	Fitness and propriety to work in the financial services	Fitness & Propriety (FIT) / FIT 1.3.1B G / prohibition order	Flowers was Chair of Co-op Bank (2010-2013). His conduct demonstrated a lack of fitness and propriety, in particular given his role in setting expectations for culture, values and behaviours. The standards expected of chairs were "necessarily of a high order." Flowers was found to have used his work mobile to call inappropriate premium rate chat lines and his work email to send and receive sexually explicit content and to discuss illegal drugs – in contravention of internal Co-op policies. After leaving the role, he was convicted of possession of illegal drugs.
FCA Final Notice to Guillaume Adolph	Misconduct in relation to LIBOR submissions	Being knowingly concerned in a contravention of Principle 5 in relation to the LIBOR benchmark / £180,000 penalty and prohibition order	The individual was an approved person who was found to have acted improperly and to be knowingly concerned in his employer's breach of Principle 5 (market conduct) by: (i) attempting to influence the submissions of other submitters to LIBOR at his firm, (ii) taking into account trading positions when making submissions, and (iii) improperly agreeing with a trader at another bank to make submissions reflecting requests made by that individual.

Tribunal / Court Decisions			
Firm / individual	**Subject matter**	**Rule / Sanction**	**Summary**
FCA Press release on Sentence of	Southwark Crown Court - FCA criminal proceedings	Perverting the course of justice /	In 2015 Alex Hope was sentenced to imprisonment for defrauding investors

Imprisonment for perverting the course of justice. See related FCA Final Notice of 9 January 2018.	for perverting the course of justice over breach of a restraint order under the Proceeds of Crime Act 2002 (POCA)	imprisonment	of more than £5.5 million and had been made subject to a confiscation order. Hope operated a collective investment scheme without authorisation, offering his investors high rates of return. In reality, most of the money was used to support his lavish lifestyle. Hope continued to deal with the funds in breach of the terms of a restraint order made under POCA and has now been sentenced to a second period of imprisonment for perverting the course of justice.
FCA v Capital Alternatives Limited, (26 March 2018) FCA Press Release	England & Wales High Court - authorised collective investment schemes	Sections 21, 383 and 397 of the Financial Services and Markets Act 2000 / Article 25 of the Regulated Activities Order / Order for restitution	The defendants were ordered to pay a total of £16.9 million in restitution for their roles in four unauthorised collective investment schemes which were unlawfully promoted to the public by false, misleading and deceptive statements. Investors were persuaded to invest in rice farm harvests in Sierra Leone and in carbon credits to be generated from land in Sierra Leone, Brazil and Australia.
R v Pabon [2018] EWCA Crim 420	Court of Appeal of England & Wales – safety of criminal conviction where expert witnesses unsatisfactory	Effect of expert witness going beyond area of expertise / appeal dismissed	A conviction for conspiracy to defraud was safe although the prosecution's expert witnesses had not complied with his duty to the court; his evidence going beyond his expert knowledge of banking. However, there was no causal link between these failings and the key issue at trial which was the defendant's dishonesty.
Garlsson Real Estate and others v Consob (C-537/16)	ECJ judgment on the double jeopardy rule in context of market conduct on a reference for a preliminary ruling	Article 50 EU Charter of Fundamental Rights - double jeopardy rule - the prosecution or the imposition of criminal penalties on the same person more than once for the same offence	The Italian regulator, Consob, had brought administrative proceedings seeking to impose a fine against Mr Ricucci and others for manipulating the price of securities. While those proceedings were ongoing, Mr Ricucci was subject to a criminal conviction arising out of the same conduct. The ECJ held that national legislation allowing administrative proceedings against a person already convicted of market manipulation is incompatible with Article 50. Further, the ECJ considered that Article 50 is not limited to administrative proceedings classified as "criminal" by national law, but to proceedings and penalties which are of a criminal nature on the basis of established criteria. The ECJ, nonetheless, stated that a duplication of criminal proceedings and penalties might be justified if they had complementary aims relating to different aspects of the same unlawful conduct. Article 50 was held to be directly applicable in national law.
Frederick and others v Positive Solutions (Financial Services) Ltd [2018] EWCA Civ 431	Court of Appeal of England & Wales – Vicarious liability of financial services business	Vicarious liability of financial advice firm for fraud	A firm of financial advisers which ran a mortgages business was not vicariously liable for a fraud (false mortgage applications) committed by one of its agents. The wrongdoing in question was part of a separate

			business conducted by the individual concerned and was not integral to advisers' business, despite the use of the firm's online portal.
Property Alliance Group Ltd (PAG) v Royal Bank of Scotland plc [2018] EWCA Civ 355	Court of Appeal of England & Wales – enforceability of interest rate swaps agreements (SWAPs) - points of law raised	Common law, negligent mis-statement, misrepresentation, exercise of contractual rights / Appeal dismissed	PAG had entered into Swaps with RBS in 2004, but had terminated them early. On its claim for negligent mis-statement over the cost of breaking the Swaps, PAG argued that RBS was in breach of duty on the basis of *Hedley Bryne* as applied in *Bankers Trust International Plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518. The Court, held that Bankers Trust did not establish a wider duty (i.e. an intermediate duty). In any event, RBS had correctly explained the Swaps, including the circumstances in which break costs might be incurred and their calculation. PAG also argued, unsuccessfully, that had it known that LIBOR was being manipulated by RBS, it would never have agreed to the transactions. While accepting RBS had impliedly represented it was not manipulating LIBOR, there was no evidence it had done so in relation to sterling LIBOR with which the SWAPs were concerned. PAG also argued that RBS' Global Restructuring Group had improperly exercised its contractual right to value PAG's property portfolio. Although PAG lost its claim on the facts, as a matter of law, the Court held this power was not unfettered. There was an implied term to use it for legitimate commercial reasons.

Speeches, Policy & Rulemaking		
What & Who	**Subject Matter**	**Summary**
FCA published Handbook Notice 53	Changes to the FCA Handbook on Dispute Resolution	The FCA has published Handbook Notice 53 setting out changes to the FCA Handbook which include: Dispute Resolution: Complaints (Politically Exposed Persons and Pensions Ombudsman).
FCA Financial Crime Guide	The FCA is updating its Financial Crime Guide for firms to reflect the new EU Market Abuse Regulation (MAR) and the UK Money Laundering Regulations 2017(MLRs).	The Guide contains an additional chapter on insider dealing and market manipulation that takes account of the MAR, setting out the FCA's views on good and bad market practice around the requirement to detect, report and counter the risk of financial crime. The FCA states that while Article 16(2) of MAR requires firms to detect and report potential market abuse, the FCA Handbook, at SYSC 6.1.1R, extends these obligations to counter the risk of financial crime generally. Firms are reminded that insider dealing and market manipulation are both predicate offences to money laundering and that they should be aware of their obligations under POCA (e.g. SARs and tipping off). The Guide does not provide any FCA guidance on Article 16 MAR itself which falls within ESMA's remit. Most other changes are minor amendments to reflect the introduction of the MLRs. The Guide is also to be re-numbered.
FCA Our Approach to	This document explains the	The FCA explains that this is one of a number of

Enforcement	FCA's approach to enforcement.	documents promised in its Mission Statement. The paper outlines its approach to enforcement and how that approach aligns with its "Mission." It also explains how the FCA seeks to address harm to its regulatory objectives and how it decides when to use its statutory powers to investigate or, where appropriate, to take civil, criminal and/or disciplinary action.
HM Treasury draft Order	Bringing the new market manipulation offences within scope of deferred prosecution agreements (DPAs)	In what are technical changes, HM Treasury has published a draft statutory instrument to bring the market manipulation offences in the Financial Services Act 2012 within the scope of DPAs. As a corollary, it removes the now repealed offences of making misleading statements and practices in section 397 of the Financial Services and Markets Act 2000 from scope. See explanatory note.

How Baker McKenzie can help

We assist financial services clients on complex and high profile banking and financial services disputes, FCA enforcement cases, and internal and external investigations. Our team can provide coordinated advice and expertise across 47 jurisdictions in Europe, the United States, the Middle-East, CIS and Asia Pacific. Clients also benefit from our lawyers' experience of working for enforcement authorities in their local jurisdictions, including the SEC and US DoJ.

Our team comprises lawyers with substantial contentious experience combined with a detailed knowledge of banking and financial services-related laws and regulations. Many of our specialists have in-house experience and all have been selected for their in-depth understanding of financial services clients' business environment and commercial objectives. We look to ensure that clients receive the right advice when they most need it.

We also frequently act for individuals, often instructed by financial institutions to act for their employees requiring separate independent representation.

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