CORLYTICS

The Corlytics Barometer - The market conduct landscape (2012 - Q3 2017)

Contents

Foreword

I am deeply appreciative to Corlytics for the opportunity to contribute this foreword. This is an excellent paper analysing the important area of market conduct-related regulatory fines over the past six years, imposed on financially regulated firms and individuals.

Since the financial crash of 2007, the level of regulator intervention has grown exponentially and remains high, forcing banks to focus their efforts on risk management and compliance. In turn, banks have chosen to respond by creating conduct risk teams that deal not only with regulatory requirements, but also the culture and behaviours required to prevent market mis-conduct. Despite its obvious importance, there is no legislation, policy or rule definition as to what is meant by 'conduct regulation', leaving many firms struggling to address this important risk control.

It is generally accepted that conduct regulation encompasses core regulatory areas such as consumer protection, market conduct rules and ethical codes of conduct. These three pillars of conduct regulation have been joined by new ones driven by the maturity, development and policy of a geographical region and the regulatory strategies of national competent authorities. Examples being the United States, Australia and certain countries within Europe and Asia. New areas joining the growing list of conduct regulation areas includes corporate governance and incentives, systems and controls, competition, anti-trust measures, fitness & probity and 'product governance'.

Conduct regulation is designed to address three main areas in each firm:

- the firm and its organisation, including the board
- the individuals in the firm, including senior management
- the impact of either the first two elements outside the firm, including stakeholders.

This Corlytics barometer outlines how regulators have responded to the firms and individuals found guilty of improper conduct. Furthermore, the report highlights the need for financial institutions to focus their attention on their conduct risk teams. The barometer also examines the geographic risk associated with where a regulated firm offers financial products and services.

Looking to the future, market conduct will not only continue to remain a hot topic on the financial services news agenda but should also become a standing item on the boardroom agenda. This is vital if boards wish to protect their firms from adding to the circa $26 billion in cumulative fines and allegations of ineffective oversight by the board collectively and directors individually.

More than ever, financial services firms and their employees need to be fully aware of the regulatory risks they face in different jurisdictions and what the regulatory requirements are for their firm.

I commend this extensive work by the highly professional and dedicated team at Corlytics to all stakeholders involved in the financial services industry.

Peter Oakes,
Non-Executive Director – Financial Services Institutions
Former Director of Enforcement, Central Bank of Ireland

Methodology

Corlytics has undertaken a study into the enforcement impact of market conduct issues in the financially regulated markets globally. By regulators in the United States (US), Europe, Asia and Africa.

To do this, we analysed market conduct related regulatory fines over the past five years, from January 2012 to September 2017. We did this both for financially regulated firms and for individuals.

Using the Corlytics ontology, we have broken market conduct issues down into nine main categories:

- Insider trading
- Market abuse
- Short selling
- Disclosure to the market
- Anti-competitive behaviour
- Trading errors
- Take over rules
- Misuse of non-public information
- Other trading violations

Market conduct - regulatory categories

Insider trading	Market abuse	Short selling	Disclosure to the market	Anti-competitive behaviour	Trading errors	Takeover rules	Misuse of nonpublic information	Other trading violations

Table 1, Market conduct regulatory categories

For the purposes of clarity, fines include: financial penalties, restitutions and disgorgements mandated by regulators. It does not include class actions, or intercompany litigation. In the case of individuals, we also examine all non-financial penalties.

Executive summary

The Corlytics data illustrates that the total value of fines levied between 2012 and 2017 is over $26.4bn USD, with 80% of these fines being issued by US regulators. 2015 was the peak year for fines in relation to market conduct. The market abuse practices uncovered as a result of rigging of foreign exchange markets by some of the major financial institutions led to heavy activity from larger regulators in the US and Europe.

Issues in relation to market abuse and disclosure to the market accounted for almost 85% of all market conduct fines. US regulators were found to be predominantly responsible across most regulatory categories for enforcement activity. However, for issues relating to anti-competitive behaviour, the US was only responsible for 25% of the fines. For this category, German regulators were responsible for about 35% of the enforcements, with France and the UK responsible for about 20% each.

Enforcement activity for market conduct in numbers 2012 - Q3 2017

26.4bn

The total value of fines in US dollars levied in this period for violations/ breaches in market conduct

85%

The percentage of fines for market conduct that violations/breaches in market abuse and disclosure to the market accounted for

7

The number of EU banks responsible for 45% of all US fines relating to market conduct

20%

The percentage of all enforcement actions globally issued by the SEC and CFTC alone

28

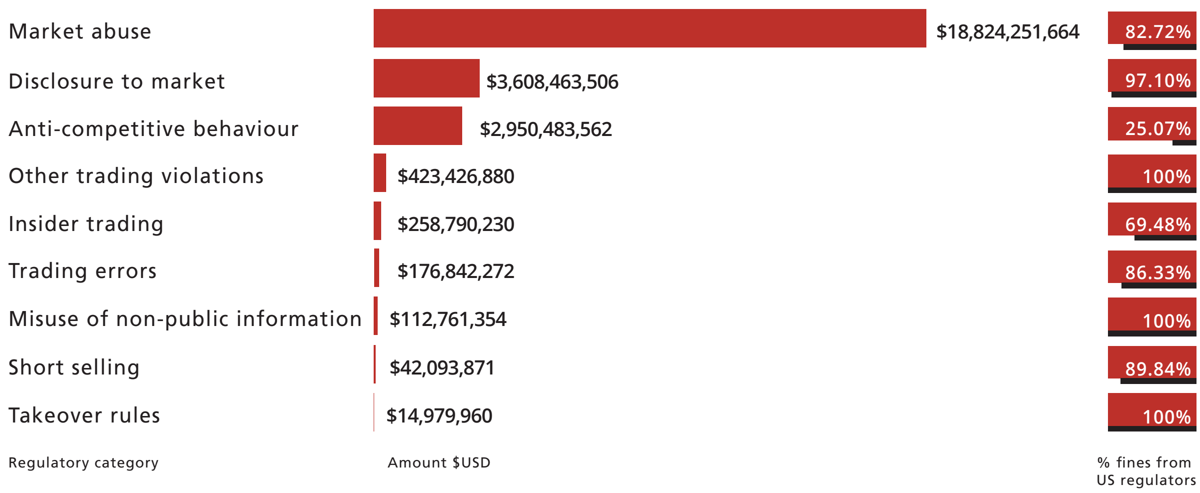
The number of enforcement actions where a prison sentence has been imposed

31=0.3

***31%** of all enforcement notices for market conduct were issued by regulators from APAC in this period. They account for only **0.3%** of total fine amount.*

Enforcement for market conduct

Chart 1. Overview of fines by regulatory category 2012 - Q3 2017



The data illustrates that there was a significant peak for conduct issues in 2015, with a big drop in both the value of and the total number of fines.

Chart 2. Overview of fines by year 2012 - Q3 2017

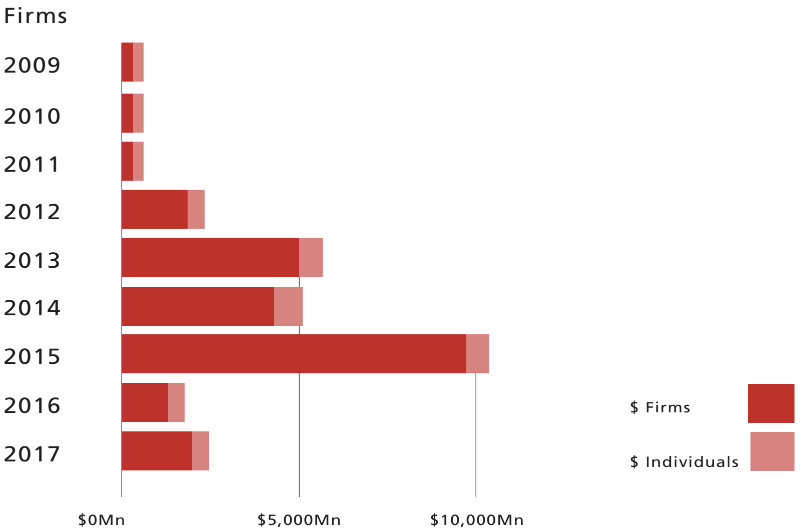
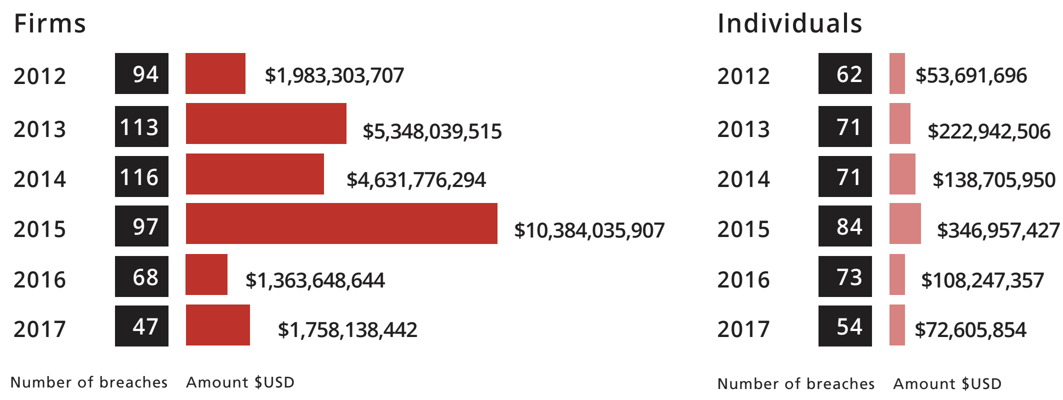


Chart 3. Global view of regulatory trends 2012 - Q3. 2017

$26,412,093,299



#1. US and UK regulators tough on market conduct issues

Conduct issues are high on the agenda in the US and the UK. The Securities and Exchange Commission (SEC) and Commodity Futures Trading Commissions (CFTC) are responsible for 20% of all enforcement actions globally. The Department of Justice (DoJ) was responsible for over $6bn USD in fines against organisations and individuals. This was followed closely by the CFTC, with $5bn USD in fines. The New York State Department of Financial Services (NYDFS) and the SEC both handed out fines of over $1bn USD for market conduct issues during the period. The Financial Conduct Authority (FCA) in the UK, also handed out fines for conduct issues of over $3.1bn USD during the period.

#2. US regulators hit seven European banks hardest for market conduct issues

Seven European banks were responsible for 45% of all US fines in the period in relation to market conduct. Many of these fines have originated from rigging in the foreign exchange markets. What is interesting for institutions is the quantum of the fines. Two US institutions were fined over $2bn USD in total by US regulators, and three European institutions were fined over $2bn USD in total by a number of US regulators. This illustrates that the US regulators are treating foreign and domestic banks in similar ways for similar issues.

#3. Asian regulators bringing greater numbers of cases than European counterparts

The Asian jurisdictions with the most active regulators (Australia, Hong Kong and Singapore) are bringing large numbers of cases for issues in relation to market conduct. Even though the fines tend to be greater in Europe and the US, Asian regulators were generally more active between 2012 to 2017. In the same period, Australian regulators have brought almost twice the number of market conduct enforcements actions (131). In comparison, the UK brought 74. The Hong Kong regulator (HKSFC) brought 89. Singapore comes in at just 55 but is far ahead of all other European regulators. France is next at 12 cases. The data illustrates just how strongly the Asian regulators are concentrating on market conduct issues.

#4. Market bans the most common non-financial consequence for conduct

In terms of non-financial consequences, market bans is the sanction that is most usually imposed by regulators, accounting for almost 30% of non-financial consequences. There have been over 139 market bans in the time period. From 2012 to 2017, there has been 28 enforcements actions where imprisonment has been imposed in the period.

#5. Regulators getting tough on non-financial firms for disclosure to market issues

In 2017, across a variety of global regulators, there have been 34 enforcement actions against non-financial firms, including ratings agencies, pharmaceutical companies, tech firms and indeed individuals for non-disclosure issues. Regulators are focussing much more closely on non-disclosure issues with concerns that individuals and firms are mis-leading the market. This is seen across regulators in the US, Asia and Europe.

Detailed analysis

All firms in the financial services industry are affected by market conduct issues. They acknowledge market conduct as a significant financial risk to business. High-profile conduct failings have increased board and management attention to culture. Banks are now taking issues in relation to misconduct very seriously and many are embedding and creating conduct risk functions within each business rather than addressing it at a group level in the second or third line of defence. In this report, Corlytics presents data and analysis relating to the result of penalties for market conduct issues.

The data and analysis presented is sourced from published enforcement notices by regulators globally and published settlement proceedings by the courts or relevant authorities. This report covers institutional and individual penalties and sanctions for market conduct:

- From January 2012 to September 2017
- For all the main regulators and fining authorities in the US, Europe and Asia
- It identifies the firms' origin where relevant to US enforcement regime
- It identifies consequences for individuals (including prison sentences)

Overview of penalties by regulator & fining authority: For firms

We can see the levels of fines levied by major regulators and fining authorities. It is clear from the table below (table 4) that in the US, the NYDFS imposes the highest average value per fine, which is followed by the United States of Department of Justice (DoJ) and Federal Reserve (FED). What is interesting is that the average NYDFS fine is almost twice that of the DoJ and over 4.5 times that of the leading European regulators.

In Europe, the EU imposes over $100m USD in average value per fine which is smaller than that imposed by NYDFS, DoJ, and the FED in the US. But higher than that imposed by CFTC, SEC in the US, all other European regulators, and the Rest of the World (RoW) regulators.

In the RoW, although the Australian Securities and Investments Commission (ASIC) imposes the highest number of fines against institutions, the average value per fine imposed by ASIC is smaller than that imposed by the Hong Kong Securities and Futures Commission (HKSFC), which imposes the highest average value per fine.

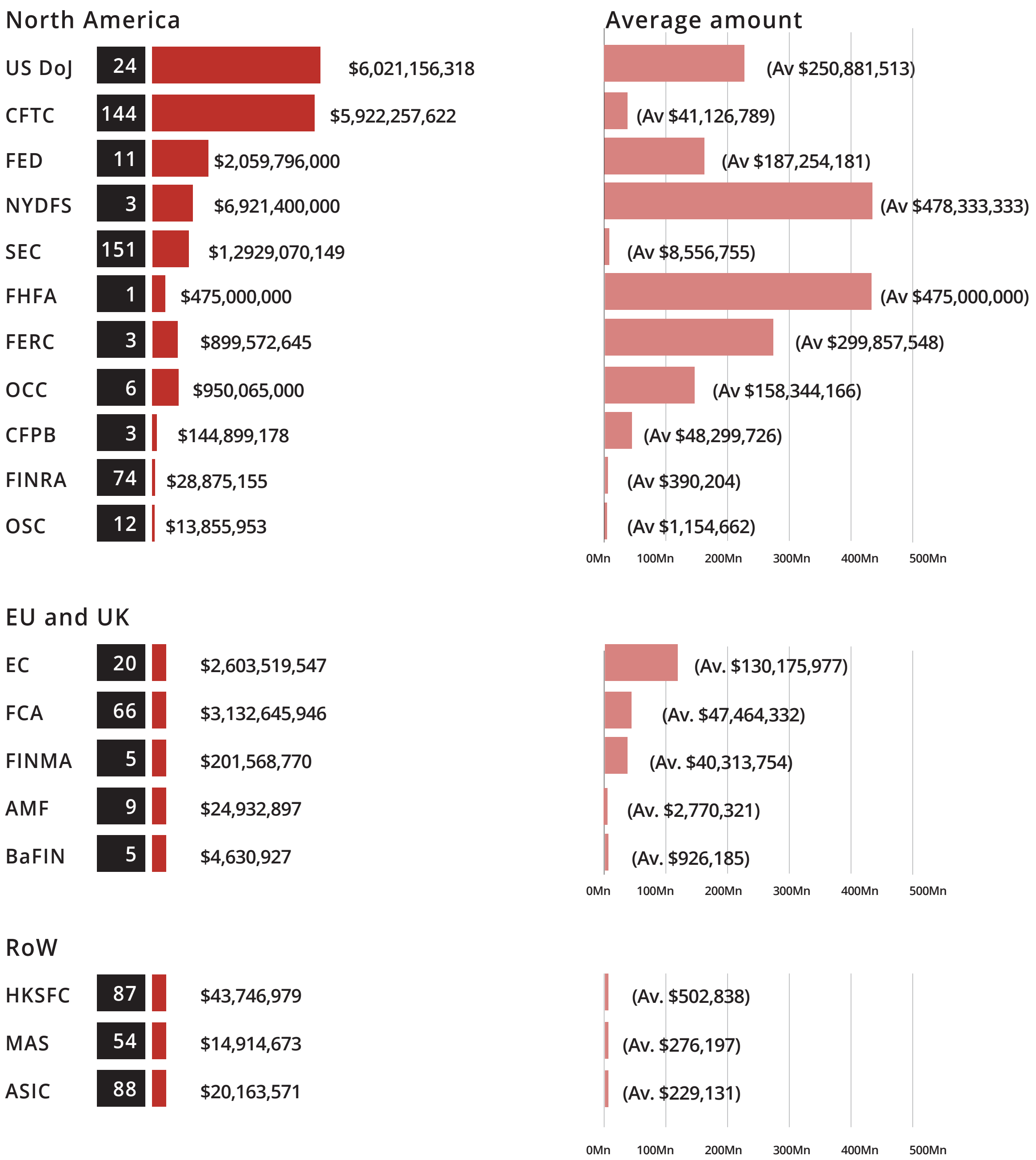
Spotlight on market conduct: Senior management

In 2016, SEC individually fined and brought specific suspension activities against a group of senior management including the CEO, CFO and other senior executives for securities fraud in relation to the sale of residential mortgage-backed securities.

Senior managers **are** ***accountable for their actions.***

Enforcement for market conduct

Chart 4. Global regulatory trends 2012 - Q3 2017



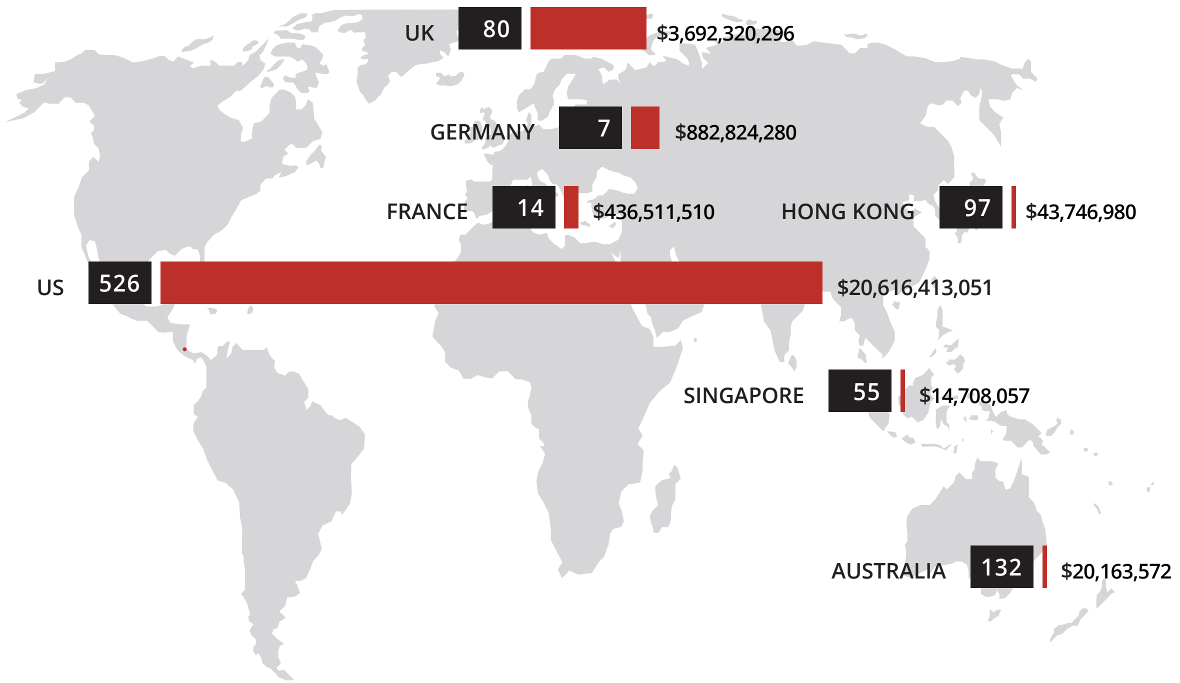
Overview of penalties by jurisdiction

For Asian and European regulators, enforcement activity is relatively balanced in terms of focussing on both individuals and firms. The US has brought the most cases against individuals to date. In the period analysed, there were 208 individual cases. However, the focus remains on enforcement activity against firms, with 318 cases in the US between 2012 - 2017. Organisations, with operations within the US, should therefore focus on ensuring proper market conduct within their US operations that have heavily regulated front offices to reduce their regulatory risk.

The average fine for firms are higher than for individuals, in most global regulators, except Australia and Singapore. This shows a continued focus by these regulators on rooting out conduct by making individuals responsible for their own actions.

The most frequent violations across the major regulators in the US, the UK and Hong Kong were for market abuse issues, while the most frequent violations in Australia and Singapore were for issues in relation to disclosure to the market. The US regulators handed out the heaviest fines over the period analysed and were responsible for almost 80% of total fines by value.

Chart 5. Market conduct - number & value of fines for firms & individuals by jurisdiction across most jurisdictions with highest levels of enforcement.



In the US, market abuse cases account for 25% of all market conduct issues with issues relating to disclosure to the market, accounting for over 20%. In terms of fine values imposed by the US regulators and/or fining authorities, the highest and second highest fine values also fall in into the market abuse category.

Overview of penalties by bank origin

Corlytics uncovered a significant finding for banks operating outside of their originating jurisdiction. In the case of banks who are based in the UK, France, Germany and Switzerland banks with branches in the US, have paid over 47% of the fines related to market conduct in the US

In fact, European banks alone paid over $9.7bn USD in market conduct fines of the $20bn USD total that was levied by US regulators. US banks also paid similar cumulative fine values, with two US firms paying fines of over $2bn USD and three European firms paying fines of over $2bn USD each. What is also interesting is that the firms (both US and European) that were fined most heavily by US regulators, also fell foul of the FCA in the UK, with large fines levied around the $0.5bn USD mark. In many instances these fines are associated with the foreign exchange rigging issues seen in the market.

Spotlight on market conduct: Senior management

In 2017 an SEC Enforcement against a cannabis consultancy firm in the US stated the firm falsely touted "record" revenue numbers to investors and claimed to be a leader in the marijuana industry when in fact some of its earnings came from sham transactions with a secret affiliate. Conduct issues span all firms, not just financial institutions

Overview of firm penalties by regulatory category

A breakdown of the categories illustrates where most regulatory activity is concentrated, and the regulatory categories which drove most of the regulators' activity over the period.

Market abuse significantly accounted for more than 71% of the total fine values over the five-year period by regulatory category, totalling at around $18bn USD level. The total fine value of market abuse peaked in 2015 at over $8.4bn USD, which was followed by disclosure to the market at over $1.9bn USD that year. In 2016, the total fine value of market abuse still outweighs the total value of the other categories but was significantly lower than in 2015. In 2017 (up to the end of Q3), the total fine value of disclosure to the market exceeds that of the other categories, including market abuse and anti-competitive behaviour, which rank at second and third highest respectively.

Market conduct - categories

Insider trading	Market abuse	Short selling	Disclosure to the market	Anti-competitive behaviour	Trading errors	Takeovers rule	Misuse of nonpublic information	Other trading violations

Market conduct - overview of firm penalties amounts

Table 2

MARKET ABUSE	H1 $USD	H2 $USD
2017	$279,610,319	$186,568,050
2016	$427,625,740	$171,040,247
2015	$8,448,130,697	$15,023,291
2014	$110,738,502	$4,144,595,331
2103	$723,346,404	$2,403,464,331
2012	$375,789,201	$1,538,319,551

Table 3

DISCLOSURE TO THE MARKET	H1 $USD	H2 $USD
2017	$912,684,148	$4,880,102
2016	$2,887,490	$113,384,347
2015	$1,588,176,075	$308,686,468
2014	$86,304,251	$3,306,872
2103	$56,941,591	$484,436,632
2012	$39,493,490	$7,282,040

Table 4

ANTI-COMPETITIVE BEHAVIOUR	H1 $USD	H2 $USD
2017	$349,532,416	$0
2016	$0	$586,956,383
2015	$18,102,855	$894,803
2014	$0	$188,262,618
2103	$0	$1,806,734,487
2012	$0	$0

Table 5

OTHER TRADING VIOLATIONS	H1 $USD	H2 $USD
2017	$12,649,752	$0
2016	$23,447,728	$7,286,222
2015	$165,302,566	$1,837,783
2014	$117,485,952	$45,070,884
2103	$39,454,854	$6,525,368
2012	$4,116,107	$249,664

Table 6

INSIDER TRADING	H1 $USD	H2 $USD
2017	$17,282,897	$605,580
2016	$21,087,408	$28,796,935
2015	$23,009,297	$34,408,751
2014	$17,836,759	$9,734,226
2103	$5,381,336	$38,006,613
2012	$12,536,234	$50,104,194

Table 7

TRADING ERRORS	H1 $USD	H2 $USD
2017	$6,902,623	$299,598
2016	$11,265,000	$21,108,662
2015	$24,741,900	$46,721,217
2014	$5,406,141	$41,289,141
2103	$3,491,263	$1,861,015
2012	$6,556,781	$7,198,931

Table 8

MISUSE OF NON-PUBLIC INFORMATION	H1 $USD	H2 $USD
2017	$99,866	$4,991,285
2016	$0	$47,407,347
2015	$1,475,358	$36,816,889
2014	$0	$0
2103	$0	$0
2012	$21,970,609	$0

Table 9

SHORT SELLING	H1 $USD	H2 $USD
2017	$13,002	$0
2016	$15,353,271	$750,684
2015	$13,969,362	$10,897,509
2014	$0	$407,874
2103	$69,007	$53,075
2012	$266,506	$313,581

Table 10

TAKE OVER RULES	H1 $USD	H2 $USD
2017	$14,979,960	$0
2016	$0	$0
2015	$0	$0
2014	$0	$0
2103	$0	$0
2012	$0	$0

Non-financial sanctions for market conduct

Making individuals responsible for their own actions through threat of penalties is becoming a favourite mechanism for regulators to improve compliance with market conduct regulation. There are many types of censure that may be levied by regulators, but from the Corlytics data, we can clearly see that both market bans and injunctions are favourites for regulators. There have been 139 market bans, 46 specific activities suspension and also 11 cases of market suspensions both of which are closely related. From the data available, Corlytics has also noted that there have been 28 cases of imprisonment for issues relating to market conduct since 2012. Other less used penalties include community service for the UK and Hong Kong regulators.

Table 11: Count of non-financial consequences

Cease and desist	75
Censure	13
Community service	7
Dismissal/ resignation	2
Enforceable undertaking	4
Imprisonment	28
Injunction	73
Injunction-enjoined from further violations of the specified laws.	66
Market ban	139
Market suspension	11
Specific activities suspension	46
Suspended sentence	14

Non-financial firms being punished in 2017

In 2017, there has been an increased focus on non-financial firms in relation to issues on disclosure to the market. Mis-leading the market will lead to traditional financial regulators and fining authorities to punish more than just financial institutions. It also brings other types of firms under their jurisdiction and attention also. Of the 34 enforcements across global regulators for issues related to disclosure, 33 of them have been against non-financial institutions including technology firms, pharmaceutical companies, ratings agencies and individuals. Market conduct issues that have been in play within financial institutions for quite some time are now coming to the foreground in other organisations.

Conclusion

Market conduct is high on the agenda of many financial services businesses – this is even more pronounced within specific parts of financial institutions that have typically seen conduct issues lead to severe enforcements actions – for example in the investment banking sector. Efforts to address conduct risk stem from the need to improve the reputation of financial institutions, reduce losses to regulatory action and provide a fairer financial system for everyone.

Although many financial institutions have put programmes in place (people, process and technology) to address the culture that lead to bad behaviour and market conduct issues, many financial institutions are still lacking the data that can provide insight as to where the greatest risks lie.

Corlytics review of market conduct issues illustrates the exposure that financial institutions face across multiple jurisdictions, regulators and thematic categories. Using this data in assessing conduct risk, senior management risk and also in risk control self-assessments, can enable organisations to determine their regulatory risk impact using a data driven approach.

"Efforts to address market conduct risk stem from the need to improve the reputation of financial institutions, reduce losses to regulatory action and provide a fairer financial system for everyone."

Should you have more questions about using the data in your assessments, please do not hesitate to contact us at insights@corlytics.com

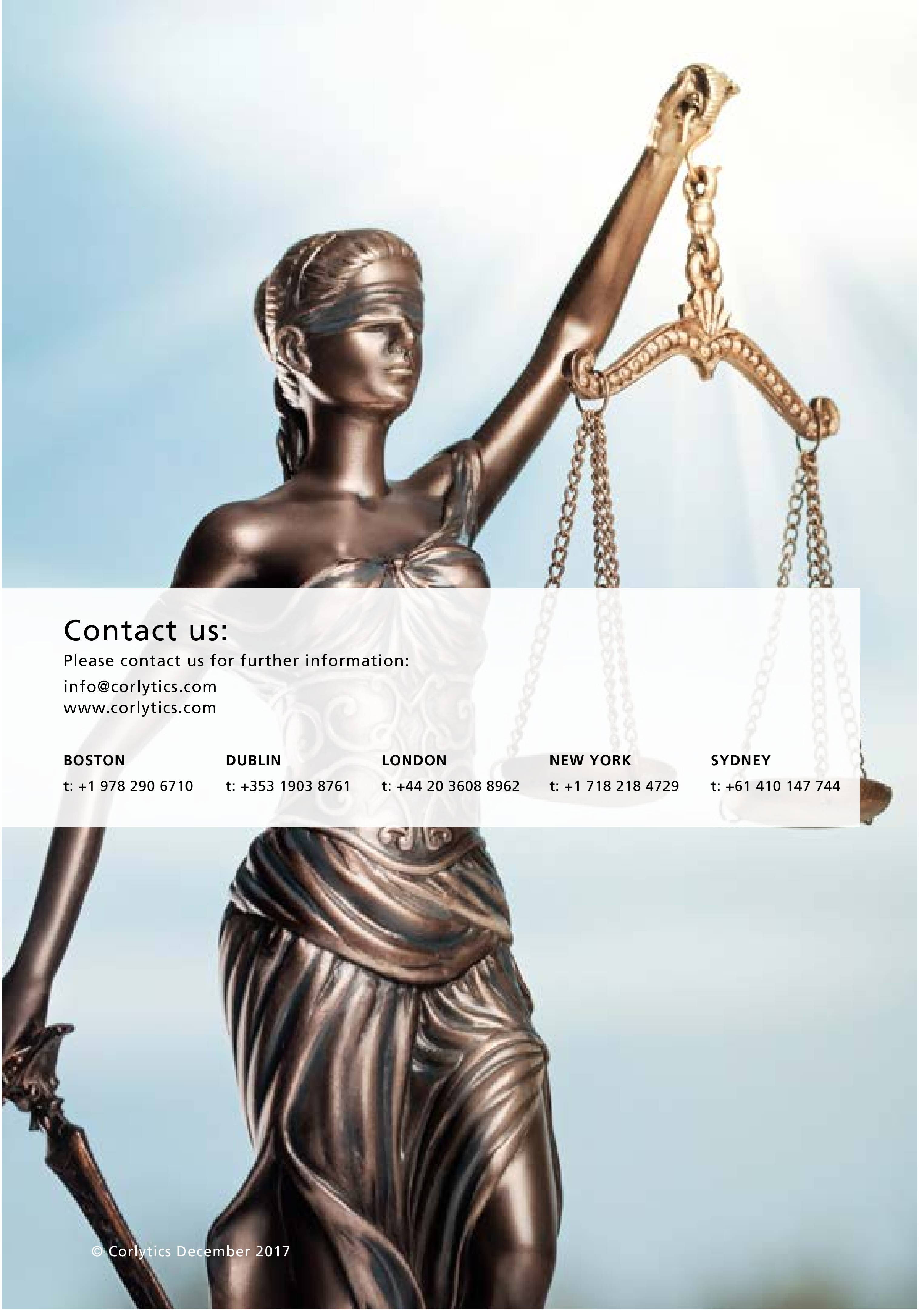
About Corlytics

Corlytics is the world leader in determining regulatory risk impact. Working in partnership with regulators and eminent financial institutions globally, we will enable a more transparent and stable financial system through greater regulatory compliance. By delivering world class regulatory risk data and analytics, we empower our partners to make transformational, informed, positive choices. Corlytics operates as a trusted strategic partner to banks and financial institutions globally.

We are at the very fore of regulatory intelligence revolution. Our forensic analysis and forecasting of fines and sentencing globally by four different professions – leading data scientists, seasoned technologists, proven banking risk practitioners and expert lawyers. We measure, predict and calculate regulatory outcomes and impact. Empowering you to make transformational, positive choices.

Set up in 2013, the Corlytics team has understood from the beginning that to restore trust and build transparency in global finance system, intelligence needs to be developed for multiple players. Data needs to be understood by different departments within financial houses. The lawyers in compliance and the mathematicians in risk. The market and the regulators need the same view.

We translate our global metadata into a common, workable picture. Regulators can learn from one another in different jurisdictions. Financial houses can visualise their risk and model their exposure.



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