Duff & Phelps

GLOBAL ENFORCEMENT REVIEW

2016

Exploring the impact of regulatory enforcement on the global financial services industry

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About the Global Enforcement Review

Now in its third year, Duff & Phelps' Global Enforcement Review provides analysis and commentary on global enforcement trends in the financial services industry. To compile this report, we studied published data released by the UK Financial Conduct Authority, the U.S. Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission, the U.S. Financial Industry Regulatory Authority, and the Securities and Futures Commission of Hong Kong in 2015 and recent years. We have also explored the enforcement trends specifically in various offshore jurisdictions in the chapter: The Changing Tides. As definitions and reporting standards vary across the authorities under review, certain data points may not be unilaterally comparable or available. We have nevertheless sought to examine figures from each regulatory body as indicative of wider trends in the global financial services industry.

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Executive Summary: The New Enforcement Landscape

After the post-crisis frenzy and benchmark rigging scandals, this year's Global Enforcement Review shows regulators returning to business as usual. However business as usual and the enforcement environment are likely to look a little different for the financial services industry.

Our analysis of financial sector regulators shows a calmer, steadier picture in 2015. Rapid growth in spending and staffing at the regulators following the global financial crisis is no longer widely evident. Regulators' staffing levels continue to increase – in part as their responsibilities grow – but at a more modest rate.

Penalties, too, despite a few big fines at the UK's Financial Conduct Authority (FCA) and US Commodity Futures Trading Commission (CFTC), are edging lower as the LIBOR and Forex manipulation cases come to a conclusion.

After a few years of high drama, enforcement is returning to normality.

But It's a New Normal

First, it is a normal where trust has been weakened. The LIBOR and Forex scandals conclusively demonstrated that the financial crisis did not see an end to the industry's cultural problems.

Second, those scandals and the penalties that resulted have recalibrated expectations when it comes to enforcement action, perhaps irrevocably. We may see fewer massive fines as the last benchmark rigging cases are finalised, but penalties for more mundane failings are likely to be more severe as a result. "Credible deterrence" doesn't mean what it used to, at least in terms of the size of penalties.

Regulators are also less tolerant of failures by firms. The US Securities and Exchange Commission (SEC), the FCA and others increasingly take strong enforcement action for failures even where no financial crime results. This is not only among the

REGULATORS' AVERAGE INCREASE IN EXPENDITURE:

9.7%

REGULATORS' AVERAGE INCREASE IN STAFF NUMBERS:

5.5%

AVERAGE INCREASE IN TOTAL PENALTY AMOUNT:

5.3%

large regulators we have studied but elsewhere too, such as shown by the more focused approach of the French Autorité des Marchés Financiers (AMF) and some offshore regulators.

Finally, individuals are not immune from the regulators' focus. A large part of the regulatory response to the crisis and subsequent scandals has been to encourage individual accountability. Whilst it has long been the case at the SEC, actions against individuals also made up the majority of cases at the FCA, Hong Kong's Securities and Futures Commission (SFC) and the U.S. Financial Industry Regulatory Authority (FINRA) last year.

Encouragements for whistleblowers, either through financial incentives (in the U.S.) or new requirements on firms to ensure they facilitate disclosures (as in the UK), as well as improved data reporting and analysis, have helped regulators identify misconduct and the individuals responsible.

In the UK, the drive for individual accountability received a further boost from the introduction of the Senior Managers Regime, introduced in March 2016. Its effectiveness in clarifying individual responsibilities in large organisations will be closely monitored ahead of its roll-out to all FCA regulated firms in 2018.

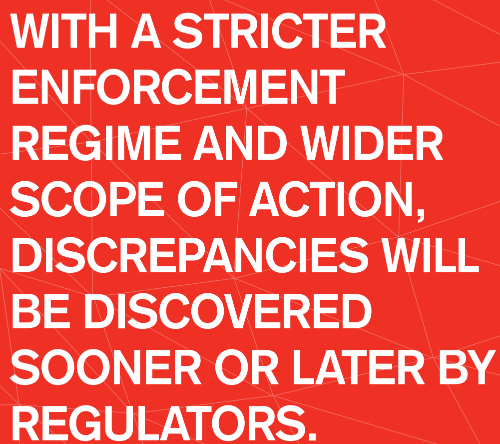
The Road Ahead: A Wider Focus

Overall, recent years have resulted in a much tougher enforcement approach. And now regulators will apply this to a much wider range of issues.

Benchmark manipulation has dominated regulators' workloads in recent years. As these cases come to a conclusion, regulators are free to look at other priorities – old and new. We may expect resurgence in insider trading action, for instance, as well as continued pressure on areas such as anti-money laundering (AML). Regulators are also increasingly looking at developing risks. Last year saw a number of first-time enforcement cases as regulators implemented new powers or came to grips with emerging issues, such as crypto currencies and cybersecurity. For those firms fortunate enough to escape some of the big enforcement drives of recent years, business as usual may feel unusually pressing as regulators focus more widely.

There are a number of ways firms can prepare, however.

First, and most obviously, all should be familiar with their regulator's publicly stated priorities and ensure their governance and compliance framework, systems and controls are in line with the standards regulators expect.



Second, they should ensure their data for reporting is in order. Just as regulators' intolerance for failures in systems and controls has grown, pressure is increasing on businesses to improve their data quality. Data analysis is behind an increasing number of enforcement actions, and regulators do not want these efforts undermined.

Finally, firms must continue to review and monitor their cultures. Recent years have shown that top-down messages and policies may disguise rather than address underlying problems, with businesses' public face and formal culture often at odds with the informal culture that prevails in practice. With a stricter enforcement regime and widening scope of action, discrepancies will be discovered sooner or later by the regulators.

We hope that you find this report of use. If you have any questions or comments, I would be pleased to hear from you. If you would like to receive our periodic regulatory insights, you can sign-up for these and other communications at www.duffandphelps.com/subscribe.

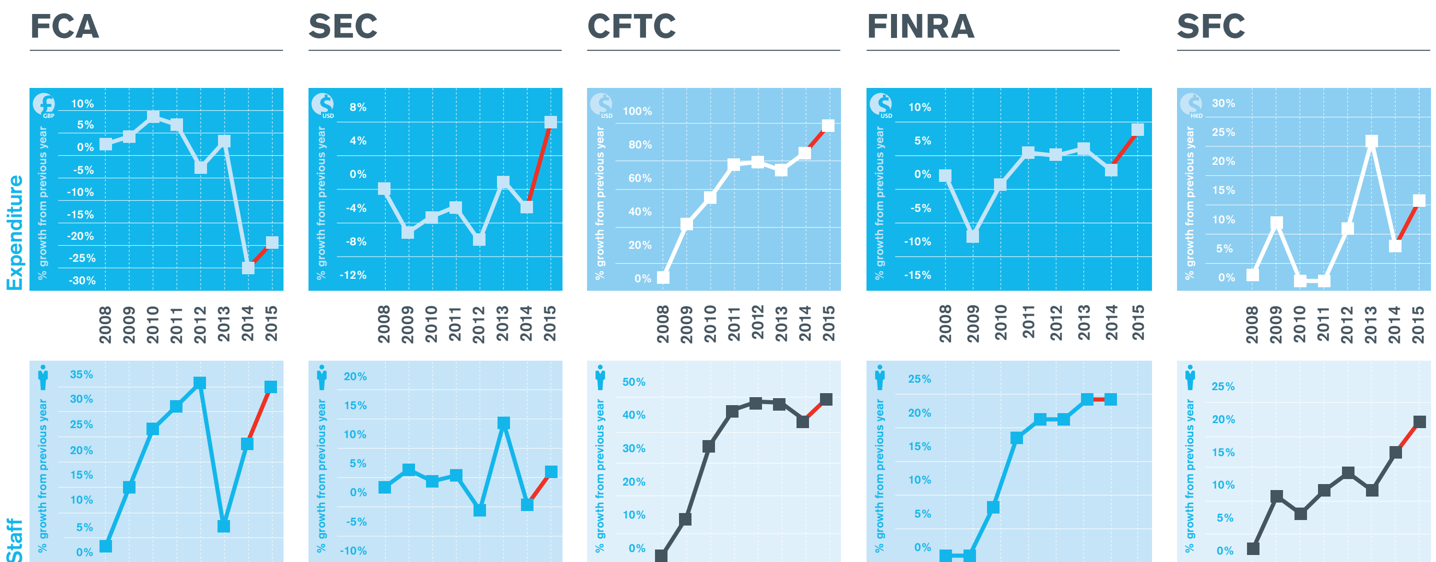
Back to Normality: Expenditure and Penalty Levels Begin to Settle

Spending up, staffing up, cases up, and penalties up: it's been a year of growth for the major financial regulators. Overall in the last year, the five regulators saw increases in expenditure (9.7%), staff numbers (5.5%), the number of cases (10.5%), and the total financial penalty amounts (5.3%)[1]. The headlines, however, only tell part of the story.

On the one hand, spending growth was largely consistent across the regulators – from an increase of 6% at the FCA to 16.2% at the CFTC. Staffing levels, too, grew on average across regulators - the highest increase (11.2%) at the FCA while FINRA remained consistent with the previous year.

On the other, this contrasts with the double-digit growth at many of the regulators in previous years. If it is a story of regulatory power continuing to grow, it remains more subdued than in the past.

Figure A – Annual Expenditure and Staff Growth Rates by Regulator



[1] The regulators' fiscal years vary: 1 October - 30 September for the SEC, CFTC and FINRA; 1 April - 31 March at the FCA and SFC

Moreover, when it comes to the numbers of enforcement cases and penalties, the averages hide big differences. The number of cases opened in 2015 at the FCA fell by close to a quarter (23%). At the SFC they increased more than half (57%).

The average total financial penalty amounts fell at the FCA (38.5%) and FINRA (28.3%), remained consistent at the SEC (1%), and increased at the SFC (18%) and CFTC (75%). The considerable increase at the CFTC is in part due to the regulator enforcing new powers granted under the Dodd-Frank Act including anti-spoofing and anti-manipulation authorities, as well as prosecutions of benchmark rate manipulation cases (including imposing the largest penalty in CFTC history of $800m against a global investment bank for manipulation of LIBOR).

Back to Business as Usual

Yet we can identify some consistent trends.

As we reported last year,[2] the big, double-digit increases in staffing and expenditure for the regulators do seem largely at an end. In the UK, the FCA faces pressure from an industry concerned about the costs of regulation,[3] and a government that has promised to end the banker bashing.[4]

Modest increases continue, however, partly as a result of growing responsibilities in recent years, such as taking on responsibility for regulating consumer credit, and more recently, claims management companies.

In the U.S., funding for the likes of the SEC and CFTC is more explicitly political, and there have been greater increases in budgets, up 9.9% and 16.3%, respectively. However, it's worth noting that the CFTC's settlement was below the figure it requested.[5] It is also well below growth in its budget in the years immediately following the financial crisis.

The story, then, is one of slower, steadier growth. Despite further damage to the industry's reputation from LIBOR and FX rigging, anger with the industry is less raw and governments are keen to avoid continually ramping up the regulatory burden. The growth in head-counts, which account for the majority of these budgets, is even more modest, partly also due to a greater reliance on technology and new ways of working (of which more later).

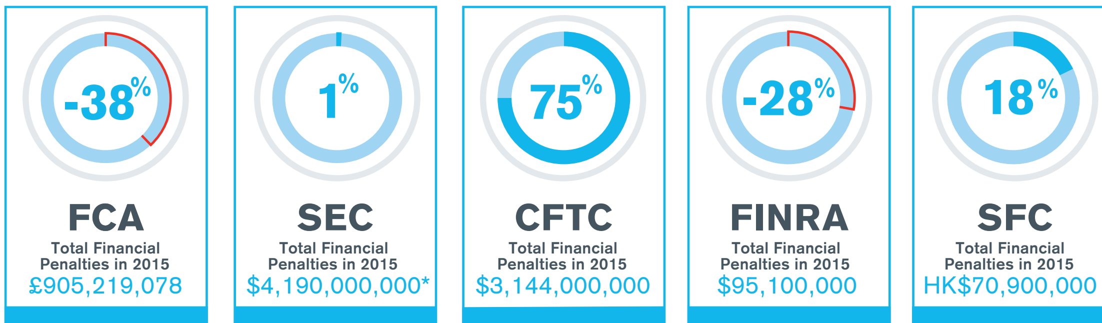
Penalties: A Downward Trend?

The total financial penalty amount on average across the regulators increased between 2014 and 2015 by 5.3% (see Figure B), with the FCA in particular seeing a significant drop. This is however reflective of several large fines relating to FX manipulation the year previously.

The average penalty size at individual regulators, meanwhile, also varies greatly but are easily distorted by a few big cases. The big increase at the SFC (47%), for example, is largely down to its total fine of HK$30 million on a global investment bank as part of a crackdown on electronic trading and dark pools.[6] It alone accounts for more than

[2] http://www.duffandphelps.com/assets/pdfs/publications/compliance-and-regulatory-consulting/global%20enforcement%20review%202015.pdf
[3] http://www.barclaysimpson.com/news/government-urged-to-cut-cost-of-financial-services-regulatory-compliance-news-801795958
[4] https://next.ft.com/content/eb8b6b1a-0b84-11e5-994d-00144feabdc0
[5] https://www.congress.gov/congressional-record/2014/12/11/house-section/article/H9284-3
[6] http://www.reuters.com/article/us-hongkong-jpmorgan-fine-idUSKBN0TY0XE20151215

Figure B – Change in Total Financial Penalty Amount from 2014 - 2015



* Includes penalties and disgorgements

40% of the total it imposed in penalties during the financial year.

In any case, the trend at the more active regulators in terms of average penalty sizes – the SEC, CFTC and FCA, which account for the majority of fines – is down. At the FCA, average penalties were down despite large fines against two global international banks relating to the Forex and LIBOR scandals. LIBOR rigging was also responsible for the biggest fine in the CFTC's history in April 2015.[7]

As these massive cases fall out of the figures it is likely to be reflected in lower total penalties issued across the big regulators. Again, we are potentially seeing a normalisation of regulatory enforcement activity – at least until a time when new cases like LIBOR surface.

No Let Up

However, business as usual doesn't mean less scrutiny for regulated firms. For most, it should mean quite the opposite.

LIBOR and FX rigging came to dominate the big regulators' workloads in the last few years. With the conclusion of this work, they can return to focus on other priorities. Unless the regulators face another crisis demanding so much attention, this should mean greater time and resources to look at a wider range of investigations in line with their enforcement priorities.

This could mean an increasing number of investigations in coming years. We are already, perhaps, seeing a revival: last year we reported a fall in the number of regulatory cases filed by the CFTC, FINRA and SFC. This year, we see an increase in the number of cases opened by those bodies, along with the SEC's continued upward trend. Only the FCA, which opened 84 cases (a reduction of 22.9%), saw a drop.

Moreover, while the impact of the LIBOR and FX scandals on regulators' resources fades, their influence on penalties is likely to prove more enduring.

Penalties were already on an upward trend before the scandals broke. The more aggressive approach of the FCA dates back to the introduction of a new penalties regime by its predecessor, the FSA, in

[7] http://www.cftc.gov/PressRoom/PressReleases/pr7159-15

2010.[8] The SEC also had by then recognised the inadequacy of its approach set out in its 2006 Statement Concerning Financial Penalties, which, as one of its commissioners has admitted, re-directed "the focus of the inquiry away from the egregiousness of the conduct".[9]

The massive fines imposed for recent infringements are having a profound effect on firms', regulators' and the public's expectations. Hundred million or even billion-dollar fines now form the context in which other enforcement penalties are seen. "Credible deterrence" is accepted as an important factor in setting these penalties,[10] and perceptions of what constitutes deterrence have been – perhaps irreversibly – altered by the last few years. In short, it is likely that penalties for more typical regulatory infringements will be higher than before the FX and LIBOR scandals broke.

Despite changes in recent years, fines in many offshore and emerging economies are not on the scale of those at the larger regulators. For firms operating in these jurisdictions, this may follow at some point.

As a result, firms in many jurisdictions face the potential of a more wide-ranging and aggressive enforcement approach from regulators in the years to come. A return to business as usual for the regulators is likely to mean compliance and control functions are busier than ever.

> Across the global landscape, penalties for more typical regulatory infringements will likely be higher than before as perceptions of what constitutes deterrence have altered over the last few years.

[8] https://corpgov.law.harvard.edu/2012/01/05/the-enforcement-regime-of-the-uk-financial-services-authority/
[9] https://www.sec.gov/News/Speech/Detail/Speech/1370540071677
[10] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD490.pdf

Brexit: A New Enforcement Reality?

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The UK's vote to leave the European Union (EU) sent shockwaves around the globe. It will undoubtedly be several years before it can be properly judged whether it was the genesis of new opportunities for the UK or a serious misstep. What's clear though is that there will be much work to be done by the UK government and regulators as well as their European counterparts.

The Hunt for Greater Resources

While the bulk of the work in the UK will presumably be done by the new 'Brexit Department' in the UK Civil Service, Brexit will undoubtedly present a significant distraction to many senior managers at the FCA. With the FCA needing to continue to commit to stated priorities, there are two possible scenarios for how the regulator could support Brexit initiatives on top of normal workload:

1. The FCA requests additional funds from industry; or

2. The regulator reallocates existing budget from across divisions.

What Does it Mean for Enforcement?

Should the second scenario above play out, there is likely to be a low risk of any major impact to the FCA's Enforcement and Market Oversight Division. The FCA has a large resource of over 3,000 staff at its disposal. Enforcement resources, however, are not the type of resource typically used for the type of work and negotiation that Brexit will entail, with policy and senior management resources being the main players. Activities and the case load may be scaled back but taking 10% off the Enforcement budget for instance will not materially change what the division is chartered to deliver.

Furthermore, with the exemption of adopted EU Market Abuse Regulation, the FCA's enforcement policy is not generally governed by the EU. The UK regulator has repeatedly shown it is more aggressive in its enforcement approach than its European counterparts, similar instead to the U.S. regulators in terms of the size of fines and types of cases it takes on (this is partly reflective of the size of the UK industry and its larger capital markets).

As the UK is a signatory to the International Organisation of Securities Commission's (IOSCO) Multilateral Memorandum of Understanding, there will also likely be no major change to consultation, cooperation and exchange of information with European and global counterparts relating to enforcement activities. This is also the same for investigations and prosecutions conducted by criminal agencies around the world in collaboration with the FCA, which of course is unusual in that it is a regulator with criminal prosecution powers.

Finally, much of the enforcement work conducted by the FCA is domestic, such as widespread mis-selling of payment protection insurance policies. Some of these rules have their roots in European legislation but they are not driven by a European push on enforcement in these areas.

While Brexit will undoubtedly create upheaval and distraction for many at the regulator and in the wider financial services industry, firms should not expect the FCA to lose focus on its enforcement approach and pursuit of individuals who don't follow the rules.

Investment in Big Data

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'Big data' has become the newest buzz word in financial markets and industry regulation. For participants ranging from broker dealers to investment advisors, and exchanges to commodity trading advisors, the use of big data has changed many fundamental management and regulatory activities.

Why Big Data?

Regulators are devoting substantial resources to the development of big data and analytic infrastructures and intend to use this in ongoing examination and enforcement activities.

In the U.S. for example, the SEC has requested over $1.7 billion in its 2017 budget to support a number of key IT and infrastructure initiatives. These include:

1. Expanding data analytic tools that assist in the integration and analysis of large volumes of financial market data, employing algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behaviour and ultimately enabling the agency to allocate its resources more effectively.

2. Improving enforcement investigations and litigation tracking to handle better the substantial volume of materials produced during investigations and litigation. Among other initiatives, the SEC needs to build capacity to electronically transmit data for tracking and loading (versus the current practice of receiving content via the mail); implement a document management system for Enforcement's internal case files; and revamp the tools used to collect trading data from market participants.

FINRA has developed its own initiatives including a dedicated "Office of Advanced Data Analytics" relying on complex data analytics and tools to target examinations of brokers. This includes enhancing data collection during routine examinations and the hiring of quantitative analysts to better use the data it receives. FINRA has also stepped up examination of data governance, quality controls and reporting practices to focus on the firm's ability to manage its risk and business activities. In addition, FINRA is focusing on big data to monitor a firm's ability to monitor both money movements and suspicious trading activity.

European regulators have directed firms through MIFID II that they will require higher data governance and quality standards. Firms will also need to focus on ensuring that their transaction reporting systems are of a sufficiently high quality, and will remain so, to avoid regulatory censure.

The Impact on Firms

The regulators' new focus on big data has created a number of surprises for financial firms. As part of normal audits and reviews, regulators are now requesting broad data dumps. Soon afterwards, the firm may receive an enforcement or deficiency notice requesting remedial action and a large fine. This pattern has been repeating itself in the U.S. and firms are finding their lack of preparation and ignorance of their data an expensive oversight.

This is also becoming a regular part of the standard exam process and in the U.S. For example, firms have been fined for violations of: Best Execution standards, Reg. SHO (Short Selling), Insider Trading, Front Running and numerous other serious breaches. Violations have cost upwards of $6 million per occurrence. Firms must be cognizant of the information they share with regulators and understand that the data may be used against them.

Someone to Blame: Rising Action Against Individuals

The regulators are getting personal. Increasingly it is individuals, rather than corporates that are the targets for enforcement action. The risks for a range of those working in financial institutions are real, and the coming year is only likely to further concentrate minds.

A focus on individuals has long been the case at regulators such as the SEC.

The SEC is becoming tougher, with typical fines against individuals doubling in the last ten years, according to one analysis.[11] Expectations are also growing, with the SEC (and also other U.S. agencies such as New York's Department of Financial Services) now holding compliance officers personally liable simply for poor implementation of compliance programmes, rather than involvement in wrongdoing, for example.[12]

At the same time, the regulator is widening its focus: an emphasis on "gatekeepers" – those it sees as having professional obligations to spot and prevent misconduct – saw the SEC charge one company's former audit committee chairman and numerous accountants and attorneys, as well various professional services firms in 2015.[13]

The SEC is not alone. While, the regulatory system may not allow financial regulators in other jurisdictions to replicate the SEC's approach, the emphasis on individuals is widespread. At the SFC, 55 out of 88 enforcement actions were against individuals (63%) in 2015, while FINRA's work is largely focused on individuals, too.[14] At the FCA, 22 out of 40 of its fines (55%) were against individuals in 2015, compared to only 29% the previous year. The total raised from fines against individuals (£6.69 million) during the year more than doubled.

Only at the CFTC did actions against individuals remain a minority in 2015 (37%, compared to 45% the previous year). However, according to the CFTC, about 90% of the enforcement division's major fraud and manipulation cases involved parallel criminal proceedings, and the calendar year saw indictments against 24 individuals and judgments imposing sentences up to 21 years in prison.

An Uphill Struggle

These increases come despite continued barriers facing regulators attempting to hold individuals accountable.

[11] http://www.wsj.com/articles/sec-escalates-financial-penalties-1436804327
[12] http://blogs.wsj.com/riskandcompliance/2015/06/24/sec-actions-stir-concerns-over-compliance-officer-liability/
[13] https://www.sec.gov/news/pressrelease/2015-245.html ibid
[14] The latest year for which annual figures are available (2014) show it barred or suspended nearly 1,200 individuals, and expelled or suspended 23 firms. http://www.finra.org/industry/enforcement

These are most obvious in large organisations, where establishing individual responsibility is difficult. In jurisdictions such as the UK, for example, corporate governance efforts in the past have emphasised dispersed responsibilities and worked against centralised power.

Combined with complex internal structures, this makes it difficult to attribute responsibility for decisions to any individual. Anecdotal evidence suggests prosecutions against "significant influence functions" (SIFs) – those individuals the FCA holds to have a significant influence over a firm's conduct – tend to be much more likely in the case of smaller firms. In the cases resulting from LIBOR rigging, for example, it was only at one small broker that SIFs were found personally liable for cultural misconduct.[15]

Whistleblowing programmes are one such route regulators are utilising in their efforts to hold accountable those individuals responsible for market misconduct and unlawful activities. The SEC's Office of the Whistleblower is authorised to provide financial awards to applicable individuals who provide original information that leads to an enforcement action resulting in monetary sanctions over $1 million. For example, the regulator paid out $38 million to eight whistleblowers throughout 2015, as well as bringing its first action against a firm for violating prohibition against confidentiality agreements designed to prevent communications with the SEC. As at 30 August 2016, the regulator has issued awards totalling more than $100 million over the past over years to whistleblowers.

[15] https://www.fca.org.uk/news/two-former-senior-executives-of-martin-brokers-fined-and-banned

> "Increases of enforcement actions against individuals come despite continued barriers facing regulators in pursing individuals. We are unlikely to see a halt in regulators' moves towards greater individual liability."

In comparison, the CFTC made only its second ever award under its whistleblower programme in 2015 (it has subsequently made two further awards in 2016).[16] The SFC and FCA have no equivalent reward regime for whistleblowers in place.

Nor is the judiciary always supportive of efforts to increase individual accountability elsewhere. In the UK, the High Court ruled in May 2015 that the FCA had inappropriately identified a senior executive in the course of its enforcement action over the "London Whale" of 2012, for example.[17] This may limit the willingness of the regulator to emphasise the role of individuals in future enforcement notices (although, it should be noted, it has not stopped the regulator subsequently fining the executive £792,900).

Pressure Grows

However, none of this is likely to halt the move towards greater individual liability.

For a start, whistleblower disclosures have grown in recent years at the SEC, increasing from 3,620 in the 2014 financial year, to 3,923 in 2015.[18] While the number of complaints is high, cases resulting in actual awards remain relatively few. It should be noted though that this in part is due to the often lengthy investigation and prosecution process. Whistleblowing disclosures also increased at the FCA – and by a bigger proportion – in the same period, from 1,040 to 1,340.[19] Data and analytics are arguably more important in identifying misconduct among both businesses and individuals; indeed, the emphasis on technology is probably one of the reasons why we see only modest increases in staff numbers at the regulators. Here, however, the FCA and others have also invested heavily in recent years, so they are unlikely to feel at much disadvantage.

Regulators are also working to clarify individual responsibilities within complex organisations. Most notably the Senior Managers and Certification Regime for banks introduced by the FCA in March 2016 (and being rolled out to all firms in 2018) marks "a new era of increased individual accountability", as the acting chief executive Tracey McDermott put it at the time.[20] Requirements include drawing up a responsibilities map describing management and governance structures and direct reports. The head of enforcement at the FCA has already predicted a rise in cases against individuals as a result.[21]

Nor is the UK alone. In the U.S., the Department of Justice's Yates Memorandum stipulates that corporations will get no cooperation credit in plea negotiations where they have not fully identified individuals with potential liability and fully cooperated in gathering and producing relevant evidence. Furthermore, New York's Department

[16] https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf
[17] http://www.reuters.com/article/britain-jpm-whale-idUSL5N0YA47P20150519
[18] https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf
[19] https://www.fca.org.uk/news/fca-introduces-new-rules-on-whistleblowing
[20] https://www.fca.org.uk/news/new-accountability-regime-for-banks-insurers-comes-into-force
[21] http://www.legalweek.com/legal-week/news/2461422/fca-enforcement-head-predicts-rise-in-cases-against-individual-executives

of Financial Services recently finalised a new rule that requires boards to certify that compliance programmes are designed to comply with a new set of regulations detailed in the same rule.

Despite an increase in action against firms (up 57.1%) and decline in actions against individuals (down 48.6%) last year in Hong Kong, the latter still account for the majority of cases, and the SFC remains heavily focused on senior management responsibilities. In fact, increasing the number of enforcement cases against individuals is among its 2016 priorities. It is likely that it – and other regulators – will be watching the results of the UK's new regime with interest.

At its heart, though, the pressure for increased individual accountability is largely cultural. Despite regulators' efforts, there remains a widespread sense of injustice that too few responsible for the pain of the financial crisis were held to account. Governments and regulators may think it is time to stop bashing the bankers; the public are less convinced.

Above all, regulators cannot afford another crisis that finds them unable to pin the blame on those responsible. Next time, they are determined to be ready. Those working in the industry must ensure that they are, too.

Falling into Line: Growing Expectation of Gatekeepers

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The SEC's focus on gatekeepers should not come as a surprise to the industry.

It publicly launched Operation Broken Gate almost three years ago in 2013, with action against three auditors.[22] The regulator, as SEC chair Mary Jo White put it, was "pursuing those who should be serving as the neighbourhood watch, but who fail to do their jobs".[23]

What may have surprised the industry since, though, is how many jobs that covers. Auditors are still firmly in the firing line,[24] but the list of gatekeepers includes lawyers, CEOs, CFOs, directors and controllers. Compliance officers, particularly, are in the frame. If the rewards the SEC offers to whistleblowers are the carrot for insiders to help identify wrongdoing, the penalties for gatekeepers failing to do so are the stick.

Concerns this may hamper efforts to attract people to these roles or inflate salaries cut little ice. To quote White again: "[F]irst, being a director or in any similar role where you owe a fiduciary duty is not for the uninitiated or the faint of heart. And, second, we will not be looking to charge a gatekeeper that did her job by asking the hard questions, demanding answers, looking for red flags and raising her hand."[25]

In fact, the focus on compliance officers and other gatekeepers is likely to intensify, and it's not just the SEC they have to worry about; FINRA[26] and the Department of Justice's Financial Crimes Enforcement Network (FinCEN)[27] are both taking a similar line with money laundering cases.

The impact more widely is unclear, however. The SEC is an influential regulator, but in jurisdictions such as the UK, the scope for change is limited. For a start, the FCA is not responsible for external audit firms or lawyers.

Principle 11 of the FCA's Principles for Businesses[28] has long required firms to disclose "anything relating to the firm of which that regulator would reasonably expect notice", and this expectation is firmly embedded in UK business culture. Few compliance officers dare keep serious wrong doing from the regulator; the obligation to report wrongdoing or face heavy sanctions simply come with the job.

This is, in essence, the culture the SEC wants to take root in the U.S. In time, compliance officers and other gatekeepers are likely to come to accept it.

[22] https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539850572
[23] https://www.sec.gov/News/Speech/Detail/Speech/1370539872100
[24] https://www.sec.gov/news/pressrelease/2015-184.html
[25] https://www.sec.gov/News/Speech/Detail/Speech/1370539872100 ibid
[26] https://www.finra.org/newsroom/2016/finra-fines-raymond-james-17-million-systemic-anti-money-laundering-compliance
[27] http://blogs.wsj.com/riskandcompliance/2016/01/13/court-rules-anti-money-laundering-law-applies-to-compliance-officers/
[28] https://www.handbook.fca.org.uk/handbook/PRIN.pdf

Individual Accountability and the Senior Managers Regime

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Eight years on from the financial crisis, public anger that those responsible were not held to account remains.

The Senior Managers Regime (SMR) that came into force this March for banks and that will apply to all FCA regulated entities from 2018 is the latest initiative to address it.

The FCA and its predecessor, the FSA, has long struggled to hold senior managers in large firms liable for compliance failures. The loss of its case against former UBS wealth management CEO John Pottage, whose fine was overturned by The Upper Tribunal in 2012, is a notable case in point.[29]

In response, the regulator turned to attestations to gain personal commitments from senior managers and ensure "clear accountability and a focus from senior management".[30] This is, in essence, very similar to the core aims of the SMR.

The SMR and associated certification regime will provide considerable boost to the effort. First, attestations remain relatively rare; in the 2015/16 financial year, the FCA requested just 44,[31] against 74 the year before. They are also limited in scope, committing senior managers only to ensuring they address specific issues the FCA has raised. Indeed, there have been concerns they skew firms' prioritisation of risk to focus unduly on those for which senior managers were on the hook.[32]

The SMR, by contrast will apply universally, first to banks and eventually to all. The biggest international banks alone signed up nearly 250 of their executives ahead of the new regime.[33] And its scope is much wider; managers must take reasonable steps to prevent regulatory breaches across their entire area of responsibility, not just address shortcomings identified by the regulator.

The regime is not as strict as it was first touted; in October the UK Treasury dropped provisions for a "presumption of responsibility" that would have shifted the burden of proof onto managers to prove their innocence in case of a breach. Nevertheless, if something does go wrong, those identified as responsible under the SMR will have serious questions to answer.

The Governor of the Bank of England, Mark Carney says the "age of irresponsibility" is over for financial services firms.[34] We shall see. But what is certain is that the age of individual accountability has taken a big step forward.

[29] http://www.tribunals.gov.uk/financeandtax/Documents/decisions/John_Pottage_v_FSA_decision.pdf
[30] https://www.the-fca.org.uk/about/supervision/attestations
[31] https://www.the-fca.org.uk/about/supervision/attestations ibid
[32] https://www.fca.org.uk/your-fca/documents/attestations-graham-beale-letter
[33] https://next.ft.com/content/18247eea-e6be-11e5-a09b-1f8b0d268c39
[34] http://www.bankofengland.co.uk/publications/Pages/speeches/2015/821.aspx

Show and Tell: The Continuing Importance of Whistleblowing

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The awards for whistleblowing remain a striking feature of the U.S. regulatory system, particularly at the SEC, yet in practice awards are rare.

In its latest fiscal year, of 3,923 tips from whistleblowers and 150 award claims, just eight awards were made.[35] At the CFTC they are less common still; last year saw just its second award ever.[36]

Their significance is twofold, however. First, just as the biggest enforcement penalties send an important message to the industry, so do some of the large awards possible under the schemes.

Eligible whistleblowers receive between 10% and 30% of the money the regulator collects from a successful enforcement action. The result is some massive pay outs for individuals. Multimillion-dollar awards are not uncommon, with the eight whistleblowers in 2015 sharing $38 million. The largest single award to date is $30 million, paid in 2014.[37] This year has already seen awards of $22 million and $17 million – the second and third highest ever.[38]

Such cases constitute powerful advertising for the whistleblowing programme.

Related to this is the second point, though: the schemes underline the importance the regulators attach to whistleblowing. As such, there is significant pressure on regulated firms to ensure they provide clear channels of complaint, with the ability to raise issues anonymously both internally and with the regulator. And that's also the case outside the U.S.

On the one hand, the FCA's review of financial incentives in 2014 concluded there was no empirical evidence they led to more or better disclosures to the regulator, and that they were too costly to administer to be worthwhile.[39] On the other, whistleblowing remains an important source of information for the regulator.

Consequently, October 2015 saw new rules for UK banks, building societies and credit unions with assets of more than £250 million, as well as Solvency II insurers. The requirements include appointing a whistleblower champion, establishing internal whistleblowing arrangements and annual reports on whistleblowing to the board.[40]

On both sides of the Atlantic, programmes are focused on protecting an important source of information for the regulators' enforcement functions; but they are equally required as part of the evidence regulators want for firms to show senior management is taking regulatory issues seriously.

[35] https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf
[36] http://www.cftc.gov/PressRoom/PressReleases/pr7254-15
[37] https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543011290#.VClbtWddUuc
[38] https://www.sec.gov/news/pressrelease/2016-114.html and https://www.sec.gov/news/pressrelease/2016-172.html
[39] https://www.fca.org.uk/static/documents/financial-incentives-for-whistleblowers.pdf
[40] https://www.fca.org.uk/news/fca-introduces-new-rules-on-whistleblowing

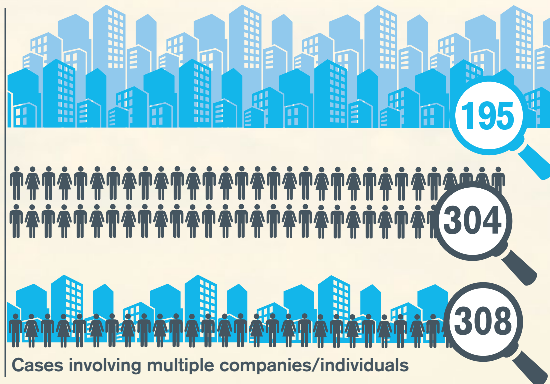
Figure C – Enforcement Focus on Companies and Individuals in 2015

Company Individual

FCA

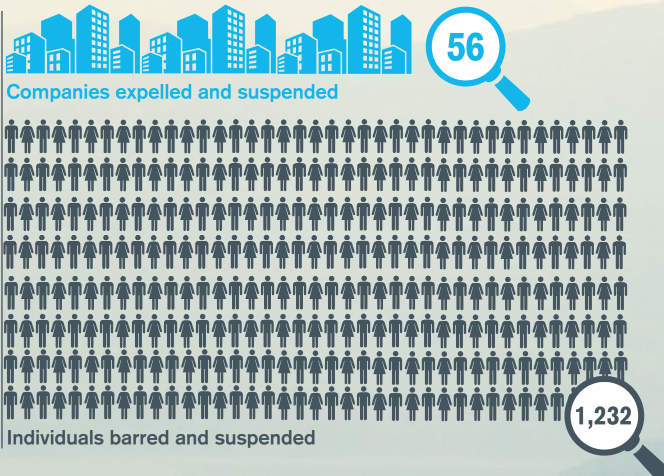
SFC

SEC



CFTC

FINRA



Growing Expectations: Widening the Enforcement Scope

LIBOR and FX rigging cases have continued to occupy regulators throughout 2015. They accounted for the two biggest penalties of the year at the FCA and the biggest monetary penalty in CFTC history. Cases continue this year.

With fewer of such cases overall, however, the decline has enabled regulators' enforcement divisions to focus on a wider range of issues and priorities. This has seen them return to some of their traditional areas of focus – and to break some new ground. Indeed, it was a year of firsts for many regulators.

Breaking New Ground

Some of the new actions can be seen as along the continuum with prior cases. For example as well as its big LIBOR case, the CFTC brought its first case for manipulation of Forex exchange benchmark rates and the ISDAFix rate. Other instances, such as two cases concerning Bitcoin, saw the CFTC breaking truly new ground.

More widely, the CFTC tackled reporting violations and market manipulation in its many forms and brought its first actions enforcing new powers under the Dodd-Frank Act, such as large trader reporting requirements.

The SEC, meanwhile, recorded a string of first-time cases demonstrating its willingness to tackle new areas of the markets and participants. We saw the first actions principally focused on high frequency trading (HFT) manipulation;[41] stock exchange order types (which again involved HFT);[42] action against a big credit rating agency[43]; for failure to report a material compliance matter to a fund board;[44] and against a major audit firm for the first time since 2009.[45]

The last of these reflects the emphasis the SEC has put on "gatekeepers", which clearly applies to firms as well as individuals. The action on failure to report to a fund board, meanwhile, is part of its wider enforcement aimed at tackling misconduct by investment advisers.

Among the most important areas for the SEC, perhaps, has been tackling disclosure by share issuers, with significant action against issuing companies. This will be welcomed by traders, many of whom have long felt regulators' focus on them in tackling insider trading ignored offences elsewhere.

[41] https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184457
[42] https://www.sec.gov/news/pressrelease/2015-2.html
[43] https://www.sec.gov/news/pressrelease/2015-10.html
[44] https://www.sec.gov/news/pressrelease/2015-71.html
[45] https://www.sec.gov/news/pressrelease/2015-184.html

The issue has also been occupying Hong Kong's regulator. Last year the SFC brought its first case against a listed company and its executives for failing to disclose inside information as soon as reasonably practicable. Perhaps a more significant first-time case for the SFC last year, however, was its first against a dark pool operator.

This appears a key focus of the regulator, which introduced a new regime for alternative liquidity pools in December. We should likely expect more cases on this issue going forward, not just from the SFC, but also from the FCA and SEC, throughout 2016.

Systems and Controls

The different regulators' areas of focus when it comes to enforcement vary widely, but a number are common to most or all. These include market integrity and abuse (whether concerning benchmarks or otherwise); governance and the roles of individuals; anti-money laundering (AML); and systems and controls.

AML and countering the financing of terrorism (CFT) remain a significant issue across jurisdictions and one on which there has long been significant effort to ensure international coordination. As benchmark scandals have faded from the headlines, the issue has come to the fore once again, bolstered by the passing of the Fourth AML Directive in Europe last June.

Systems and controls meanwhile are under intense scrutiny by regulators, and are increasingly themselves the basis for enforcement actions. The SEC, particularly, has shown itself over the last year to be willing to take action on lax internal controls and other technical violations even without any supporting evidence or accusations of fraud.

That's also true elsewhere. In November 2015, the FCA imposed a £72 million fine for failures to apply enhanced levels of due diligence to a group of ultra-high net worth clients who were politically exposed persons (PEPs).[46] That was despite the fact that there was no evidence the transaction in question actually involved financial crime; the bank, it seems, was simply trying to avoid inconveniencing their valued customers.

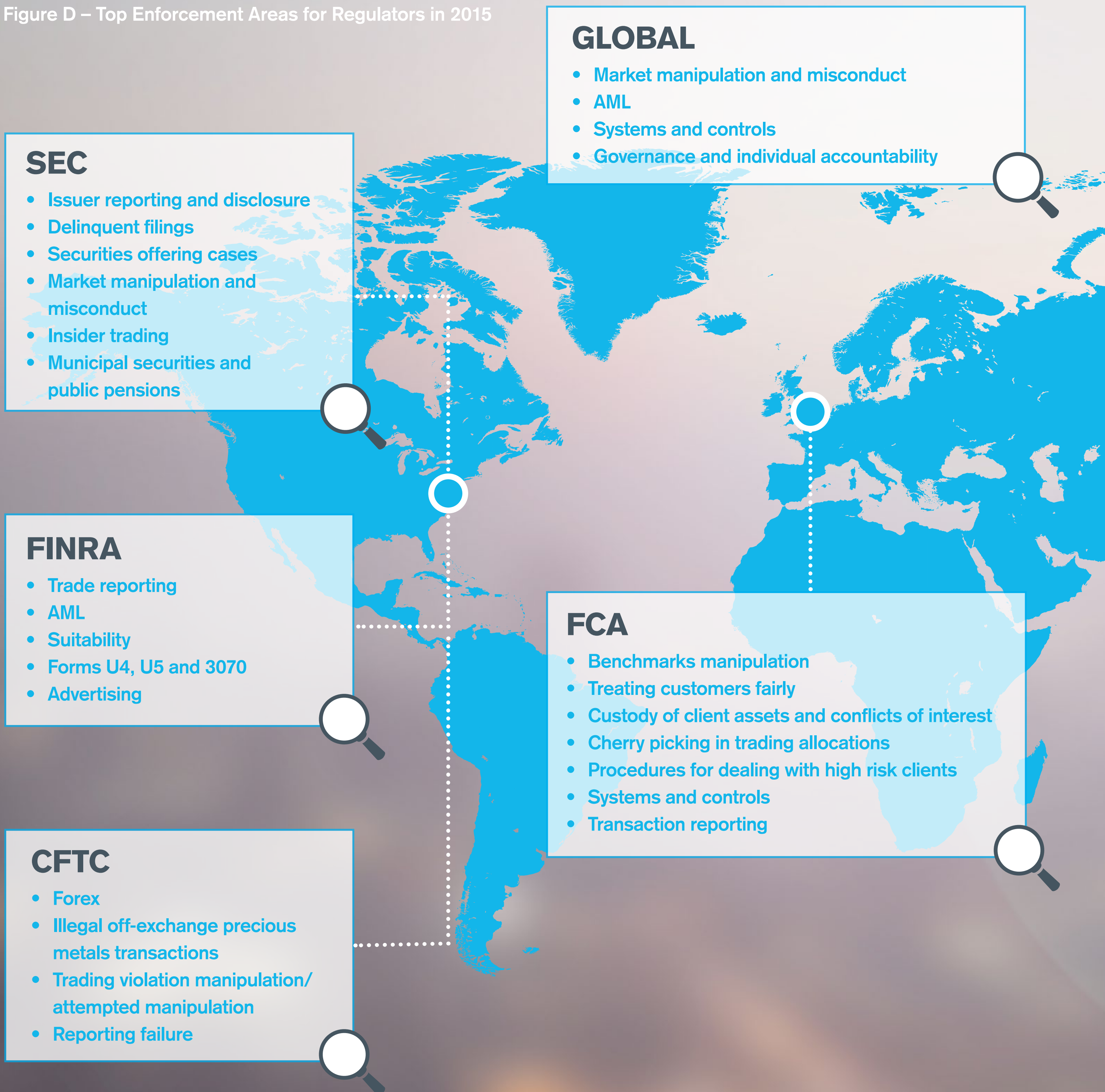
> "It went to unacceptable lengths to accommodate the clients," the FCA noted.

Another of the FCA's notable cases during the year, meanwhile, saw it not only fined a foreign-owned bank for failing to address concerns regarding its financial crime systems and controls; it also invoked a rarely-used power to prevent the bank taking new customers from high-risk jurisdictions for over four months. Again, the case was not related to an accusation of a financial crime.[47]

For many regulators, it seems, having poor controls is now a strict liability offence – and it carries significant penalties.

[46] https://www.fca.org.uk/news/fca-fines-barclays-72-million-for-poor-handling-of-financial-crime-risks
[47] https://www.fca.org.uk/news/the-financial-conduct-authority-imposes-2-1m-fine-and-places-restriction-on-bank-of-beirut

Figure D – Top Enforcement Areas for Regulators in 2015



Data Mining

Another trend across regulators concerns data. Just as regulators are demanding good systems and controls, they are also putting pressure on businesses to improve their data quality. This is because so many of the regulators' enforcement actions now rely on it.

Again, this is particularly evident at the SEC. Its total number of cases for the year includes 87 cases involving trading on inside information, for instance. Of these, it notes: "Many of these cases involved complex insider trading rings which were cracked by Enforcement's innovative uses of data and analytics to spot suspicious trading."[48]

A data-driven approach was also used by the SEC for the first time in 2015 to identify potentially fraudulent trade allocations, where an adviser was disproportionately allocating profitable trades to favored accounts.[49] Such "cherry picking" has also been a key focus of the FCA over the last year, with action against both companies[50] and individuals.[51]

Certainly, given the emphasis on data quality in Markets in Financial Instruments Directive (MiFID) II provisions coming into force in the UK in 2018, its importance is only likely to grow.

The effectiveness of regulators' enforcement today relies more than ever on the ability to gather reliable and comprehensive data from those they regulate. As a result, ensuring this is available – just like ensuring correct systems and controls are in place – is increasingly an enforcement priority in its own right.

[48] https://www.sec.gov/news/pressrelease/2015-245.html
[49] https://www.sec.gov/news/pressrelease/2015-132.html
[50] https://www.fca.org.uk/news/fca-fines-aviva-investors-176m-for-systems-and-controls-failings
[51] https://www.fca.org.uk/news/fca-fines-and-bans-former-investment-analyst-at-aviva-investors

Zero Tolerance: A Strict Approach to AML

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Regulatory requirements related to AML and economic sanctions are becoming more tighter. The last year has shown regulators giving organisations no leniency for even technical breaches.

In the UK, last November's £72 million fine against a global investment bank was striking. The deal in question was big, and the politically exposed persons (PEPs) involved were identified as particularly at risk of exposure to bribery or corruption. Nevertheless, the FCA found no evidence of a criminal transaction, and the bank merely breached its own policy, one based on minimally prescriptive regulator guidelines for dealing with PEPs.

More recently, the US Treasury's Office of Foreign Assets Control (OFAC) has demonstrated a similar zero-tolerance to economic sanctions. Its $305,000 settlement with a multinational oil field services corporation for alleged violations of sanctions against Cuba was relatively modest; but the bar it sets for efforts to establish beneficial ownership is extremely high.

In that case, the companies were fined for investment in a consortium in Angola in which a Cuban-owned oil company had only a 5% interest. Best practice among regulated U.S. financial institutions typically calls for identifying beneficial owners to 25% for all customers, and to 10% for those that are high risk. The 25% requirement was the standard used in the recently finalised U.S. Treasury Customer Due Diligence Rule. With this enforcement action OFAC has clearly restated the strict liability and absolute nature of prohibitions on transactions with sanctioned parties. A 'risk based approach' to economic sanctions then, involves an understanding that anything less than the identification of all beneficial owners carries risk.

Offshore regulators too are ramping up pressure on AML breaches. In May 2016, the Monetary Authority of Singapore (MAS) announced that it had notified a Swiss private bank of its intention to withdraw the firm's status as a merchant bank, citing breaches of AML requirements, insufficient senior management oversight and gross misconduct by some staff. The MAS also levied financial penalties of S$13.3 million for 41 breaches of the MAS's notice on AML regulations, as well as referred six members of the bank's senior management and staff to the Public Prosecutor to evaluate if criminal offences had been committed.

The Focus Continues

The regulators' approach may seem surprising given concerns around "de-risking". The impact of banks' strategies to avoid potential breaches of AML regulation on access to finance is increasingly well recognised.

As a survey for the World Bank in November 2015 noted: "[S]ome banks appear to be cutting off business relationships with entire classes of customers based on the country or type of financial service – rather than implementing a risk-based approach."

Both OFAC[52] and the FCA[53] have acknowledged the problem. The FCA's business plan for the current year even commits it to ensuring unintended consequences of AML regulation are minimised. Yet enforcement is more aggressive than ever.

The reason is perhaps simple: egregious breaches of regulations continue to occur far too frequently. While such abuses continue, regulators want every tool they have to tackle them. That means we are unlikely to see expectations of banks' financial crime controls to lessen any time soon.

[52] http://bankingjournal.aba.com/2015/11/szubin-risks-should-be-managed-not-avoided-altogether/
[53] https://www.fca.org.uk/news/fca-research-into-the-issue-of-derisking

Time for a New Perspective on Culture

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Regulators continue to put their faith in culture. The need to build a culture of compliance is a frequent refrain from all the big regulators – and it has been for more than a decade.[54]

Yet problems persist. According to a report by the Group of Thirty (G30) last year, the financial sector has still failed to implement comprehensive cultural and conduct reforms.

"[S]ome firms are further along on the cultural journey, while others have barely begun or are trying but failing to achieve change," it noted.[55]

Consequently, we can expect regulators to continue their efforts. Culture is the first of FINRA's exam priorities for 2016, for example;[56] meanwhile according to Andrew Bailey, the new head of the FCA, culture is of "upmost importance".

"My assessment of recent history is that there has not been a case of a major prudential or conduct failing in a firm which did not have among its root causes a failure of culture as manifested in governance, remuneration, risk management or tone from the top," he told an audience in May.[57]

As Bailey acknowledged, however, regulators face a considerable challenge to influencing culture, not least because it is not just about the "tone from the top".

"[A]s important as tone from the top [is] the willingness of people throughout the organisation to enthusiastically adopt and adhere to that tone," he said.

Lifting the Lid

In fact, all firms have both a formal and informal business culture. The former, determined by corporate policies and official communications (internal and external) is easily audited and assessed. The latter – the internal characteristics, relationships, expectations and motivations among the people in the organisation – is largely invisible to regulators.

It is when there is an asymmetry between these cultures that the risk of non-compliant behaviour is greatest. In these cases, a well-managed formal business culture serves only to hide the dangers of the informal culture that will ultimately determine behaviour.

To tackle this, businesses and the regulators must address both: analysing behaviours within the organisation; assessing and acknowledging the asymmetries between formal and informal cultures; and putting in place the processes, tools and training to address these.

Until they do so, efforts to see real cultural change in the industry will continue to meet with frustration.

[54] See, for example, https://www.sec.gov/news/speech/spch042303lar.htm
[55] http://group30.org/images/uploads/publications/G30_BankingConductandCulture.pdf
[56] http://www.finra.org/sites/default/files/2016-regulatory-and-examination-priorities-letter.pdf
[57] http://www.bankofengland.co.uk/publications/Pages/speeches/2016/901.aspx

France Gets Tough

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It is not only the likes of the regulators we have covered in our research that are demonstrating the extent of their enforcement powers. There has been a marked change in the approach of the Autorité des Marchés Financiers (AMF), the French financial markets regulator, as seen for example through a series of sanctions and settlements focusing on valuation practices within investment management firms.

In 2013, the AMF merged two divisions: the market offences team (or investigations unit) which has far-reaching enforcement powers, with the regular "inspection of professionals" team which conducts ongoing audit type inspections of investment management firms. Since the merger took place, a new enforcement regime has emerged which is placing significantly more demands on investment management firms and their compliance functions.

The AMF has historically sanctioned firms for violations or non-compliance relating to market abuse issues, breaches of fiduciary duties to clients or of market conduct rules. More recently and with greater enforcement powers, the AMF is stressing the need for firms to comply with the whole rule book and conducts inspections on this basis. Firms have been sanctioned for compliance procedural and operational transgressions that are absent of any breach of fiduciary duty or evidence of market abuse.

In the past, firms were generally informed in advance that an inspection was about to commence. Following the merger, inspectors have arrived at many firms without notice and with far-reaching authority to request access and receive to documents and copies of email accounts for key staff members. Firms are finding the ongoing inspection process to be detailed and thorough. Allocating sufficient time and resource internally to management of the inspection process is essential to ensure a positive outcome.

The AMF's financial penalties can be high and, in a consistent trend we have observed globally, frequently target individuals. Of the 65 fines the regulator issued last year, 42 were against individuals, with several six-figure fines and one of €1 million.[58] Only two individuals were cleared of charges. Moreover, while the AMF can keep sanctions anonymous, it publishes its decisions and in most cases does name the firms and individuals involved.

Fines against firms can also be significant. In one December 2015 decision, a high-profile market conduct case, the AMF imposed two fines of €5 million each.[59]

Showing the Way

However while the approach has changed, it is possible to overstate the changes brought in with the AMF's new enforcement regime. The total fines imposed last year – €21.3 million – was actually down from 2014's record of €32.9 million. The number of fines also fell, from 79 to 65, as did the number of inspections opened, from 36 to 42.[60]

Furthermore, the AMF is increasingly using its power, introduced in 2012, to offer negotiated settlement agreements in less serious cases. In 2015, 12 settlement agreements totalling €1.3 million were agreed. Cases of market abuse are currently excluded from settlement agreements, but there are proposals to change this. Finally, while they can be significant, the AMF's fines – particularly those imposed on firms – are still not at the level of some of those imposed by the SEC and FCA.

Nevertheless, the key similarities between those regulators and the AMF now far outweigh the differences. The penalties for some infringements may be smaller, but sanctions can be expected for even minor procedural transgressions and inadequate controls, as well as genuine malfeasance. Like its counterparts elsewhere, the AMF as a regulator is continually focusing efforts on rebuilding customer and investor trust and will not tolerate any compliance failings or risks to the integrity of the financial system.

[58] http://www.amf-france.org/Sanctions-et-transactions/Decisions-de-la-commission/Chronologique/Liste-Chronologique/Sanction.html?year=2015&docId=workspace%3A%2F%2FSpacesStore%2Fc7dcf6af-9016-47f7-9522-49c326754050
[59] http://www.amf-france.org/en_US/Actualites/Communiques-de-presse/Comission-des-sanctions.html?docId=workspace%3A%2F%2FSpacesStore%2Fd83d375f-f736-40d0-9412-f722decfb4cc
[60] http://www.amf-france.org/en_US/Actualites/Communiques-de-presse/AMF/annee-2016.html?docId=workspace%3A%2F%2FSpacesStore%2F75c26b3e-d4c1-4d4b-94d9-6648b57e2f66

The Price of Everything...

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It is easy to dismiss the importance of fair value when it comes to alternative asset classes, but it's also wrong. Even if they are a long-term asset class, fair valuations throughout the holding period (not just at entry and exit) are vital to avoid regulatory and enforcement action.

Without a fair value measurement framework, it's impossible for investors to accurately match their holdings to asset-allocation models; without it, investors cannot reasonably fulfil fiduciary duties to ensure managers are sticking to their mandate; and without it, performance-based fees will not reflect the actual performance.

As the search for yield leads investors to make greater allocation to illiquid alternatives, these and other reasons have increased the focus on valuations. And that, in turn, has made valuation increasingly important to regulators and enforcement agencies.

An Increased Focus

Regulatory attention on alternatives' valuations is not new. It extends back to the issuance of SFAS No. 157 by the U.S. Financial Accounting Standards Board in 2006, the introduction of the Dodd-Frank Act in 2010 in the US and, in the EU, the 2011 Alternative Investment Fund Managers Directive. For that matter, the focus on valuation dates back to the US 1940 Investment Company Act. While the level of scrutiny focused on valuation since has ebbed and flowed, over the past year, attention applied to valuation seems again to be on the upswing.

In its 2015 Exam Priorities, the SEC's Office of Compliance Inspections and Exams marked out alternative investment companies (having "experienced rapid and significant growth compared to other categories of mutual funds"), including their valuation policies, as a particular focus.[61] This has been backed by enforcement action.[62]

Action to date has focused on investor protection and, particularly, fees. As the SEC's co-chief of asset management enforcement put it in one of the recent cases, "Fund managers can't tell investors one thing and do another when assessing fees and valuing assets."

But regulators have another role as well: market integrity. Good valuations are essential to detect market abuse and identify risks to market stability.

Looking for Goldilocks

This is, in part, why simply taking a conservative approach which potentially under values assets is no answer, since it still means inaccurate data for regulators. Understating the value of alternative assets results in lower capital requirements for banks under the EU's Prudent Valuation Regulations, for example. Nor is it in investors' interests.

Understating as much as overstating affects investors' ability to accurately determine their asset allocation, particularly in relation to risk management. Without a fair valuation – neither too hot, nor too cold – investors cannot realistically compare asset classes on a like-for-like basis.

Both investors and regulators will increasingly expect firms to be able to show they are getting this right. If they don't, we shouldn't be surprised to see more enforcement action in the future.

[61] https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf
[62] See, for example https://www.sec.gov/news/pressrelease/2015-52.html and https://www.sec.gov/news/pressrelease/2015-52.html

The Changing Tides: Trends in Offshore Financial Centers

The Panama Papers leak of millions of documents in April 2016 has put the spotlight back on offshore jurisdictions[63] and fuelled public perceptions that these jurisdictions are conduits for the wealthy to conceal their fortunes. Further exacerbating these claims are longstanding doubts surrounding offshore jurisdictions' regulatory and enforcement regimes. Yet, our research shows that these perceptions may need to change: while offshore jurisdictions may be small, their profile as key financial services hubs grows along with the sophistication of their regulatory and enforcement environments.

A Broad Range

Offshore regulators - while often very different in their approach, remit and public reporting of enforcement actions - are not afraid to use their powers and many are effective in doing so.

In the context of analysing enforcement trends, it is important not to assume that the industries of these financial centres are all the same simply because they share the label "offshore".

Offshore financial services industries are deeply rooted in the history of their jurisdictions and have evolved independently from one another, as have the local regulators. For instance, the Channel Islands are often seen as the place with the expertise to service complex structures with a focus on fund administration and private client business; one of the key sources of business for the BVI economy is company incorporations; and the Cayman Islands is the largest domicile of hedge funds. As such, offshore regulators' scope, priorities and enforcement approaches vary considerably between one another and their onshore counterparts.

However, while very different in their approach, remit and level of public reporting of enforcement actions, offshore regulators are not afraid to use their powers against regulated firms. Equally so, there is evidence to suggest their methods are just as robust as their onshore counterparts. This is illustrated by the Council of Europe's MONEYVAL reports on both Jersey[64] and Guernsey[65] in the last year which highlight that although it would like

[63] For this research, we studied regulators in Jersey, Guernsey, Singapore, Luxembourg, Ireland, Mauritius, BVI, Bermuda, Malta and Cayman Islands (please note this list is not exhaustive)
[64] http://www.jerseyfsc.org/pdf/MONEYVAL_Council_of_Europe_2015_Report_Jersey.pdf
[65] http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/GUE_MER_(2016)18_en.pdf

LIKE ONSHORE EQUIVALENTS, INDIVIDUALS WHO OPERATE IN OFFSHORE JURISDICTIONS ARE NOT IMMUNE FROM REGULATORS' SCOPE.

to see more prosecutions[66] and bigger fines[67] for AML breaches, the reports were a strong endorsement of both enforcement regimes.

An Enforcing Nature

Signs of a stronger enforcement focus at many of these regulators are becoming apparent. Like onshore equivalents, individuals who operate in offshore jurisdictions are not immune from regulators' scope.

Provided in Table 1 is an analysis of the various enforcement approaches offshore centres have recently taken. Broadly speaking, enforcement actions across offshore jurisdictions, where published, generally falls into three key areas:

- AML/CFT and sanctions compliance
- Fitness and propriety
- Regulatory breaches and failures

There is, in particular, a shared focus when it comes to AML concerns where international pressure for action is high. The Monetary Authority of Singapore (MAS) has recently taken action to withdraw a Swiss bank's status as a merchant bank for AML failures which led to that bank's demise in Singapore. The MAS also levied financial penalties of S$13.3 million for 41 breaches of the MAS's notice on AML regulations, as well as referred various senior management and staff of the bank to Singapore's Public Prosecutor for evaluation of potential criminal misconduct.

Likewise much of the enforcement focus in the Channel Islands (Jersey and Guernsey) has been in relation to AML/CFT in the fiduciary sector and suitability of advice provided by local investment business firms, including a prosecution in Jersey 2015 which targeted a money laundering reporting officer.[68] AML is also a priority in Guernsey, Bermuda, Malta

[66] http://www.coe.int/en/web/portal/-/council-of-europe-experts-urge-jersey-to-increase-money-laundering-convictions
[67] https://www.coe.int/en/web/portal/-/moneyval-publishes-a-report-on-guernsey

and, indeed, the British Virgin Islands, whose enforcement action and fine of $31,500 against a legal and corporate advisor was partly for AML failings.[69]

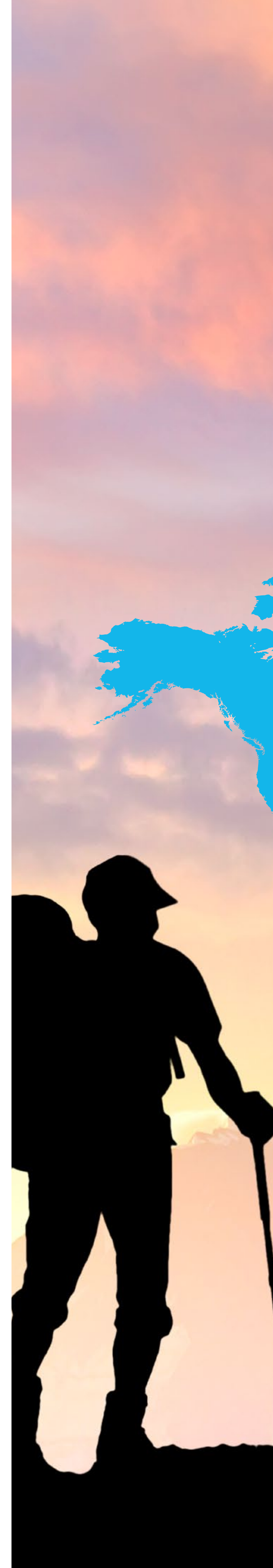
At regulators where the power to impose fines is well established, there are also signs that fine amounts are increasing along with focus on imposing them in the first place. The Jersey Financial Services Commission launched its civil penalties regime in 2015. The Guernsey Financial Services Commission introduced the same in 2013, which applies to both companies and individuals. The Central Bank of Ireland, for instance, saw fewer penalties issued in 2015 (nine, against 11 the year before) but an increase in their size – a total of €7.34 million,[70] against €5.42 million in 2014 and €6.35 million in 2013.[71] One of its cases in 2015 was said to be the most significant and extensive regulatory investigation to date.

In Singapore, last year, the MAS imposed penalties of SG$14.9 million, and that includes action against individuals: in the first quarter, it fined the chief executive of a listed company SG$2.5 million for misleading disclosures to the market and a former remisier SG$157,000 for false trading. In Bermuda, while the Bermuda Monetary Authority (BMA) does not publish enforcement cases and fines, its 2015 Annual Report states that a number of enforcement actions were taken during 2015.

The Road Ahead

Post-Panama Papers, international pressures in relation to transparency have significantly increased. In seeking to improve their credibility, many centres over the coming years will likely move to a more open and transparent approach regarding their enforcement actions. Publishing enforcement data is a powerful and influential tool to inform the market about regulatory concerns, as well as driving better behaviours within the industry. The BMA for example, has already taken steps to address this in its 2016 business plan. Fines as well as a focus on individuals' accountability in offshore jurisdictions will also likely continue.

As firms become more global, differences in approach to compliance due to regulatory arbitrage are becoming less acceptable. Firms would be well-advised to ensure a sound compliance governance structure and mind-set is implemented within their organisations wherever they are based. In addition to their own regulator, keeping abreast of new priority areas focused on by regulators around the globe can also provide an indication of what may soon be coming to their shores.



[68] http://www.jerseyfsc.org/pdf/Public-Statement-STM-July-2015.pdf
[69] http://www.bvifsc.vg/Publications/EnforcementAction/tabid/378/ctl/EnforcementSummary/mid/1188/actionId/17062/language/en-GB/Default.aspx
[70] https://www.centralbank.ie/publications/Documents/Central%20Bank%20of%20Ireland%20Annual%20Report%202015.pdf
[71] https://www.centralbank.ie/press-area/press-releases/Documents/Annual%20Report%202014.pdf

Figure E – Enforcement Action in Offshore Jurisdictions in 2015

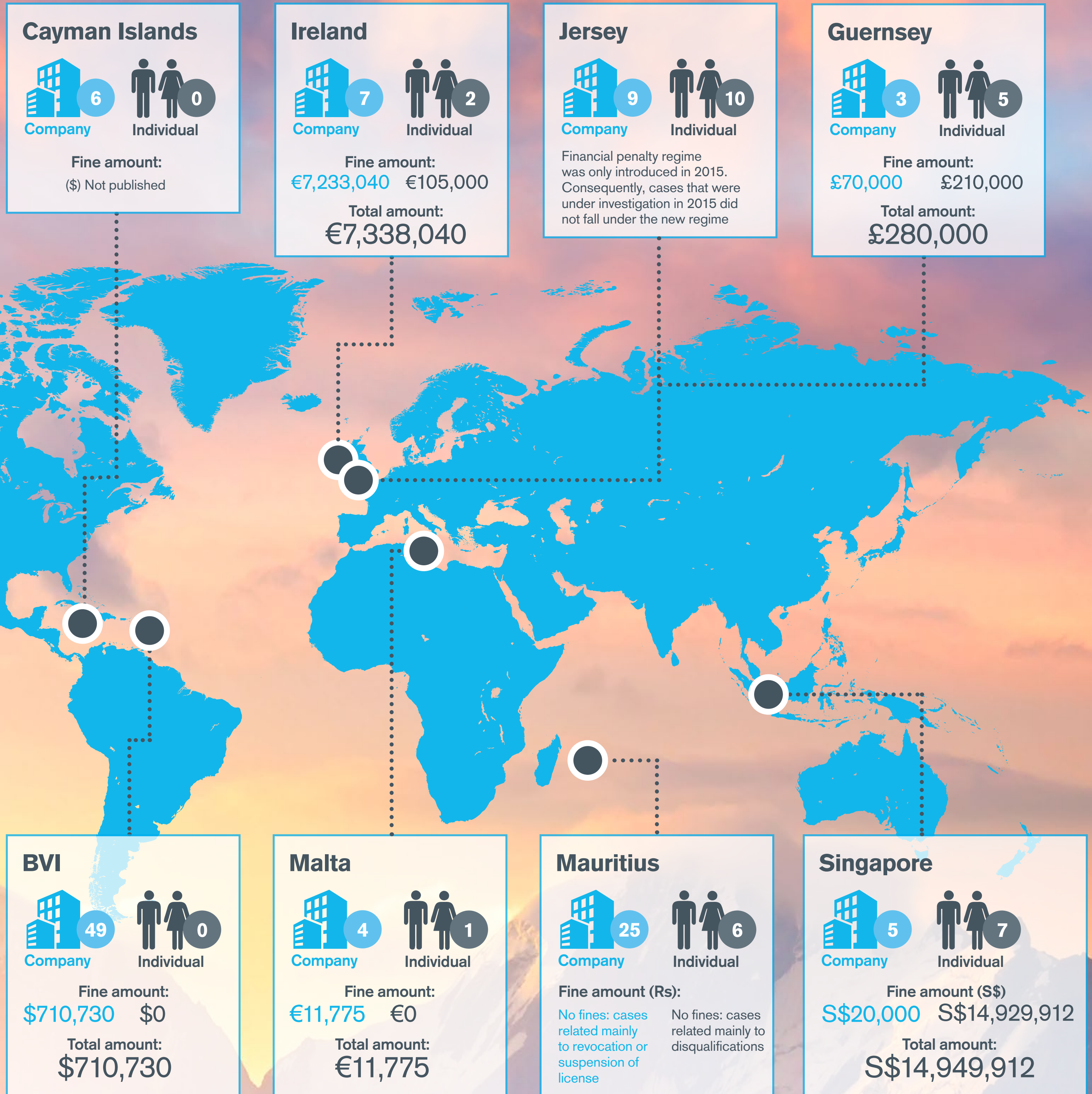


Table 1 - Analysis of Enforcement Actions in Offshore Jurisdictions in 2015

Jurisdiction and Regulator	Characteristics	Key Enforcement Actions
Bermuda Bermuda Monetary Authority (BMA)	• In 2016 a number of legislative changes have come into effect to enhance the AML/CTF regime. Enforcement action regarding AML/CTF breaches may increase • The BMA is preparing for the 4th round mutual evaluation to be undertaken by the Caribbean Financial Action Task Force in early 2018 • The BMA's 2016 business plan states that it has historically limited disclosing details of enforcement actions, but in light of international views, it plans to publish details of enforcement cases to assume a more visible role	• BMA does not publish results of all enforcement action. • Fines reported in the 2015 Annual Report include: – $250,000 fine under Trust law – $75,000 fine under the Investment Business Act – Further case appealed to Appeals Tribunal
British Virgin Islands (BVI) British Virgin Islands Financial Services Commission (BVIFSC)	• BVI is a well-regulated and commercially flexible jurisdiction • BVIFSC regularly publishes results of enforcement action however this often takes the form of lower value fines for less material breaches • Fines focused on companies and not individuals • In early 2016 there was an upward trend in enforcement action relating to deadline contraventions, such a late filing of accounts with low value administrative fines levied	• $31,500 fine imposed on international law firm Limited for contravention of AML/CFT codes • $97,000 fine imposed on insurance company for contravention of AML/CFT codes • $15,000 was imposed on global fiduciary services provider for contravention of AML/CFT codes
Cayman Islands Cayman Islands Monetary Authority (CIMA)	• CIMA notes that generally it does not normally disclose details of the information received or the findings or recommendations made during an investigation • In 2015 fines tended to relate companies placed into liquidation. 2016 has seen an increasing trend in the publication of decision notices against individuals	• Decision notice in 2016 against director of company for not being fit and proper. Director registration cancelled • Decision notice in 2016 to cancel mutual fund registration as fund not compliant with the law • Decision notice published in 2015 to cancel funds registration due to regulatory breaches
Guernsey Guernsey Financial Services Regulator (GFSC)	• The GFSC tends to use civil penalties (introduced in 2013) as a key deterrent in its approach to enforcement and publishes the majority of its decisions • In 2015/2016 enforcement trends suggested an increase in the number of sanctions levied by the regulator • Guernsey was recently subject to a visit from MONEYVAL (Council of Europe) on its AML/CFT regime, the results of which, were for the most part positive	• A recent key case related to a company and its directors which were subject to a regulatory fine. They appealed to the courts which upheld the fine but asked the GFSC to reconsider the amount
Ireland Central Bank of Ireland (CBI)	• The CBI has a civil penalty regime for companies and individuals • The CBI saw fewer penalties issued in 2015 (nine, against 11 the year before) but an increase in their size – a total of €7.34 million • Individuals are also often subject to fines, disqualifications and public statements	• €5 million fine imposed on an Irish building society, the CBI's most significant and extensive regulatory investigation to date • €1.75 million fine imposed on payment services provider for AML/CFT failures

Jurisdiction and Regulator	Characteristics	Key Enforcement Actions
Jersey Jersey Financial Services Commission (JFSC)	• In 2015, the JFSC introduced a civil penalties regime for companies (not individuals); as yet no fines have been levied as part of enforcement action. It is anticipated civil penalties may start to be used by the regulator in 2016 • At present the JFSC uses public statements and restrictions on employment in the case of individuals • Jersey was recently subject to a visit from MONEYVAL (Council of Europe) which concluded that Jersey has a mature and sophisticated regime for tackling money laundering and the financing of terrorism	• Director banned from holding any position in a regulated business as a result of reckless conduct, with a public statement issued • Public statement issued on a large regulated trust company business relating to serious breaches of the codes of practice. The company was sold to a larger regulated trust business
Luxembourg Commission de Surveillance du Secteur Financier (CSSF)	• The Luxembourg regulator does not publish details of any of its enforcement cases. It is understood enforcement action is taken against directors although this is not publicised	• Limited information on enforcement action publicly available
Malta Malta Financial Services Authority (MFSA)	• The MFSA enforcement division has recently undertaken responsibility of the supervision of AML/CFT. By 2015 year end, it had carried out nine inspections, jointly with the Financial Intelligence Analysis Unit • Enforcement action taken tends to be focused on restrictions to the conditions of licenses. Only one fine was imposed in 2015	• In 2015, there were 36 new cases with six relating to licence holders, eight fraudulent activity or scams, six unregistered Corporate Service Providers, one dealing with binary options, and three licence holders in breach of license conditions • €11,775 fine levied on an insurance broker for breaches of insurance regulations
Mauritius Financial Services Commission Mauritius (FSC Mauritius)	• Enforcement action focuses on disqualifications and revocation of licenses • The FSC Mauritius has stated that it champions a prevention based model as opposed to focusing on ex-post enforcement actions	• Five directors of a financial services firm disqualified for five years in 2015 due to failings in their fitness and propriety
Singapore Monetary Authority of Singapore (MAS)	• The MAS only has civil penalty enforcement jurisdiction for market abuse. It does not have powers of criminal enforcement. This lies with the Commercial Affairs Department (CAD) of the Singapore police force and any resultant criminal prosecution is undertaken by the Public Prosecutor • Since March 2015 however, the MAS and CAD have started to jointly investigate market abuse. The decision whether to prosecute a case civilly or criminally will only be made after the investigation completes • MAS announced in June 2016 that with more than 1,500 financial institutions now operating in Singapore, strong enforcement capability was needed. Two new departments created: – AML Department will formulate regulatory policies relating to money laundering and other illicit financing risks, and supervise how firms manage these risks – Enforcement Department will handle the joint investigations with the CAD for market abuse and enforce breaches of MAS' banking, insurance and capital markets regulation	• Fines against three individuals totalled $14.3 million for market abuse breaches • Other enforcement actions in 2015 include prohibition orders, compositions, reprimands and warnings • The first joint MAS-CAD investigation was reported in April 2016 where four large brokers were raided as part investigations of market misconduct

Looking Ahead: 2016 and Beyond

"I have seen the future and it is very much like the present, only longer," authors Martin A. Cohen and Sheldon Shacket once joked. Many of the priorities of regulators in the coming year certainly won't be a complete surprise. The trends in enforcement over the last year offer a good indication of where regulators will focus their efforts in the future.

In many respects, firms can therefore expect more of the same – with perhaps the exception of the massive, headline-grabbing cases that continued last year which now seem to be fading. In the first seven months of 2016, penalties imposed by the FCA, for example, totalled approximately £10.5 million. It would take something quite unexpected to come close to last year's total of £905 million in the remaining months.

The Return of Insider Trading

More of the same means more individual enforcement, for example. This will come from the continued focus on senior management responsibilities at the likes of the SFC and on firm culture at FINRA and the FCA[72], as well as continued work on gatekeepers at the SEC. However, it is also likely to be apparent in a renewed focus on insider trading.

Big benchmark cases saw insider trading take a back seat in recent years, but the SEC case in May 2016 involving a high profile sports personality[73] has helped put it back in the spotlight. As a top priority of the CFTC and another of the SEC's for the current year it is likely to stay there, and it is an area where regulators have had considerable success penalising individuals in the past.

There is also likely to be a continued focus on market manipulation, with a particular focus on spoofing at both the SEC and CFTC. Last year saw a number of cases brought by both on the issue,[74] as well as the first criminal conviction in this area.[75] It remains a top priority for both regulators in 2016. FINRA meanwhile has already this year started offering monthly cross-market equities supervision report cards, to help firms identify spoofing.[76] Failure to tackle it is unlikely to be looked on kindly.

New Ground

There will be new areas that see regulatory scrutiny, too.

Some of these will come from regulators turning their attention from banks to elsewhere in the financial sector. The FCA, for example, is in the midst of a wide-ranging market study into

[72] https://www.fca.org.uk/news/fca-publishes-2016-17-business-plan
[73] https://www.sec.gov/news/pressrelease/2016-92.html
[74] https://www.sec.gov/news/pressrelease/2015-273.html https://www.sec.gov/news/pressrelease/2015-236.html http://www.cftc.gov/PressRoom/PressReleases/pr7264-15
[75] http://www.reuters.com/article/us-court-spoofing-verdict-idUSKCN0SS2QQ20151104
[76] https://www.finra.org/newsroom/2016/finra-issues-first-cross-market-report-cards-covering-spoofing-and-layering

competition in the asset management industry, which includes investigating the role of investment consultants.[77]

REGULATORS' ATTENTION WILL FOCUS ON NEW AREAS IN 2016.

The SFC, meanwhile, has introduced a new Professional Investor Regime in Q1 2016.[78] How this impacts the industry is the subject of some debate which leaves the door open for potential future enforcement for those who find themselves on the losing side of the argument. Also there is an anticipated revision of the conduct of business rules due in Q4 2016 or thereabouts, and it will be interesting to see what changes that heralds.

In the U.S., rules requiring financial institutions to identify beneficial ownership have just passed, and the AML community is expecting a rule bringing SEC-registered investment advisors within the scope of the Bank Secrecy Act's expansive regulatory requirements is expected any day. The first of these imposes significant new due diligence obligations on financial institutions and their customers. The second will also lead to significant changes in compliance and examination thereof for investment advisors.

Some new areas will come from changes in the industry itself and the economy more widely. In particular, we are seeing an increased focus from regulators on the impact of technology.

There's been much said about bitcoin and cryptocurrencies, and last year saw the first cases concerning bitcoin from a major regulator, the CFTC.[79] With the determination that virtual currencies are commodities covered by existing law, more cases are likely to follow. The increasing use of mobile payments is also likely to give rise to cases in the future.

A more immediate concern for most regulators and firms, however, is simply cybersecurity – an explicit priority this year for all three U.S. regulators and the SFC. The SEC has named it the biggest risk facing the financial system.[80] 2015 also saw the SEC bring its first cybersecurity related enforcement action against an investment adviser for inadequate policies and procedures, as well as compromising the personally identifiable information of its clients and contacts. The SFC also has concerns. It issued a circular in March 2016 to licensed corporations outlining its concerns around inadequacies in risk assessments, cybersecurity awareness training, data protection and incident responses.[81] In May 2016, the Hong Kong Monetary Authority (HKMA) also announced the Cybersecurity Fortification Initiative (CFI) through which it intends to raise the levels of cybersecurity in banks in Hong Kong. With all of these messages being sent to the industry, it is only a matter of time before further enforcement follows for those that do not listen.

[77] https://www.fca.org.uk/news/fca-publishes-terms-of-reference-for-asset-management-market-study
[78] http://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=16EC15
[79] http://www.cftc.gov/PressRoom/PressReleases/pr7231-15
http://www.cftc.gov/PressRoom/PressReleases/pr7240-15
[80] http://www.reuters.com/article/us-finance-summit-sec-idUSKCN0Y82K4
[81] http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=16EC17

The FCA, too, used its business plan for 2016/17 to address cybersecurity issues.

In late 2015, the CFTC also proposed enhanced cybersecurity rules that will require derivatives clearing house organisations, trading platforms, designated contract markets, and swap data repositories to conduct five types of cybersecurity testing.

> "A lack of technological resilience among many firms, complexity as systems have evolved over time, the need to balance investment in innovation with maintaining existing systems and infrastructure and a lack of IT expertise at board level are some of the reasons this area (cybersecurity) continues to present significant challenges. Given the impact on firms, consumers and markets, this failure poses both conduct risks and potentially a systemic risk."[82]
>
> FCA Business Plan 2016/17

Nevertheless, technology is not just a risk, but an opportunity, and the UK regulator at least is keen not to let concerns hamper innovation. Another of its priorities for the year is to continue its work on "Project Innovate". This includes a new "Regulatory Sandbox" allowing financial services firms to test innovative products, services, business models and delivery mechanisms without immediately having to meet all the normal regulatory requirements. It will be interesting to see how the experiment works in practice.

Best Laid Plans

However, there are any number of uncertainties that make predicting the future pattern of enforcement difficult.

One is changing personalities. As of July 2016 the FCA has a new chief executive, former Bank of England deputy governor Andrew Bailey. The SFC, too, appointed a new head of enforcement in March – Thomas Atkinson, former director of enforcement at the Ontario Securities Commission, Canada. Even allowing for a commitment to continuity (Bailey has said the most pressing need is for "stable leadership"),[83] both are likely to have an influence on enforcement priorities in the years ahead.

[82] https://www.fca.org.uk/static/documents/corporate/business-plan-2016-17.pdf
[83] http://www.bankofengland.co.uk/publications/Pages/news/2016/024.aspx

Politics and public perception will also have an impact. The presidential election in the U.S. and political fallout from the result of the EU referendum in the UK will both have consequences that are difficult to determine. The fortunes of the finance industry, given the significant costs of compliance, will also inevitably influence regulatory attitudes and expectations.

The biggest uncertainty around regulators' enforcement priorities, however, remains the behaviour of the regulated firms themselves. Regulators' business plans will only take us so far. If the last couple of years have demonstrated anything, it is the ability of unexpected issues to hijack the regulatory agenda and come to utterly dominate enforcement activity in terms of workload, profile and penalties.

Benchmark abuses did not come to light as a result of regulatory initiative. Rather their revelation determined regulatory priorities for at least a couple of years. Quite simply, they were abuses that could not be ignored. Likewise, the big cases of 2016 and beyond may reflect the current priorities of the regulators – or something else entirely. Only time will tell.

To borrow a famous quote from physicist Niels Bohr: "Prediction is very difficult, especially if it's about the future."

That remains as true as ever.

"PREDICTION IS VERY DIFFICULT, ESPECIALLY IF IT'S ABOUT THE FUTURE."

Niels Bohr

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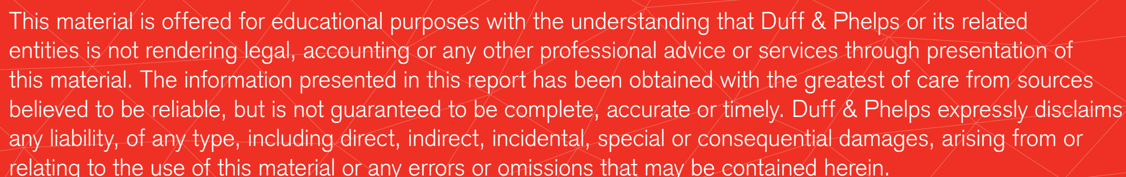

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