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United States

Recent Developments at the SEC

On September 1, President Trump nominated Robert Jackson to be a Commissioner of the Securities and Exchange Commission (SEC). Mr. Jackson is the Director of Columbia University Law School’s Program on Corporate Law and Policy. Mr. Jackson, along with President Trump’s other nominee, Hester Pierce, received unanimous approval from the Senate Banking Committee and currently await confirmation by the full Senate, which would bring the SEC Commission to full strength.

At a Securities Enforcement Forum in October, SEC Co-Directors of the Division of Enforcement Stephanie Avakian and Steven Peikin provided insight into the Division’s initiatives and priorities. Mr. Peikin stated that Enforcement would no longer pursue Former Chair Mary Jo White’s “broken windows” strategy (i.e., pursuing minor violations of securities laws) and instead would focus on bringing select cases that send a broader message to the industry. He also noted that the Division may pull back from pressing companies to admit wrongdoing as a condition of settlement.

SEC Publishes Annual Report for Division of Enforcement

In November, the SEC published its Annual Report for the Division of Enforcement, outlining new focuses for the Division and detailing the statistics for FY 2017. The Report describes five guiding principles for the Division going forward:

**Principle 1:** Focus on the Main Street Investor

**Principle 2:** Focus on Individual Accountability

**Principle 3:** Keep Pace with Technological Change

**Principle 4:** Impose Sanctions That Most Effectively Further Enforcement Goals

**Principle 5:** Constantly Assess the Allocation of Our Resources

For FY 2017, the number of stand-alone enforcement actions decreased significantly when compared to FY 2016. The bulk of that difference is attributable to 84 actions brought in FY 2016 as part of the SEC’s Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, a voluntary self-reporting program that targeted material misstatements and omissions in municipal bond offering documents. When the 84 MCDC actions are excluded, there were 464 stand-alone enforcement actions in FY 2016, compared to 446 in FY 2017.

SEC Announces Initiatives for the Division of Enforcement

The SEC recently announced its plans to create a Cyber Unit and Retail Strategy Task Force that will build on the Division of Enforcement’s efforts to address cyber-based threats and protect retail investors. The Cyber Unit will focus on cyber-related misconduct while the Retail Strategy Task Force will focus on those issues that directly affect retail investors.

The Cyber Unit will target cyber-related misconduct such as market manipulation schemes involving false information spread through electronic and social media, hacking of material non-public information, and misconduct through the use of the dark web and intrusions into retail brokerage accounts, among other things. With the creation of the Cyber Unit, the SEC is expanding its technical expertise and demonstrating that it too will evolve and
adapt as cybersecurity threats become more advanced. The agency is making it increasingly clear that it expects those it regulates to make corresponding improvements in cyber defense capabilities. For additional information on the SEC’s new Cyber Unit, see the Legal Alert written by Michael Bahar and Brian Rubin.

The Retail Strategy Task Force plans to use its experience in identifying misconduct impacting retail investors along with the use of data analytics and technology to identify large-scale retail-related misconduct. The SEC stated: “By dedicating additional resources and expertise to developing strategies to address misconduct that victimizes retail investors, the division will better protect our most vulnerable market participants.”

SEC and US Department of Justice Reverse Stance on SEC ALJs

On November 30, the SEC issued an order ratifying the appointment of all five of its administrative law judges (ALJs) with respect to pending administrative proceedings. The order was released a day after the US Department of Justice (DOJ) reversed course and told the US Supreme Court that the SEC’s ALJs are inferior officers and not employees. This was in response to a petition to hear a challenge to the SEC’s ALJs on constitutional grounds. The DOJ reasoned that SEC ALJs exercise “significant authority” which, under Supreme Court precedent, makes them officers subject to the requirements of the US Constitution’s Appointments Clause. The Supreme Court has yet to decide whether it will hear the case.

The SEC’s order may delay some administrative proceedings as its ALJs must now reconsider their rulings in those matters so that their decisions are made under the ALJs’ new authority. By ratifying the appointment of its ALJs, the SEC has resolved any concerns that its in-house proceedings violate the Appointments Clause. Earlier in the year, the SEC stayed administrative proceedings assigned to ALJs where respondents could seek review in the US Court of Appeals for the Tenth Circuit, following a decision that ALJs were indeed officers subject to the Appointments Clause.

DOJ Wants to Improve Coordination with Foreign Law Enforcement Agencies

Deputy Attorney General Rod Rosenstein says the DOJ wants to improve coordination with foreign law enforcement agencies and domestic regulators. Speaking at a conference in New York on November 8, Mr. Rosenstein said, “The department is mindful of piling on concerns when it pursues parallel enforcement actions.” Mr. Rosenstein said the DOJ is working on proposals for improved coordination with international law enforcement and regulatory agencies, as well as federal, state and local agencies. While looking to increase coordination with other agencies, Mr. Rosenstein did not say that companies would escape settlements with multiple agencies. Additionally, he stated that the DOJ would continue to pursue claims against individuals, continuing the policy established last year in a memorandum written by former acting Attorney General Sally Yates.

Financial institutions that are typically subject to multiple regulatory agencies have raised concerns about those agencies bringing enforcement actions related to the same conduct without taking into consideration the penalties sought by other regulators. While these agencies have different jurisdictions and enforcement mandates, the companies argue that the penalties being paid to the other agencies should reduce the penalties that would otherwise be sought. While regulators claim to take into account the penalties levied by other agencies, Mr. Rosenstein said the DOJ is going to work to improve coordination among regulators and enforcement agencies: “It’s not always going to be possible. It’s not always going to be appropriate. But my point is that it should be on the table.”

Mr. Rosenstein’s full remarks can be accessed here.

FINRA Recognizes Cooperation in Settlements

Recently, the Financial Industry Regulatory Authority (FINRA) settled two high-profile matters involving apparent failures by brokerage firms to supervise the sales of certain types of securities. In the first case, FINRA fined a firm $3.25 million (and ordered more than $9 million in customer restitution) for allegedly failing to establish and maintain a supervisory system and written procedures reasonably designed to detect and prevent short-term trading of Unit Investment Trusts (UITs). In the second matter, FINRA ordered another firm to pay more than $3 million in customer restitution for recommending complicated investment products (volatility-linked exchange-traded products) to clients without fully understanding their risks and features. FINRA found that the firm failed to implement a reasonable system to supervise the sale of these products and failed to provide reasonable training. In both settlements, FINRA recognized the firms’ cooperation in investigating and resolving the matters.

At a recent Securities Enforcement Forum, Russell G. Ryan, deputy chief of FINRA’s Department of Enforcement, agreed that cooperation with FINRA was a key message from the two cases. He stated that the Staff would take into consideration proactive, genuine efforts to cooperate with FINRA. Such efforts include initiating a firm-wide investigation, hiring consultants to analyze data, establishing a plan for remediation, and providing substantial assistance to FINRA. In particular, he noted that in one case, the firm paid restitution but no penalty, and in the other, the sanctions included restitution and only a modest fine.

CFTC Updates Self-Reporting and Cooperation Guidelines

On September 25, the US Commodity Futures Trading Commission (CFTC) issued an Updated Advisory on Self Reporting and Full Cooperation. The updated advisory expands upon guidance given in a pair of January 2017 advisories addressing “Cooperation Factors in Enforcement Division Sanction Recommendations” for individuals and companies. The January advisories identified three areas the CFTC considers in assessing cooperation: (1) the value of cooperation to the CFTC investigation or enforcement action; (2) the value of cooperation in connection with the CFTC’s broader law enforcement interests; and (3) relative culpability and other factors such as mitigation and remediation.
The updated advisory identifies additional information for individuals and companies to receive full credit for self-reporting and cooperation. First, wrongdoing must be reported to the CFTC prior to an imminent threat of exposure and promptly after becoming aware of the misconduct. Second, during the enforcement investigation, there must be full cooperation in accordance with the requirements set out in the January advisory. This cooperation includes “cooperating up, not down” so the CFTC can bring charges up the chain of supervision. Third, there must be timely and appropriate remediation to fix flaws in compliance and control programs.

The decision on whether to self-report is a difficult one. But the CFTC has made clear that if an individual or company self-reports, fully cooperates and makes restitution, it will recommend a significant reduction to the civil monetary penalty and perhaps a non-prosecution agreement.

Swedish-Based Telia Company AB Paying $965 Million for Alleged FCPA Offenses

Telia Company AB, an international telecommunications company, has agreed to pay $965 million to resolve charges related to violations of the Foreign Corrupt Practices Act (FCPA) to win business in Uzbekistan. The global settlement with the SEC, DOJ, and Dutch and Swedish law enforcement authorities is the largest FCPA enforcement action ever. While Telia is a Swedish company and not an issuer regulated under the FCPA, the charges date back to 2007 when the company was publicly traded in the United States.

According to SEC’s and DOJ’s press releases, Telia paid more than $330 million in bribes to a shell company controlled by a Uzbek government official who was related to the President of Uzbekistan. The family member had influence over the Uzbek governmental body that regulated the telecom industry. The bribes provided Telia with access to valuable telecom assets in the Uzbek market.

Forex Executive Convicted of Fraud

The head of global foreign exchange at an international bank was convicted in federal court of defrauding a bank client by trading ahead of a planned foreign currency exchange to increase the price in advance of a Forex deal.

A client came to defendant’s bank to convert approximately $3.5 billion from the sale of a subsidiary into British pound sterling. The defendant and a trader at the bank were aware of the planned Forex deal and began purchasing pounds for the bank’s account. Another employee allegedly provided advice regarding how to drive up the market without raising suspicion. On the day of the exchange, the defendant continued trading to increase the price of the pound to the US dollar. The bank failed to advise the client of its trading in pounds in advance of the transaction.

The government claimed that this trading caused the price of the pound to spike—benefitting the bank to the detriment of the client. The defendant asserted the client was aware of the “pre-hedge” to buy pounds and that the trading was both “legitimate and appropriate” in order to accumulate the necessary pounds to fulfill the client’s order. Ultimately, the jury found the defendant guilty of eight counts of wire fraud and one count of conspiracy.

This was the first of many DOJ investigations into Forex rigging that are set for trial. The DOJ is pursuing other cases against Forex traders for allegedly coordinating Forex trades to impact daily benchmarks and suppress competition.
United Kingdom

FCA Fines Merrill Lynch £34.5 Million for Transaction Reporting Failings

On October 23, the Financial Conduct Authority (FCA) published its Final Notice to Merrill Lynch International, fining it £34,524,000 for failing to report 68.5 million exchange-traded derivative transactions over a two-year period.

The Notice outlines breaches of Principle 3 (management and control) of the FCA's Principles for Businesses and Article 9 of EMIR (the regulation on over-the-counter derivative transactions, central counterparties and trade repositories) (Regulation 648/2012). With regard to breaching Principle 3, the FCA stated that Merrill Lynch failed to:

- Have adequate oversight for reporting trading in exchange-traded derivatives;
- Undertake testing to ensure the completeness and accuracy of its reports relating to trading in exchange-traded derivatives;
- Allocate adequate and sufficient resources to report trading in exchange-traded derivatives; and
- Address known issues within its risk management systems regarding timely reporting.

Merrill Lynch’s deficiencies were exacerbated because it was previously subject to two Final Notices also relating to transaction reporting breaches. The FCA expects firms to comply with transaction reporting requirements. The FCA has directly reported on their importance and has publicized a number of enforcement actions regarding similar transaction reporting deficiencies.

An accompanying FCA press release stated that this is the first enforcement action against a firm for failing to report details of trading in exchange-traded derivatives under EMIR. Commenting on the Final Notice, Mark Steward, FCA Executive Director of Enforcement and Market Oversight, stated that the FCA will continue to take appropriate action against any firm that fails to meet transaction reporting requirements.

FCA Fines Former Bond Trader for Market Abuse

On November 22, the FCA published its Final Notice to Paul Walter, a former bond trader at Bank of America Merrill Lynch International Ltd., fining him £60,090 for engaging in market abuse contrary to section 118(5) of the Financial Services and Markets Act 2000 (FSMA).

On 12 occasions in July and August 2014, Mr. Walter engaged in a trading strategy that manipulated the quotes of other market participants and led them to buy Dutch State Loans (DSLs) at a higher price, or to sell at a lower price, than they otherwise would have done. Three of these occasions led to a market participant making a complaint to the BrokerTec trading platform.

Mr. Walter’s abusive trading netted him €22,000 in profits.

The FCA accepted that Mr. Walter committed the market abuse negligently rather than deliberately because he did not appreciate that his actions constituted market abuse. But the FCA regarded his actions as a serious example of market abuse, particularly because of the following aggravating factors:

- He was an approved person and had 20 years of experience in trading government bonds.
- He should have realized that his behavior constituted market abuse. His behavior was a serious failure to act in accordance with the standards reasonably expected of market participants and did not cease even after he was informed of concerns about his behavior.
- Through his trading strategy, he sought to influence the prices of DSLs to his advantage and to the detriment of other market participants. Such behavior undermines confidence in the UK markets.

**BoE Consultation on Procedure for Enforcement Decision Making Committee**

On November 10, the Bank of England (BoE) published a Consultation Paper on how a new Enforcement Decision Making Committee (EDMC) will operate. The EDMC is intended to strengthen the independence and robustness of the BoE’s decision making process in any contested enforcement cases. The paper follows from an earlier consultation carried out in July 2016, in which the BoE proposed the establishment of the EDMC. Responses to that consultation supported the EDMC’s establishment.

The BoE proposes that the EDMC will be the BoE’s decision making body in connection with contested enforcement cases within the statutory regimes operated by the BoE in relation to:
- Prudential regulation;
- Financial Market Infrastructure (FMI); and
- Resolution.

The EDMC will strengthen the BoE’s enforcement processes by ensuring a functional separation between its investigation teams and its decision makers in contested enforcement cases. The EDMC will be a committee of the BoE. It will be made up of individuals who are not BoE employees and who will be independent from its existing executive management structure. The consultation closes on February 2, 2018.

**FCA Speech on Recent Enforcement Trends**

The FCA has published a speech by Mark Steward, FCA Director of Enforcement and Market Oversight, on recent enforcement trends with a focus on wholesale markets. Mr. Steward discussed:
- The recent increase in the number of investigations the FCA has commenced and the reasons for this increase;
- What the starting point for FCA investigations should be;
- MiFID II and the FCA’s work to develop its capacity to collect and aggregate order book data from all venues using a cloud-based platform, which he describes as a “sea change” in the FCA’s ability to view the whole market; and
- The FCA’s approach to enforcement for firms that are not fully compliant with their obligations under MiFID II after January 3, 2018.

**FCA Speech on Culture and Conduct in Financial Services**

On September 20, the FCA published a speech by Jonathan Davidson, FCA Executive Director of Supervision: Retail and Authorizations, on culture and conduct in financial services through the lens of the Senior Managers and Certification Regime (SMCR).

Mr. Davidson discussed the progress the FCA has made on its mission as a conduct and competition regulator and why and how that has shaped its continuing focus on culture. Points of interest in the speech included:
- In addition to the Mission Document it published in April 2017, the FCA will publish a follow-up paper in early 2018 on how it approaches supervision. This paper will address the challenge of how to approach supervising around 56,000 firms with huge variations in size and business type. The FCA cannot “continuously and closely” supervise outcomes in every one of these firms; its ambition is to be forward looking and preemptive by addressing root causes. The two root causes it sees as important are firms’ strategy and business models and their culture.
- While the FCA does not seek to prescribe firms’ strategies and business models, it does aim to understand preemptively how business models are evolving to anticipate where there are risks of harm that might emerge and then use the most effective regulatory tools to ensure that the risks are mitigated. Its approach to supervision will cover this area in more detail.
- The FCA looks to assess what management is doing to manage culture in four ways. First, whether there is a clearly communicated sense of purpose and approach: the “what,” the “how” and the “why.” Second, what is the “tone from the top”: what staff members hear and see from senior management. Third, whether there are the formal governance processes and structures: the policies and systems that specify expected behaviors and decisions. From a conduct culture point of view, the FCA looks for a reasonable conduct risk framework: is there a clear explanation of conduct risks, and systems and controls for mitigating them, and risk indicators for monitoring them? Fourth, what are the people-related practices, including incentives and capabilities.
- The emerging field of behavioral economics has important implications for how financial services culture can embody and deliver on the conduct rules. Mr. Davidson gave some examples that showed how an ethical culture can be more powerful than one based solely on financial incentives. In his view, it could be a sound business proposition for firms to move from a compliance culture to an ethical culture.
FCA Speech on Effective Compliance with MAR

On November 14, the FCA published a speech by Julia Hoggett, FCA Market Oversight Director, on effective compliance with the Market Abuse Regulation (Regulation 596/2014) (MAR).

In her speech, Ms. Hoggett considered both MAR and the overall market abuse regime, which she described as “the environment created by the interplay of the full spectrum of laws, rules and guidance aimed at tackling market abuse... including, but not limited to, MAR.” Points of interest in Ms. Hoggett’s speech included:

- More than a year since the application of MAR, the FCA now expects firms to be compliant with all of MAR’s requirements. To be most effective, compliance with MAR is a state of mind rather than simply a set of rules. For example, firms must be a vigilant in identifying the potential for insider information, have the skill to make the assessment on whether the conditions of the definition are met, and be aware of what to do next. If this critical thinking has not taken place, there is a risk that systems and controls will only go so far.

- The way in which the FCA is now set up to carry out market surveillance is different from its structure several years ago, and it will continue to evolve. Three departments within the Directorate of Market Oversight are wholly engaged with the ongoing efficacy of both MAR and the market abuse regime more widely: the Listing Transactions Department, Primary Market Oversight, and Secondary Market Oversight. The FCA would welcome more engagement with the issuer community on MAR.

- The FCA has also adapted its organizational structures to ensure it looks for an appropriately broad range of market behaviors. While it will always focus on insider dealing, whether in individual instruments and cross-market, the FCA has significantly bolstered its resources allocated to market manipulation.

- The evidence from suspicious transaction and order report (STOR) submissions shows that they are dominated by equity insider dealing, which represents more than 70% of all submissions received by the FCA. While equity insider dealing has been a clear focus for the FCA in the past, all relevant markets are vulnerable to both insider dealing and manipulation. Accordingly, the FCA is now more focused on seeking out evidence of market manipulation across asset classes, and combating abuse wherever it exists.

- The FCA expects firms to ensure that their systems are constantly evolving to meet the changing nature and needs of their businesses, including evolving regulatory demands. However, as they innovate, firms must keep their surveillance and reporting capabilities in lock-step with developments in their business, such as a change in the nature of the products they provide or the cross-execution platforms they develop.

- Firms must align their efforts to combine financial crime with their efforts to combat market abuse, on the basis that the two are inextricably linked. Where a firm has had repeated concerns about the trading behavior of a client, leading it to raise multiple STORs, it is wholly legitimate for the FCA to also ask whether that firm has properly considered its regulatory obligations (set out in SYSC 6.1.1R) to counter the risk of financial crime.

- The FCA must continue to adapt both to technological change and the evolution of market behaviors. It will not shy away from pursuing “hugely important but inevitably complex” market abuse cases when they arise. Ignorance of the requirements of MAR, or the absence of intent to commit market abuse, is not a defense to breaches of MAR. Market participants should therefore take all necessary steps to understand their obligations under MAR and ensure they conduct themselves appropriately.

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Hong Kong

SFC’s Enforcement Priorities

In October, Thomas Atkinson, the Executive Director of the Enforcement Division for the Securities and Futures Commission (SFC), delivered a keynote speech at the Pan Asian Regulatory Summit that focused on the SFC’s enforcement priorities over the next year and reflected on the progress made over the last year.

Mr. Atkinson explained that the SFC would be focusing on “quality over quantity” when it came to enforcement, meaning that the SFC intends to focus on the most serious cases which pose the highest threat to the reputation and integrity of the market. The key risk areas identified included corporate fraud and misfeasance, insider dealing and market manipulations, and sponsor misconduct.

Mr. Atkinson further advised that the SFC would be focusing on its enforcement priorities along with the priorities of the SFC as a whole. This formed part of the SFC’s move towards a more proactive and preventive approach to regulation.

Mr. Atkinson also highlighted the cooperation between the SFC and other regulators. In Hong Kong, the SFC has collaborated successfully on investigations with the Hong Kong Monetary Authority (HKMA) and signed a Memorandum of Understanding with the Hong Kong Police. Outside of Hong Kong, the SFC has developed a close relationship with the China Securities Regulatory Commission.

SFC Issues Statement on Initial Coin Offerings

The SFC issued a statement in September on Initial Coin Offerings (ICOs) that highlights the potential application of Hong Kong’s security laws to ICOs.

In particular, the statement describes circumstances in which digital tokens might be properly considered to be “securities.” In such circumstances, parties dealing in, advising, managing or marketing a fund investing in tokens which are truly “securities” could be considered to be engaging in a regulated activity and may be required to be licensed by or registered with the SFC (irrespective of whether the parties are located in Hong Kong).

For example, where an ICO offers digital tokens which represent equity or ownership interests in a corporation, these tokens could be regarded as “shares” and, therefore, “securities.” The SFC noted as one example a situation where token holders were given rights similar to those of shareholders (for example, the right to a dividend and the right to participate in the distribution of the corporation’s surplus assets upon winding down).

SFC Issues Guidelines on Risk Associated with Internet Trading

In October, the SFC issued guidance aimed at reducing the risk of hacking associated with internet trading. The guidelines require licensed or registered persons engaged in internet trading to implement 20 baseline requirements in order to increase their cybersecurity and mitigate the risks of hacking.

The guidelines follow a public consultation where a number of responses from the securities and banking industry were received. The SFC recognizes that cyber risk poses an increasingly significant threat to the integrity, efficiency and soundness of financial markets both in Hong Kong and worldwide.

One of the most significant requirements that has emerged from the guidelines is the requirement to implement two-factor
authentication when clients log in to their internet trading accounts. This requirement will take effect on April 27, 2018, while all other requirements will take effect on July 27, 2018.

The HKMA also wrote to Registered Institutions (RIs) to remind those that offer Internet trading services that they should implement the requirements set out in the SFC guidance. The HKMA further advised that the requirements of the guidelines would be incorporated into the Supervisory Policy Manual module TM-E-1 on “Risk Management of E-banking” in due course.

Managing Conflicts of Interest in Financial Groups

The HKMA and the SFC have completed a jointly conducted thematic review of the effectiveness of controls with respect to conflicts of interest arising from the sale of in-house products by RIs and licensed corporations (LCs) within a single financial group.

The review revealed that intermediaries had, in general, put in place policies and procedures with respect to conflicts of interest. However, some areas warranted further attention. In particular, the HKMA and SFC identified deficiencies in the following areas:

1. Order execution and related disclosures;
2. Product due diligence;
3. The selling process, particularly with regard to discretionary portfolio management; and
4. Management supervision, controls and monitoring.

In a circular published following the conclusion of the this review, the HKMA and SFC has provided examples of good industry practice as well as reminding RIs and LCs of the required regulatory standards.

Hong Kong’s Key Enforcement Highlights

**SFC Secures Criminal Conviction for Marketing**

At the end of September, the SFC secured a conviction against the Hong Kong subsidiary of a US brokerage firm for actively marketing to the Hong Kong public the services provided by its US affiliate which was not licensed by the SFC. The firm was fined $20,000 and ordered to pay the SFC’s investigation costs. This was the first criminal conviction secured by the SFC against an entity for the offense of actively marketing in Hong Kong regulated activities carried on outside of Hong Kong under the Securities and Futures Ordinance.

**SFAT Upholds SFC Disciplinary Action**

In November, the Securities and Futures Appeals Tribunal (SFAT) upheld the SFC’s disciplinary action against an international bank in Hong Kong in relation to the sale of derivative products in the run-up to the global financial crisis in 2008.

In particular, the SFAT found that the SFC had been correct to conclude that the bank was culpable of material systemic failings in its marketing and sale of derivative products by failing to meet the standards set out in the SFC’s Code of Conduct and ancillary guidelines.

As a result of these findings, the SFAT imposed a fine of HK$400 million and suspended the bank’s registration for Type 4 regulated activity (advising on securities) for one year and partially suspended the bank’s registration for Type 1 regulated activity (dealing in securities). This represents the highest fine ordered by the SFAT.

**Danny Fung Kwong Shing**

The SFC has banned Danny Fung Kwong Shing (“Mr. Fung”), a former account executive of Fulbright Securities Limited, from re-entering the industry for life and imposed a fine of HK$542,071. The disciplinary action followed an investigation by the SFC which found that Mr. Fung had conducted more than 700 unauthorized transactions, fabricated telephone order recordings, and impersonated a client. It was also found that more than 50 of the unauthorized transactions were conducted under a premeditated scheme to secure profits for one individual while causing significant losses to others.

The SFC found that Mr. Fung’s conduct was gravely dishonest and that he was not a fit and proper person to be licensed.

**Yip Wai Pang**

The HKMA has suspended Yip Wai Pang, a relationship manager of a bank responsible for handling client accounts, for completing six sets of Individual Financial Statements (IFs) for two personal guarantors of a corporate client without their consent and without verifying the accuracy of all the information therein and for forging the signatures of the two personal guarantors on the IFs.

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DFSA Reinforces Individual Accountability and Censures Finance Officer for Misconduct

The Dubai Financial Services Authority (DFSA) has recently issued a censure against a Finance Officer (FO) of a PIB Category 4 Authorized Firm (the Firm), for misconduct.

The FO was responsible for submitting the Firm’s financial reports to the DFSA each month. The FO failed to verify the reports that he submitted and instead relied on claims made by an unnamed individual, which turned out to be inaccurate. The DFSA considered that this reliance fell below the standard reasonably expected under the DFSA’s Principles for Authorized Individuals. In particular, by virtue of Article 85 of the Regulatory Law, the FO violated:

a. Principle 2 (GEN Rule 4.4.2) because he failed to exercise sound judgement and diligence in performing his role; and

b. Principle 6 (GEN Rule 4.4.6) because he had significant responsibility and failed to take reasonable care to ensure that the business of the Firm, for which he was responsible, complied with legislation applicable in the DIFC (namely, the applicable regulatory requirements in PIB).

The DFSA has previously imposed fines on individuals for similar breaches. However, given the specific circumstances of this case, in particular the conduct of the unnamed individual and the FO’s subsequent cooperation with the DFSA, a censure was considered an appropriate sanction by the DFSA in this case.

A copy of the decision notice can be accessed here.

The UAE Securities and Commodities Authority Launches a Strategy for an Islamic Capital Market

The Securities and Commodities Authority (the SCA) has launched a strategy for the development of an Islamic capital market (the Strategy), which includes:

– The supervisory role played by the SCA (legislation and powers);
– The role played by self-regulatory organizations (SROs) (i.e., financial markets); and
– The challenges encountered.

According to the Strategy:

1. The supervisory role played by the SCA will include the issuing of legislative regulations for the regulation and supervision of Islamic capital market products such as shari’ah-compliant mutual funds and hedge contracts; additional disclosures of Islamic products; updates on sukuk and capital adequacy regulations through assigning weights to Islamic products; the introduction of the shari’ah board governance and stipulating the qualifications of its board members; the organization of training programs and an integrated awareness program dealing with Islamic financial markets.

2. The role of the financial markets would be to issue provisions regulating listing and trading securities and shari’ah-compliant hedge contracts; formulating shari’ah-compliant equity screening provisions; updating existing clearing, settlement and trading regulations concerning Islamic products; and developing investment indicators for Islamic securities.
3. The Strategy has identified several challenges facing the Islamic capital market such as the high costs of Islamic contracts; the increased complexity in the composition of Islamic financial products; the difference in the beliefs and approaches of the different schools of Islamic law; the need to offer credible products that can compete with conventional instruments; and the need to have trained and qualified human resources to create Islamic products that are shari'ah-compliant.

Efficient implementation of the Strategy will:

- Ensure a more regulated and more structured Islamic capital market;
- Provide greater transparency because players in the Islamic capital market will be required to comply with legislative provisions issued by the SCA and the financial markets including compliance with disclosure requirements;
- Help overcome currently prevalent challenges, such as the difference in perspectives and schools of Islamic law, because uniform legislative provisions and regulations will have to be adhered to; and
- Ensure that through the various training programs available human resources will be qualified to create Islamic products that fulfill shari’ah purposes.

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Impact of Sapin II Law: Bank Agrees to Pay €300 Million to Settle French Probe into Tax Evasion

The Sapin II Law introduced an opportunity for legal entities—prosecuted for corruption, money laundering, tax fraud or other offenses—to enter into a settlement with the Financial Public Prosecutor (Convention Judiciaire d’Intérêt Public). This new settlement procedure would result in the dismissal of charges in exchange for a fine, depending on the amount of illicit profits up to a maximum of 30% of firm’s average annual turnover. The firm must also undertake to implement adequate anti-corruption procedures under the supervision of the Agence Française Anticorruption (AFA) and to indemnify the victim.

On October 30, 2017, the first Convention Judiciaire d’Intérêt Public (Judicial Agreement of Public Interest) was entered into between the French National Financial Prosecutor’s Office and the Swiss private bank subsidiary of a large international bank, which had been under formal investigation in France since 2014.

The bank agreed to pay €300 million to French authorities to settle a long-running investigation into allegations for unlawful financial or banking solicitation of French prospects or of prospects residing on national territory that organized money laundering of proceeds for tax evasion. The bank acknowledged these findings in the agreement. The agreement also indicated that the bank had enhanced its procedures and controls to prevent future violations.

While the agreement does not have the nature or effect of a criminal conviction, it will not be extended to any individuals under investigation (i.e., directors and officers) who may remain criminally liable.

The English version of the Convention Judiciaire d’Intérêt Public between the French National Financial Prosecutor and HSBC Private Bank (Suisse) is available here.

The French version of the ratification of the settlement by the President of the Tribunal de Grande Instance on November 14, 2017 is available here.

Impact of MiFID II: The AMF Publishes a Guide for FIAs

The new European Directive on Markets in Financial Instruments (MiFID II), which was transposed into French law with the ordinance of June 23, 2016, will go into effect on January 3, 2018. As a consequence, Financial Investment Advisors (FIAs) will be subject to a national regulatory regime which will implement and enforce the rules of MiFID II. In anticipation thereof, the AMF published a guide in October to help FIAs prepare for the new European Directive.

The guide focuses on the main topics of MiFID II that affect FIAs. Specifically, the guide consists of seven key topics:

1. Impacts of MiFID I and MiFID II on FIAs;
2. Reinforced FIA monitoring and authorization procedure;
3. Rules of governance for FIAs and prevention of conflicts of interest;
4. Independent investment advice;
5. Governance of financial instruments;
6. Enhanced client disclosure; and
7. Assessment of the suitability of products and services.
In this context, the AMF intends to publish an expanded edition of the Guide for FIAs once the provisions of the AMF General regulation, which will enact the provisions of the MiFID II, have been provided.

The complete Guide is available [here](#).

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**Selling of “Investment Diamonds” Sanctioned by AGCM**

On October 31, two companies, along with a handful of Italian banks, were fined €15 million by the Italian Antitrust Authority (AGCM) for disseminating false and misleading information regarding the sale of diamonds via banking channels.

The “investment diamonds” investigation arose in 2016 when a number of customer associations asked the Commissione Nazionale per le Società e la Borsa (CONSOB) to commence a formal investigation after a report aired on television casting these sales in a suspicious light.

While CONSOB determined that the diamond transactions did not fall within the scope of the conduct rules in the Italian Consolidated Law on Finance (TUF), AGCM concluded that where certain specific conditions are met, the selling of diamonds has to be regarded as an offer of financial products. In particular, AGCM determined that an offering document and application should be provided on the basis of transparency and correctness principles, which govern the provision of financial services.

AGCM further found that the companies’ and banks’ behavior, albeit irrelevant from the TUF perspective, amounted to unfair trade practices, that resulted in a violation of the relevant Italian Consumer Code provisions. In fact, AGCM detected a number of elements supporting the companies’ liability for dissemination of false and misleading information, including:

a. the selling price of the diamonds, while presented as an “objective” market price, was determined to be more than the purchase price and more than the relevant international benchmarks (Rapaport and IDEX), and

b. the possibility of liquidating the products was not as “prompt” and “easy” as had been depicted.

With respect to the banks, AGCM stressed that the assistance they provided—presenting the offer and participating in meetings between the companies and the clients—gave the companies credibility, leading the clients to invest without further inquiries.

The fines issued by AGCM may trigger a CONSOB investigation aimed at determining whether the facts of the transactions, specifically the role played by the bank employees, necessitate application of TUF provisions. Should an investigation be initiated, it could result in further sanctions against the companies and the banks.

**New Protections for Whistleblowers**

On November 15, the Italian Parliament approved legislation providing anti-retaliatory protections for whistleblowers in the private sector. Previously, Italian regulations only provided whistleblower protections to individuals employed by a government entity.

This new regulation represents an effort by the legislature to promote integrity and accountability in the private sector.
Under the new provisions, an employee who reports alleged wrongdoings in the workplace is afforded the following safeguards:

- He/she cannot be subject to any direct or indirect act of discrimination and/or retaliation by the employer due to the reporting;
- He/she cannot be dismissed, de-skilled, sanctioned, transferred or be subject to any other organizational measure which may affect him/her negatively. In this respect, it should also be emphasized that, if disputes between the employee and the employer arise, the burden of proof rests upon the latter; and
- His/her identity is to remain anonymous.

More information on this new regulation can be accessed here.
No Legally Valid Right of Pledge on Contract Portfolio of Estate Agency

On August 9, 2017, the judge of the court of North-Holland ruled that a right of pledge on an assignment portfolio of an estate agency is legally invalid because the assignment portfolio cannot be considered a “right” in the sense of article 3:239 paragraph 1 of the Dutch Civil Code (Burgerlijk Wetboek, DCC).

In this case, the assignment portfolio of the estate agency was pledged by a bank as security for a credit facility. The real estate agency went bankrupt, and therefore a bankruptcy trustee was appointed who was charged with the administration and liquidation of the bankrupt estate. The bank submitted its claim against the real estate agency with the bankruptcy trustee and referred to its right of pledge on, among other things, the assignment portfolio. The bankruptcy trustee informed the bank that he was not able to fulfill the assignments for the estate agency’s clients. For this reason, the bankruptcy trustee sold the assignment portfolio to a third party.

The bank sought a declaration that the established right of pledge on the assignment portfolio was legally valid and that the bankruptcy trustee should pay the amount to the bank which the bankruptcy trustee received from the sale of the assignment portfolio.

Pursuant to article 3:81 paragraph 1 DCC and 3:228 DCC, a right of pledge can be established on an independent transferable (property) right. In addition, according to article 3:239 paragraph 1 DCC, a right of pledge can be established on a right which can be executed against one or more persons, provided that at the time that the right of pledge is being established, the pledged right already exists or will arise directly from an existing legal relationship. According to the court, the assignment portfolio cannot be considered a “right” under article 3:239 paragraph 1 DCC because when an assignment is provided to an estate agency, the estate agency does not acquire concrete rights against the person who provided the assignment that can be considered a (future) property right. According to the court, the assignments are at the most a “potential right” to receive brokerage, for example, the moment a sale or lease agreement exists. These circumstances do not fall within the scope of article 3:239 paragraph 1 DCC because the formation of such an agreement was uncertain at the time the right of pledge was established. Therefore, the judge ruled that the assignment portfolio could not be pledged by the bank.

The full judgment can be found here (only in Dutch).
Right of Pledge on Receivables

On April 4, 2017, the court of appeal Arnhem-Leeuwarden held that the debtor of a disclosed pledged receivable should in principle always pay its debt to the pledgee when the pledgee executes its right of pledge. Pursuant to article 3:246 paragraph 4 DCC, a pledgor is allowed to collect the debt with permission from the pledgee. In this case, the permission from the pledgee was subject to certain conditions. The pledgor was only authorized to collect the debt if the debt was higher than the claim of the pledgee for which the right of pledge was established. The court of appeal held that such permission is not compatible with the principle that it should be clear to whom a debtor should pay its debt, so that the debtor will be discharged from its payment obligations. For this reason, the debtor should not be harassed by two authorized collectors: the pledgee (for the amount of its claim against the pledgor) and the pledgor (for the amount that remains).

The full judgment can be found [here](only in Dutch).

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Partial Revision of the Anti-Money Laundering Ordinance - FINMA


Based on the recommendations stipulated in the FATF Report 2016 as well as practical experience gained in several supervisory and enforcement investigations, the Swiss Financial Market Supervisory Authority (FINMA) partly amended its AML ordinance of June 3, 2015 (AMLO-FINMA).

The new provisions aim to ensure better compliance with the “Customer Due Diligence” procedures as set out in FATF’s Recommendation 10. The consultation period for the revised AMLO-FINMA (draft AMLO-FINMA) ended in October 2017. The final provisions are expected to enter into force in 2018.

Planned Key Changes to AMLO-FINMA

Global Supervision of Branches and Group Companies

The FATF Report 2016 concluded that Switzerland must improve its legal and regulatory framework for financial intermediaries to enforce group-wide consolidated monitoring of customer transactions. Risk prevention measures identified included, among others, information-sharing systems (e.g., centrally located data servers, group-wide transparency regulations) between a group’s compliance department in the home country and the compliance units in host countries. The sharing of customer data and the exchange of relevant information between group companies as well as between branches and their headquarters was highlighted as being critical for a group-wide uniform compliance practice and an effective prevention of legal, compliance and reputational risks.

According to article 5 paragraph 1 of AMLO-FINMA, financial intermediaries must ensure that their branches and group companies abroad comply with the main principles defined in the Anti-Money Laundering Act (AMLA) and the AMLO-FINMA which are:

- the prohibition to accept assets which the financial intermediary knows or must assume originate from a criminal offense or a qualified tax evasion, whether or not the crime or offense has been committed in Switzerland or abroad (article 5 AMLO-FINMA);
- prohibition to enter into a business relationship with a company or private individual which the financial intermediary knows or must assume is financing terrorism or is a criminal organization, or is a part of or supports such an organization (article 6 AMLO-FINMA);
- prohibition to establish a business relationship with a fictional bank unless it is an entity of a properly consolidated supervised financial group;
- establishment of the controlling person or the beneficial owner of the assets;
- application of a risk-based approach; and,
- special clarification duties in case of increased risks.
Financial intermediaries have a duty to inform FINMA if local rules and regulations contradict the basic principles of AMLO-FINMA or if compliance with such standards would lead to serious competitive disadvantages for the financial institution (article 5 paragraph 3 AMLO-FINMA).

To comply with the FATF Report 2016 recommendations, FINMA specifies the application of a risk-based approach (see 5th bullet point above) insofar as the new provision requires that certain business relationships and transactions must be categorized at least as normal or high-risk business relationships and normal or high-risk transactions in accordance with articles 13 and 14 AMLO-FINMA.

**Global Supervision of Legal and Reputational Risks**

Financial intermediaries with branches abroad and financial groups having foreign subsidiaries must record, limit and supervise their legal and reputational risks connected with money laundering and terrorist financing globally (article 6 paragraph 1 AMLO-FINMA).

The FATF Report 2016 determined that financial institutions are not always aware of their respective duties and responsibilities on a consolidated level. Therefore FINMA defined, in the draft AMLO-FINMA, four additional requirements pertaining to group-wide responsibilities to fight money laundering and terrorist financing:

- In addition to the risk assessment at the legal entity level (article 25 paragraph 2 AMLO-FINMA), financial intermediaries must establish a consolidated risk assessment. Both analyses may be combined in one document (article 6 paragraph 1 letter a draft AMLO-FINMA).

- A global surveillance of legal and reputational risk is only possible if the financial intermediaries are provided with the appropriate information by its branches and subsidiaries abroad. Providing information on an \textit{ad-hoc} or case-by-case basis does not fulfill FATF’s requirements. Therefore, FINMA requires that financial institutions establish a reporting system that includes regular and standardized reports from branches and subsidiaries to the group-unit that is globally responsible for supervising legal and reputational risks in connection with the fighting of money laundering and terrorist financing (article 6 paragraph 1 letter b draft AMLO-FINMA). The report must include quantitative (number of business relationships with politically exposed persons, assets under management, etc.) and qualitative (changes in the risk assessment of a specific transaction or business relationship, etc.) elements and must provide all information that allows an independent third party (e.g. FINMA, external auditor) to comprehend and to form its own opinion on whether the financial institution properly globally supervises its legal and reputational risks in connection with the fighting of money laundering and terrorist financing (article 6 paragraph 1 letter b draft AMLO-FINMA).

- Financial intermediaries are responsible for reports by their branches and subsidiaries on a proactive and timely basis. For example, if they start a new business relationship or continue an existing business relationship, they are obliged to report those transactions that may have, from a consolidated point of view, a particularly high-risk potential. Such reports are required especially where important financial assets or politically exposed persons are involved (article 6 paragraph 1 letter c draft AMLO-FINMA).

- The new provisions require that group compliance (second line of defense) regularly carries out risk-based internal controls at the branches and subsidiaries abroad. Especially effective are on-site random test and inspections of the branches’ and subsidiaries’ business relationships and transactions (article 6 paragraph 1 letter d draft AMLO-FINMA).

In addition to these regulations, financial intermediaries must ensure that the compliance function and internal audit, in addition to the external auditor, have access to all relevant information regarding the business relationships of all branches and subsidiaries (article 6 paragraph 2 draft AMLO-FINMA).

**General Due Diligence Obligations**

The FATF Report 2016 was critical of the fact that according to Swiss law, there is no general obligation for financial intermediaries to implement reasonable measures to verify the beneficial owners’ written self-declaration and that there are no general and systematic obligations to take reasonable measures to verify the identity of the beneficial owner.

Accordingly, FINMA included three additional obligations in the draft AMLO-FINMA to satisfy the FATF Report 2016’s recommendation:

- Financial intermediaries must verify, using risk-based measures, whether the person identified as the beneficial owner in accordance with the law is in fact the beneficial owner. The measures taken must be documented (article 9a draft ALMO-FINMA). The new duty applies to all business relationships, not only high-risk clients.

- Financial intermediaries must clarify the reasons for the use of domiciliary companies (article 9b draft AMLO-FINMA). This criterion is closely linked with the criterion “complex structures” (article 13 paragraph 2 letter h AMLO-FINMA). Not all business relationships using a domiciliary company are high-risk business relationships. The criterion “complex structures,” however, is an indication for a high-risk business relationship. To be able to assess whether in any specific situation this indication applies to a business relationship, financial intermediaries must understand the reasons for using a domiciliary company.

- According to FATF Recommendation 10, documents, data or information collected under the Customer Due Diligence process is kept up-to-date and relevant by undertaking reviews of existing records. FINMA is implementing an equivalent requirement in the article 9c draft AMLO-FINMA. This requirement for regular and ongoing reviews, even in the absence of any event changes, is new and differs from the existing reviews in case of an event-changing situation (e.g., article 13 paragraph 6, articles 17 and 20 draft AMLO-FINMA). The financial intermediary must define the periodicity of a client information update in its internal guidelines (article 26 paragraph 2 letter d draft AMLO-FINMA).

- To comply with FATF Recommendation 16, FINMA stipulates (in the draft AMLO-FINMA) the obligation of financial intermediaries
when executing wire transfers to ensure that such wire transfers contain certain required and accurate originator information as well as required beneficiary information (article 10 paragraph 1st draft AMLO-FINMA).

Specific Due Diligence Obligations – High-Risk Business Relationships

The financial intermediary must develop criteria which flags a high-risk business relationship.

To comply with FATF Recommendation 19, FINMA added the following criteria (article 13 paragraph 2 draft AMLO-FINMA) (amendments in italics):

- **Letter a:** Domicile or residence of the contractual party, the controlling person or the beneficial owner of assets as well as the nationality of the contractual party or the beneficial owner of assets: especially residency in a country which is considered by the FATF to be “high-risk” or “non-cooperative.”
- **Letter b:** Type of business activities and place of business of the contractual party and/or the beneficial owner of the assets: especially if business activities take place in a country which is considered by the FATF to be “high-risk” or “non-cooperative.”
- **Letter c**<sup>bis</sup>: Mediation or support of business activities by a third-party service provider.
- **Letter g:** Origin or target country of frequent payments: especially payments from a country which is considered by the FATF to be “high-risk” or “non-cooperative.”
- **Letter h:** Complex structures, especially the use of a domiciliary company
  1. in connection with another domiciliary company
  2. in connection with another company
  3. with fiduciary shareholders
  4. in a non-transparent jurisdiction
  5. obviously without any comprehensive reason
  6. for the purpose of a short-term asset placement.
- **Letter i:** Frequent high-risk transactions.

In a periodic risk assessment, financial intermediaries must determine if any of these criteria are relevant for their business activities. The criteria must be specified in internal guidelines and must be taken into consideration for the determination of their high-risk business relationships (article 13 paragraph 2<sup>nd</sup> draft AMLO-FINMA).

Business relationships with persons, resident or domiciled in a country which is considered by the FATF to be “high-risk” or “non-cooperative” and for which the FATF is calling for increased due diligence, are always considered “high-risk” business relationships (article 13 paragraph 3 letter d draft AMLO-FINMA).

Specific due diligence obligations – high-risk transactions

Financial intermediaries must develop criteria to recognize high-risk transactions. To comply with FATF Recommendation 19, FINMA added the following criterion (article 14 paragraph 2 draft AMLO-FINMA):

- **Letter d:** Origin or target country of payments: especially payments from a country, which is considered by the FATF to be “high-risk” or “non-cooperative.”

Finally, payments from or to a country which is considered by the FATF as “high-risk” or “non-cooperative” and for which the FATF is calling for increased due diligence, are always considered “high-risk” transactions (article 13 paragraph 3 letter b draft AMLO-FINMA).

Organizational measures

According to the FATF Report 2016, an independent body or business unit must make the reports to the Money Laundering Reporting Office Switzerland (MROS). Based on the FATF recommendations, the draft AMLO-FINMA (article 25a) states that only top management decides whether reports according to article 9 AMLA and article 305 paragraph 2 Criminal Code are delivered to the MROS. Top management may delegate the task to one of its members, who is not directly responsible for the business relationship in question, to the Money Laundering Body or to any independent unit (a non-profit-oriented unit such as the Compliance Function, etc.).

Suspect Business Relationships and the Right to Notify the Authorities

Based on a decision of the Federal Criminal Court on March 18, 2015 (confirmed by the Swiss Supreme Court on May 24, 2016), paragraph 1 and 3 of article 31 have been deleted in the draft AMLO-FINMA. Thus, the court introduced a duty to report in the event of “mere doubt.”

It is important to remember that, according to Swiss law, financial intermediaries are considered an integral part of the system and thus are required to act as an initial filter in order to avoid the MROS being inundated with unfounded Suspicious Activity Reports (SARs). SARs must be filed according to article 9 AMLA after the clarifications provided for in article 6 paragraph 2 AMLA have been carried out and a suspicion that the assets were linked to an offense could not be removed.
Conclusion

If entered into force in the version published in October 2017, the partially revised AMLO-FINMA will have direct financial, personnel and organizational impact on financial intermediaries. The impact is mainly due to the new duty for financial intermediaries to regularly update customer information, especially for business relationships with normal risks.

The periodic updating of customer information will generate additional costs for many financial intermediaries. However, the biggest impact is expected in the standardized retail banking business. In business with wealthy private clients and in corporate banking, the financial intermediaries maintain regular personal customer contact. In mass business with individual clients, such an individual exchange is usually missing.

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