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Berwin Leighton Paisner LLP's Corporate Crime & Investigations team is led by partners *Aaron Stephens* and *Daren Allen*. The team regularly share their views on topical corporate crime and investigations issues with our subscribers.

In their column for September *Aaron Stephens* and *Andrew Tuson* consider:

- BNY Mellon settlement with US Securities and Exchange Commission
- Proposals for tougher financial sanctions enforcement
- FCA's increased focus on commodities markets

Aaron Stephens and Andrew Tuson, Berwin Leighton Paisner

BNY Mellon settles hiring practices case with US Securities and Exchange Commission

Since 2011 there has been much scrutiny across Wall Street and elsewhere regarding hiring practices at financial institutions in the context of their relationships with sovereign wealth funds. In mid-August 2015 The Bank of New York Mellon (**BNY Mellon**) settled civil/administrative proceedings brought under the Securities Exchange Act of 1934 (**Exchange Act**) by agreeing to make a payment of US$14.8 million (comprised of disgorgement of US$8.3 million; a civil penalty of US$5 million; and US$1.5 million of prejudgment interest). The underlying allegation in the SEC proceedings was that BNY Mellon had violated the anti-bribery and internal accounting provisions of the Foreign Corrupt Practices Act 1977 (**FCPA**). In settling the proceedings, BNY Mellon did not admit or deny the SEC's findings.

The case is instructive for corporations across all industry sectors, not just financial services. It concerned BNY Mellon's relationship with an unidentified Middle Eastern sovereign wealth fund. The fund in question is wholly owned by the country in question, and the Minister of Finance serves as the Chairman of the fund while senior board members are all political appointees. The fund had been a client of the bank since 2000, but in 2010/2011 the bank was making efforts to attract more of the fund's business for its asset management and servicing operations. The SEC alleged that – in order to obtain or retain the fund's business - BNY Mellon agreed to provide valuable internships to relatives of two senior, influential officials of the fund. Given the state ownership of the fund and the roles of the senior officials in question, those senior officials were construed to be government officials (thus engaging the FCPA).

In setting out its case, the SEC referred to evidence suggesting that in providing the internships to the son and nephew of one official, and the son of another official, BNY Mellon:

- failed to follow its standard hiring procedures, despite the fact that it had a well-established, formal and competitive summer internship programme for both undergraduates and postgraduates;
- agreed to hire the individuals before even meeting or interviewing them;
- overlooked its normally stringent hiring standards, because none of the individuals possessed the necessary academic or professional credentials to qualify for the formal internship programme;
- provided the individuals with an "enhanced" work experience, as their "bespoke" internships were longer and more varied than the typical internships offered through the bank's formal programme;
- provided the internships even though there was no expectation that the individuals would convert into full time staff, which was the usual expectation applying to the bank's formal internship programme; and
- tolerated "less than exemplary" performance by the individuals, including repeated absences from work.

Moreover, the bank was criticised by the SEC for deficiencies in its FCPA-related policies, training and internal controls during the relevant time period. It was noted that while the bank had a standard code of conduct and a specific FCPA policy, employees were provided with little guidance or training on the bribery risks associated with hiring family members of government officials. In addition, there was no system for flagging potentially problematic hires and staff and client relationship managers were afforded wide discretion to make hiring decisions of this nature without sufficient oversight (and, crucially in our view, without anyone from legal or compliance being involved to assess FCPA risks).

BNY Mellon was given credit for its cooperation with the SEC's enquiries and for carrying out a remediation programme, including various steps it had begun taking even before the SEC's investigation commenced.

As often seen in cases of this nature, the SEC's investigation uncovered various unhelpful emails and other documents which were no doubt written in good faith, but helped the SEC to articulate a meaningful link between the internships and the bank's desire to retain the fund's business by doing an "expensive favour" for the two officials. Indeed, there was also evidence suggesting that the officials in question wanted to keep the internships secret from the fund - presumably to avoid their professional integrity being called into question if the fund found out that they had requested (and in many ways pressured) the bank to provide internships to their relatives. These are classic "red flags" which can be spotted and addressed by experienced legal and compliance staff, provided they are properly included in the process.

US regulators and other officials have publicly stated that in principle there is no bar on banks or other company's hiring the family members of public officials, even those who may be connected to existing or prospective clients. However, the clear message of this case is that all candidates for employment (even short internships) need to be subject to consistent and transparent hiring processes, and that doing an "expensive favour" for an important client outside of the normal processes can turn out to be very expensive indeed.

See *Practice note, Bribery Act 2010: compliance and enforcement issues for financial institutions (www.practicallaw.com/6-504-4741)* .

UK Government poised to get tougher on financial sanctions enforcement

In this Summer's budget the Chancellor announced that by Spring 2016 there will be a new Office of Financial Sanctions Implementation (**OFSI**) within HM Treasury and that legislation will be tabled early in this Parliament to increase the penalties for non-compliance with financial sanctions, see *Legal update, July 2015 Budget: key financial services announcements (www.practicallaw.com/6-617-2233)* . Currently, UK financial sanctions enforcement is the responsibility of the Asset Freezing Unit at HM Treasury, but the unit has not been particularly active on the enforcement front, especially when compared to the US Office of Foreign Assets Control (**OFAC**). It not clear yet whether OFSI is being established to mimic OFAC by being an aggressive and energetic enforcer, but this is clearly a step in that direction. Much will depend on its staff, its budget and the actual powers that are granted to it by legislation. We will consider the topic again once draft legislation is tabled.

Market abuse – FCA's increased focus on commodities markets

Market abuse in the commodities markets has become a key area of focus for the FCA. This is emphasised by the recommendations of the *Fair and Effective Markets Review (www.practicallaw.com/2-616-4206)* and from the FCA's recent thematic review into commodities trading (LINK). Through its review, the FCA has now highlighted concerns that commodities trading firms have not learned the lessons from the FCA's enforcement cases concerning market manipulation. The FCA has highlighted key ways in which commodities trading firms should take steps to improve their controls around the risk of market abuse.

This comes against the backdrop of commodities firms facing increased regulation, which we can expect the FCA to use to detect and punish financial crime. In particular, through the Market Abuse Regulation which is to come into effect in July 2016, spot commodity contracts will fall within the scope of the UK market abuse regime. When MiFID II comes into effect in January 2017, more commodities trading firms are likely to need to be regulated by the FCA in the UK.

The key issues identified by the FCA in its thematic review are as follows:

- The FCA found that many commodities trading firms had not considered how issues in the LIBOR, FX and Gold enforcement cases applied to commodities markets. The FCA found that some firms were unwilling to consider how these benchmark manipulation enforcement cases applied to the markets they traded. Many firms believed that commodity markets were "too deep, too liquid" and had "too many participants" to be manipulated. The FCA says that it found complacency in some firms towards the risk of market abuse.
- Most firms had not carried out a market abuse risk assessment and therefore could not demonstrate they conducted adequate monitoring and surveillance across the full range of market abuse risks. In particular, the FCA found that some firms did not have effective procedures to identify suspicious transactions and escalate them to the FCA through suspicious transaction reports (this is a point also made in the recommendations of the Fair and Effective Markets Review, which found that suspicious transaction reports relating to fixed income currency and commodity asset classes were only a fraction of those filed in relation to equity markets).
- Firms which had formal governance and committee structures were more likely to have effective controls around identifying market abuse and conflicts of interest.
- Where Compliance sat with the business, the FCA found that Compliance was better able to identify the risks of market abuse and better market conduct guidance was given. In particular, the FCA found that it was beneficial for Compliance to attend regular trader meetings, as this meant that Compliance was likely to have good awareness of market abuse risks and trading issues.
- The FCA found that effective market abuse controls included training programmes with topical examples of market abuse and surveillance systems which used both the firm's trading experience and examples from the market. The FCA found that traders' understanding of the risks of trading on the basis of inside information was poor.

- The FCA found that effective surveillance for market abuse would include transaction sampling at higher risk periods, such as around contract expiry or around important announcements. Surveillance should also be aimed at higher risk individuals.

Given the issues set out in the thematic review and in the Fair and Effective Markets Review, commodities trading firms should proceed with caution and ensure that their surveillance systems are robust, so that suspicious transactions are identified and escalated to the FCA. Maintaining practical training programmes for traders will also be critical in demonstrating that the appropriate culture is being fostered and that the risks of market abuse are being appropriately managed. Given the FCA can often take enforcement action following thematic reviews, it is particularly important that commodities firms ensure that they have the appropriate risk controls in place and that this can be demonstrated to the regulator in a coherent and timely fashion.

Resource information

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