

13 December 2017

UK and U.S. Enforcement Update: Lessons from Key Cases

Robert Hadley, Partner, K&L Gates LLP – London

Michael McGrath, Partner, K&L Gates LLP – Boston

Sarah Turpin, Partner, K&L Gates LLP – London

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U.S. ENFORCEMENT UPDATE

- SEC Enforcement Priorities and Trends
 - Trends for 2017 and 2018
 - Initial Coin Offerings (ICOs)
 - Disgorgement Priorities
 - Performance Advertising
 - Compliance Officer Liability
- SEC Examination Priorities and Guidance



ENFORCEMENT TRENDS

- **754** enforcement actions during the 2017 Fiscal Year
 - Compare to **868** total actions in 2016
- \$3.8 billion in disgorgement and penalties over the 2017 Fiscal Year
 - 7% drop (\$4.08 billion in 2016)
- Preference for litigated proceedings on the wane
 - Back to “neither admit nor deny”?
- Whistleblowers protections: employment agreement scrutiny for anti-retaliation and “pre-taliation” language
- Fiduciary duties of advisers and conflicts of interest



INITIAL COIN OFFERINGS (ICOS)

- No Action Letter: 25 July 2017
 - Decentralized Autonomous Organization (DAO) Report
 - First public statement regarding ICOs
- SEC determined some “coins” or “tokens” for sale are actually securities and can be regulated
- Chairman Clayton:
 - “I have yet to see an ICO that doesn’t have a sufficient number of hallmarks of a security”
- 4 December 2017: Emergency asset freeze to halt PlexCoin ICO





DISGORGEMENT PRIORITIES

- Kokesh v. SEC

Unanimous decision that disgorgement is a penalty (not an equitable remedy)

- Subject to five year limitation period
- Some question whether SEC can seek disgorgement at all
 - \$15 billion lawsuit against SEC

- Impact

- Benefits of self-reporting must be scrutinized
- Cooperation and tolling agreements more important than ever
- Factor in settlement discussions
- Resources issue for SEC staff





PERFORMANCE ADVERTISING

- In the Matter of F-Squared Investments, Inc.
 - \$35 million settlement
 - Admitted misleading investors through falsely advertising the hypothetical performance of an investment product
- “Follow-on” Actions
 - Virtus
 - Cantella
 - 13 Advisers
- Obligations applicable to performance advertising
 - Accuracy and full disclosure
 - Retention of records that substantiate performance claims
 - Due diligence of third-party performance claims



CHIEF COMPLIANCE OFFICER LIABILITY

- Susan M. Diamond, Advisers Act Rel. No. 4619 (Jan. 19, 2017)
 - Private funds adviser allegedly filed Forms ADV with false statements that financial statements were audited and would be distributed
 - COO found liable for overseeing completion of forms containing the false statements
- David I. Osunkwo, Adviser Act Rel. No 4745 (Aug. 15, 2017)
 - Outsourced COO failed to file timely and accurate Forms ADV and amendments; filings overstated AUM and total number of client accounts; allegedly relied on and failed to verify CIO's inaccurate statements
 - Violations of IAA Sections 204 and 207, \$30,000 penalty, and 12 month industry suspension
 - Firms sanctioned for recordkeeping and filing violations

2017 OCIE EXAMINATION PRIORITIES

- Market-wide risks
- Protection of retail investors
 - Electronically delivered investment advice
 - Wrap fee programs
 - ETFs
 - Registered advisers
 - Recidivists and employers that hire them
 - Analyze multi-branch advisers
 - Instances of conflicts of interest
- Protect senior investors and retirement investments
 - ReTIRE initiative to protect investors with retirement accounts
 - Monitor public pension advisers
 - Identify potential financial exploitation of seniors





2017 OCIE EXAMINATION PRIORITIES

- Multi-Branch Adviser Initiative, focusing on:
 - Advisers that offer services from multiple locations, focus on compliance programs and personnel for remote locations
 - Programs under the Compliance Rule, the implementation of policies at both main and branch offices, the supervision structure for branch offices, the empowerment of compliance personnel in branch offices, and the accuracy of branch offices' filings
 - Investment recommendations from branch offices



COMMON DEFICIENCIES

- The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers (Feb. 7, 2017)
 1. Compliance Rule
 2. Inadequacies in Required Filings
 3. Custody Rule
 4. Code of Ethics Rule
 5. Books and Records Rule



UK ENFORCEMENT UPDATE





FCA ENFORCEMENT 2016-2017

- Extending the Accountability Regime
 - Market Abuse Insider Dealing
 - Criminal Prosecution
 - Higher Fines - £225.5 million (including one of £163 million) so far in 2017 after only £22.2 million in 2016
 - Senior Management: encouraging a culture of individual responsibility
 - More Investigations





FCA ENFORCEMENT 2016-2017

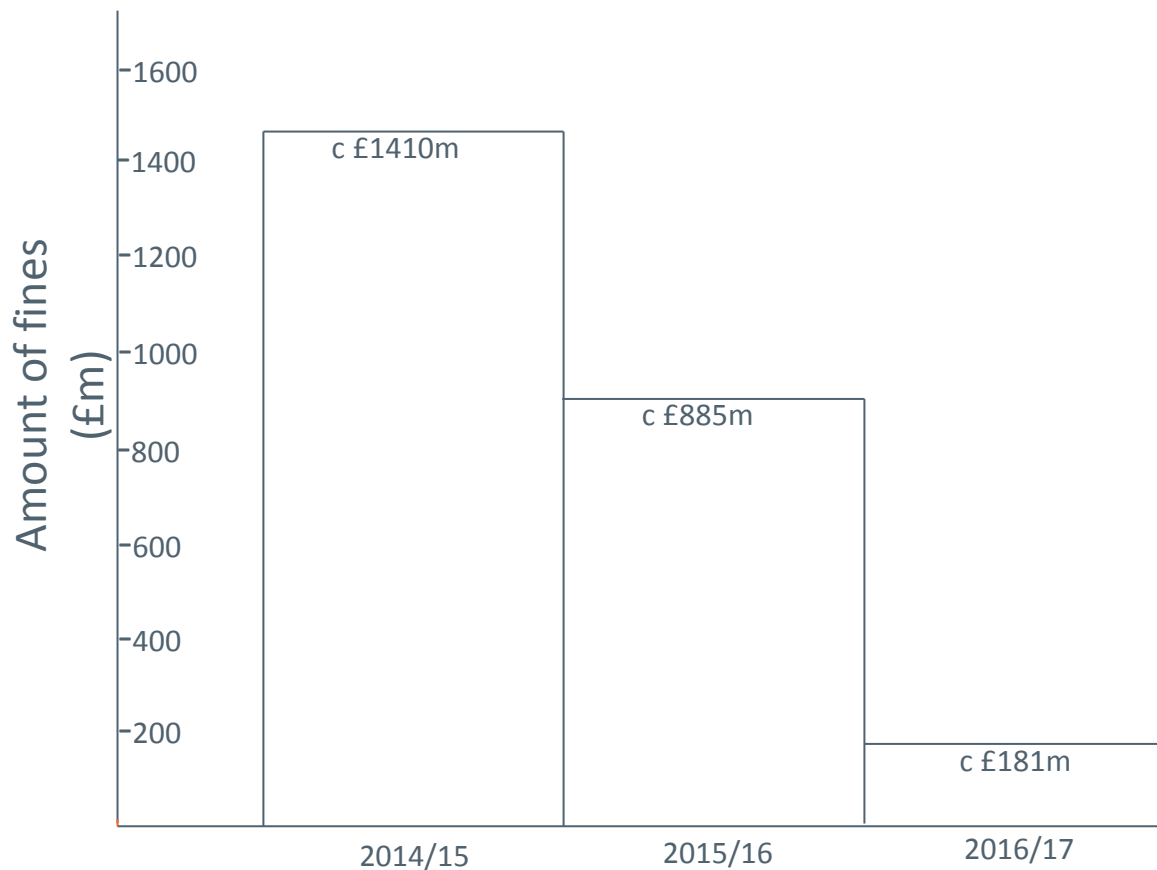
- Actions against individuals
 - £0.9 million in 2016/17 – £4.2 million in 2015/16
- Actions against firms
 - £180.1 million in 2016/17 – £880.4 million in 2015/16





FCA ENFORCEMENT 2016/17

TOTAL VALUE OF FINES IN RECENT FINANCIAL YEARS



SENIOR MANAGERS REGIME

- Attestations
 - Total number of attestations in last four most recent quarters – 76
 - Investment Management in Q2 2017/18 – 0
- The Senior Managers and Certification Regime (SM&CR) to be implemented in 2018
- Proposals published on 26 July 2017 to extend the SM&CR to almost all regulated firms. Three parts to expansion:
 - Five Conduct Rules that will apply to all financial services staff at FCA authorised firms
 - The responsibilities of Senior Managers clearly set out and then be held personally to account
 - Under the Certification Regime, firms will certify individuals for their fitness, skill and propriety at least once a year, if they are not covered by the Senior Managers Regime but their jobs significantly impact customers or firms





INDIVIDUAL ACCOUNTABILITY

- David Watters Compliance Officer
 - Pension Transfers
 - Statement of Principle 6 – due skill, care and diligence
 - Fined £75,000





INDIVIDUAL ACCOUNTABILITY

- Steven Smith
 - Money Laundering Reporting Officer
 - Sonali Bank (UK) Limited
 - Statement of Principle 6 – due skill, care and diligence
 - Knowingly concerned in Bank's breach of Principle 3 systems and controls
 - Fined £25,600 (£17,900 after 30% discount)
 - Prohibition from SMF16, SMF17, CF10, CH11

SYSTEMS AND CONTROLS

- Transaction Reporting
 - £49.3 million (£34.5 million after 30% discount)
- Anti-Money Laundering
 - £220 million (£163 million after 30% discount)
 - Sonali Bank (UK) Limited as above
 - £4.6438 million (£3.256 million after 30% discount)
 - 240 days restriction on accepting deposits from new customers (168 days after 30% discount)
- Market Abuse Inside Information
 - £1.5 million (£1.2 million after 20% discount)
 - Restriction on new corporate broking clients
 - Principle 3 systems and controls
 - Also SYSC10.1.6R, 10.1.10R(1), 10.1.11R

MARKET ABUSE

- Paul Walter
 - Experienced Bond Trader
 - Pre-MAR
 - Beat the algorithms
 - Spoofing / Layering
 - False and misleading impression / secure artificial price





MARKET ABUSE - MARKET MANIPULATION

- MAR Article 12(1)(a): “entering into a transaction, placing an order to trade or other behaviour which:
 - (i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument....; or
 - (ii) secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level”
- ESMA Guidance
 - https://www.esma.europa.eu/sites/default/files/library/2015/11/esma_2012_122_en.pdf





MARKET ABUSE

- Paul Walter
 - 12 instances
 - Book profit €22,000
 - Did not intend to commit market abuse
 - Should have realised that what he was doing was market abuse
 - Fine £60,090 (No prohibition)





MARKET ABUSE – MARKET MANIPULATION

- Section 90 Financial Services Act 2012 – Criminal Offence
- Any act or...course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant instruments... if –
 - P intends to create the impression; and
 - P intends by creating the impression, to induce another person to [deal or not deal or act or not act in or on] the investments; or P knows the impression is false or misleading or is reckless and P intends to make a gain or cause a loss
- Defence of reasonable belief





INTERNAL INVESTIGATIONS

- Legal Professional Privilege
- Director of the Serious Fraud Office v Eurasian Natural Resources Corporation Limited [2017] EWHC 1017 (QB)
 - Litigation privilege – Investigation is not prosecution / litigation
 - Cross-border issues





GLOBAL APPROACH TO ENFORCEMENT

- Worked with US Securities and Exchange Commission (SEC) in relation to breaches of the US Foreign and Corrupt Practices Act by the Och Ziff Capital Management Group resulting in the firm agreeing to enter into a Deferred Prosecution Agreement for payment of \$213 Million on 29 September 2016
- Worked with the New York Department of Financial Services (NY DFS) to secure its outcome for breaches of PRIN 3 and SYSC related to culture/governance and financial crime in the investment bank sector; serious anti-money laundering failings resulted in the largest financial penalty to date for AML control failings (£163 million)





MAXIMISING INSURANCE COVERAGE FOR REGULATORY AND CRIMINAL INVESTIGATIONS

- D&O and E&O cover – may be combined
- Potential obstacles to coverage
 - Specified Wrongful Act requirement
 - Coverage triggers can be limited
 - Legal costs and expenses – potential limitations
 - Civil fines and penalties (regulator may prohibit recovery)
 - Common coverage exclusions (fraud/dishonesty etc.)
 - Late notification/non-disclosure



MAXIMISING INSURANCE COVERAGE FOR REGULATORY AND CRIMINAL INVESTIGATIONS

- Additional elements of cover worth requesting
 - pre-investigation
 - investigations resulting from self-reporting or whistleblowing
 - dawn raids
 - internal investigations
- Coverage implications of Senior Managers' regime





INVESTMENT MANAGEMENT REVIEW

- Multi-firm review of Investment managers ensuring effective oversight of best execution (March 2017)
 - Firms should have a strategy to ensure that all relevant parts of the business are compliant in ensuring best execution
 - Firms should have clear management responsibility and co-ordination between the front office and compliance to ensure a robust monitoring framework
 - Firms should test funds and client portfolios to ensure that investors are not paying too much for execution and investors should be compensated if they are.
 - Firms should ensure that their order execution policy accurately reflect the firm's business model
 - Firms should ensure regular monitoring to identify deficient trades or trends





INVESTMENT MANAGEMENT REVIEW

- Asset Management Market Study Final Report (June 2017)
 - The FCA proposes to:
 - strengthen the duty on fund managers
 - require fund managers to appoint a minimum of two independent directors to their boards
 - introduce technical changes to improve fairness around the management of share classes
 - A single, all-in-fee to investors consistent and standardised disclosure of costs and charges to institutional investors





ENFORCEMENT 2017 – 2018

- Firms' Culture and Governance
- Individuals/Senior Management
- Implementation of MiFID II
- Higher Fines
- Competition
- Implementation of ring-fencing in retail banking
- Market abuse systems and controls
- Friends with US





THANK YOU

