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Serious Fraud Office Closes Forex Investigation

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Introduction

The Serious Fraud Office (SFO) recently announced that it had closed its criminal investigation into allegations of fraudulent conduct in the foreign exchange (FX) market. The SFO began its investigation in July 2014 following the referral of material by the Financial Conduct Authority (FCA). This note explores the SFO's decision to drop its FX investigation and discusses some of the possible reasons behind it.

Regulatory FX findings

The SFO's decision is perhaps surprising given that Martin Wheatley, previously head of the FCA, had said that the allegations regarding FX market rigging "*have been every bit as bad as we've had for Libor.*" In November 2014 the FCA imposed fines totalling over £1.1 billion on five banks for failing to control business practices in their FX trading operations which enabled traders at these banks to manipulate FX benchmarks. Meanwhile, in a co-ordinated action with the FCA, the US Commodities Future Trading Commission simultaneously imposed fines of \$1.4 billion on those same banks and ordered them to introduce remedial measures to strengthen their internal controls and procedures. A Swiss-based bank has also been sanctioned by the Swiss regulator FINMA.

These actions were followed in May 2015 by the imposition of a similar-co-ordinated penalty of some \$2.4 billion against a British bank by the FCA and several US regulators. This included a fine of over £284 million by the FCA, the largest financial penalty ever imposed by the FCA or its predecessor, the Financial Services Authority (FSA).

The FCA alleged that traders at those banks had attempted to manipulate fix rates (both alone and in collusion with traders at other institutions), deliberately triggered clients' "stop loss orders" (where the bank agrees to transact with a client at a specified rate if the currency trades at that rate) and shared confidential information with other market participants. The FCA held that these actions were carried out for the banks' own benefit and to the potential detriment of their clients and other market participants. This behaviour was facilitated by traders at different institutions communicating through messaging services and online chat rooms. The traders were held to have formed tight-knit groups based on mutual benefit; describing themselves using phrases such as the "*A-team*", "*the 3 musketeers*" and "*the players*".

It was alleged by the regulators that traders used these chat rooms to share confidential information about their clients' businesses and about fix orders prior to the fix. They used this information to determine their trading strategies and to attempt to trigger stop loss orders and manipulate the fix in the desired direction (for example, to ensure that the rate at which the bank had agreed to sell a particular currency to its clients was higher than the average rate it had bought that currency in the market). For example, the FCA Final Notice against one US bank indicates that on one occasion the bank's traders had net "buy orders" on a fix date, which meant it would benefit if it was able to move the fix rate upwards (as the US bank would profit if the fix rate at which it sold Euros was higher than the average rate at which it bought Euros in the market). The US bank's traders co-

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ordinated with traders of another bank, "Firm A", which also had net buy orders, to manipulate the rate fix higher. Firm A stated "*I'd prefer we join forces*" and the trader at the US bank responded "*perfick...lets do this...lets double team em.*" Similarly, on another occasion, a trader at a British based bank co-ordinated with traders at other institutions who had net client sell orders (and so who would benefit if they were able to move the fix rate lower), to manipulate the GBP/USD fix lower. Following a fall in the 4pm fix rate for GBP/USD the traders congratulated each other stating "*nice work gents...I don my hat*", "*hooray nice team work*", "*have that my son...v nice mate*" and "*dont mess with our ccy [currency]*".

Regarding stop loss orders (which could be profitable if a particular currency could be sold to a client at a higher rate than the bank had bought that currency in the market), one trader, in attempting to force the market through a particular level described himself as "*just jamming a little stop here*".

The FCA's Final Notices also highlight the value of collusion amongst traders. For example, one trader thanked a trader at another firm for disclosing his selling interest ahead of a fix as it helped them align their trading ("*cheers for saying you were same way helped me go early*"). Further, a trader within one group complained in a chat room about another trader in the group not disclosing a large net order to him in advance of a fix: "*u are uselees [useless] ... how can I make free money with no fcking heads up*".

Comment

Given the huge fines imposed by the FCA and US regulators, the size and importance of the foreign exchange market (with a daily average volume turnover of approximately USD5 billion) and the conduct disclosed in the regulatory notices, the SFO's decision to drop its investigation - especially when compared to its stance on Libor - is surprising.

The SFO's statement noted that "*whilst there were reasonable grounds to suspect the commission of offences involving serious or complex fraud, a detailed review of the available evidence led us to the conclusion that the alleged conduct, even if proven and taken at its highest, would not meet the evidential test required to mount a prosecution for an offence contrary to English law.*" Under the CPS Code for Crown Prosecutors (the "CPS Code"), when deciding whether to bring charges, the SFO must be satisfied that there is sufficient evidence to provide a realistic prospect of conviction (before then considering whether such a prosecution is in the public interest). The test here is whether a jury is more likely than not to convict the defendant of the charge alleged - a lower standard to that which a jury in a criminal case must be satisfied of prior to any conviction. The CPS Code stipulates that the SFO must consider what the defence case may be, and how it is likely to affect the prospects of conviction.¹

What stands out from a reading of the FCA Final Notices are the lack of policies and guidance regarding both the use of chat rooms by traders, and what were acceptable communications. For example, in its findings against one bank, the FCA noted that what limited guidance there was regarding the general use of chat rooms was not specific to the FX trading business and did not explain in sufficient detail the types of chat room communications that were considered to be unacceptable. Meanwhile at one bank, where the front office had primary responsibility for identifying, assessing and managing the risks associated with its spot FX trading business, some individuals responsible for managing front office matters were not only aware of but also at times involved themselves in the alleged FX market manipulation. Given this prevalent culture and the

¹ The judge may uphold a submission of no case to answer if he/she concludes that a properly directed jury could not properly convict upon the prosecution evidence (following the test set out in *Galbraith*)

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lack of guidance, some FX traders may have sought to argue that their conduct was simply not dishonest. However, in the recent failed Libor trial (noted below) these arguments did not seem to dissuade the SFO from continuing its investigations and bringing prosecutions.

Furthermore, the FCA has been clear in their conclusions that the chats and behaviour identified in the FX investigations show an intention by some traders to manipulate the FX markets and prejudice the interests of other market participants and/or their clients. It would appear on evidential and public interest considerations clearer to continue with these investigations than the alleged manipulation of Libor which, as described in a report by Martin Wheatley, is “a flawed benchmark” and where arguably there is a lack of identifiable victims (i.e. those who weren’t also involved in the conduct complained about).

What may have ultimately discouraged, or given the SFO some reservation in continuing its investigation, is the recent acquittal of the six brokers in the second Libor trial at Southwark Crown Court in January 2016. Given the nature of those acquittals and the expense of such trials, which are often contested, it is possible that the SFO has decided to take a more cautious approach to prosecuting individuals. As a result of its budgetary constraints it was recently reported that the SFO had asked the government for an extra £21 million to meet urgent cash needs. Furthermore, despite the recent extension of David Green QC’s contract as Director until April 2018, the SFO’s outlook may well be short term. As Southwark Crown Court is currently struggling to find court space for trials before 2018, it is unlikely that any potential FX manipulation trial would have concluded prior to David Green QC’s departure.

The SFO’s struggle in its prosecution of individuals is in stark contrast to its recent successes in relation to corporate investigations. In November 2015 the courts approved the SFO’s first Deferred Prosecution Agreement against Standard Bank PLC. In February 2016 Sweett Group PLC was sentenced having pleaded guilty to an offence under section 7 of the Bribery Act 2010. The company received a £2.5 million fine and was ordered to pay the SFO’s costs. Many other corporate investigations continue. The distinction may well be as a result of the fact that some corporations make admissions for commercial reasons whilst individuals often contest the charges they face, especially where the sentencing guidelines are such that it is worth a fight, no matter the strength of the evidence. US style plea-bargaining, of course, has no place in the English judicial system.

Conclusion

The closure of the SFO’s FX investigation stands in direct contrast to its continued prosecution of former Libor and Euribor traders although the rationale for continuing one and not the other is unclear. It is worth remembering that in 2012 David Green QC stated publically that the SFO’s reputation should be judged on its investigation of Libor. No such promise was made in relation to the FX investigation. Therefore, whilst the third Libor trial of former US Dollar Libor traders recently commenced at Southwark Crown Court, one is left to wonder whether the decision to stop the FX investigation was really based on a lack of evidence or whether budgetary constraints and the reputation of the SFO had a role to play.

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