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HSBC FINED £57M BY THE PRA OVER HISTORIC DEPOSIT PROTECTION FAILURES //

The PRA has imposed a financial penalty of £57,417,500 on HSBC Bank PLC (HBEU) and HSBC UK Bank PLC (HBUK), for historic deposit protection failings. The firms failed to implement the Depositor Protection part of the PRA Rulebook (the DP Rules) by inaccurately identifying deposits that were eligible for protection under the Financial Services Compensation Scheme (FSCS).

The firms' cooperation, including the early admission of certain rule breaches, resulted in a 15% reduction of the penalty, and their agreement to settle at an early stage meant they qualified for a further 30% discount. Without these reductions the fine would have been £96.5m. Nevertheless, it remains the second highest fine imposed by the PRA, eclipsed only by the £87m fine imposed on Credit Suisse in July 2023.

The FSCS and the DP Rules

Eligible deposits held by UK banks under the FSCS are protected up to a limited of £85,000 (£170,000 for joint accounts). This means the FSCS would repay depositors the first £85,000 of their deposits in the event their bank fails. Eligible and potentially eligible deposits must be marked as such. Ineligible deposits include sums deposited by credit institutions, investment firms, financial institutions or where the deposit holder's identity has not been verified.

The ability of the FSCS to make timely pay outs to depositors is dependent on firms accurately identifying and marking deposits as eligible, potentially eligible or ineligible, and being able to provide this information to the PRA and the FSCS in a timely way. The PRA sets out requirements for regulated firms concerning the production of this information in the DP Rules. In particular, under the DP Rules firms must maintain a 'Single Customer View' (SCV) which is a single, consistent view of a depositor's aggregate eligible deposits within a firm, plus related analysis and reports.

Details of the breaches

The firms' breaches included:

- Not marking eligible deposits in a way that would allow for their immediate identification as eligible or potentially eligible and, in the case of HBEU, incorrectly marking 99% of its eligible deposits as ineligible for FSCS protection;
- Failure to produce finalised SCV reports on an annual basis;
- Inaccurate attestations that the relevant systems met the PRA's requirements;
- Failure to assign clear ownership for the processes required under the DP Rules; and
- Failure to ensure that a senior manager under the Senior Managers and Certification Regime (SMCR), was allocated responsibility for these processes and the integrity of the information required under the DP Rules.

The PRA also found that governance shortcomings were an important contributing factoring. In particular, the Final Notice highlighted that the internal working group established to investigate whether deposits were being correctly reported was governed informally, minutes were not properly taken, and members of the working group gave conflicting accounts of its objectives and who was accountable for the group's work.

The PRA also found that HBEU had failed to disclose information to it "which it would have reasonably expected notice". This was due to a 15-month delay between the firm becoming aware of information which reasonably suggested it may have been mislabelling its deposits and its notification to the PRA.

These failings meant the firms breached PRA Fundamental Rules 2 and 6, as well as DP Rules 11, 12 and 14. HBEU was also found to have breached DP Rule 50, and Fundamental Rules 7 and 8. This is the first PRA enforcement action where a breach of Rule 8 has been found.

PRA Fundamental Rules

PRA FR2: A firm must conduct its business with due skill, care and diligence.
PRA FR6: A firm must organise and control its affairs responsibly and effectively.
PRA FR7: A firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.
PRA FR8: A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.

Comments

The PRA found that the firms' failure to accurately identify eligible deposits and generate reliable SCV data undermined its readiness for resolution and in doing so it increased the potential risk to the wider UK financial system by undermining FSCS protection.

The Final Notice provides a reminder to all banks with FSCS-eligible deposits:

- To reassess the views they have taken on the interpretation and operation of the DP Rules, particularly where those views could affect the eligibility of deposits; and
- To ensure that the governance arrangements they have in place for compliance with the DP Rules are clear, and that they are devoting adequate resources to discharging their obligations under these rules.

RECENT NEWS //

SFO Update: Another raid by the SFO in new fraud investigation; Former Petrofac senior executives charged with bribery; Nick Ephgrave delivers first public speech as director

On 21st February the SFO announced it had raided three residences and made four arrests as part of a new fraud investigation into property management company Signature Group. The company bought buildings in the UK for redevelopment into hotels, residential apartments, and offices spaces. The business attracted more than 1000 investors from the UK and abroad with promised returns of between 8% and 15%. The business went into administration in 2020, with losses of up to £140m. The investigation into Signature Group is the fourth to be launched by the SFO since Nick Ephgrave took over as director and follows a recent spate of dawn raids by the agency.

The SFO has charged two former executives of Petrofac Ltd with bribery offences, for their alleged role in making corrupt payments to secure contracts. Mr Chedid, Petrofac's former COO, was charged with three counts of bribery and Mr Salibi, a former executive, was charged with two counts of bribery. The SFO alleges that between them Mr Chedid and Mr Salibi were involved in offering and paying agents over US$30m to influence the awarding of contracts worth approximately US$3.3bn. The contracts related to oil facilities in the UAE. The charges are part of the SFO's wider investigation into Petrofac and its employees, which was opened in 2017. In late 2021, Petrofac pleaded guilty to seven counts of the corporate offence of failing to prevent bribery and was ordered to pay confiscation of £22.8m, a fine of £47.2m and the SFO's costs of £7m.

On 13th February, Nick Ephgrave gave his first public speech as Director of the SFO. He outlined the SFO's priorities for the future and plans to meet the challenges facing the agency. The key takeaways from the speech were:

- **More Dawn Raids**: Ephgrave said we can expect more dawn raids and swifter action by the SFO under his tenure.

- **Incentives for whistleblowers**: The Director raised the possibility of new measures to pay or incentivise whistleblowers in the UK, referring to similar measures used in the US.

- **Assistance by offenders:** Ephgrave also said he wanted to make renewed use of sentence reduction offers to offenders, to obtain their assistance in investigations.

These agreements can be made under s.74 of the Sentencing Act 2020 but are not used very often in the UK.

- **New offences under ECCTA:** The director said he wants the SFO to be the first to prosecute the new corporate criminal offences in the Economic Crime and Corporate Transparency Act (ECCTA). Ephgrave said the new offences are "great tools, let's be bold about using them."

- **Case Progression:** Ephgrave accepted that the SFO must progress cases much faster. To achieve this, he referred to a new "rigorous and intrusive review" strategy to ensure investigations stay focused on core issues and don't drift. He also promised a more pragmatic approach to closing investigations where it is clear they aren't going to reach the threshold for charge.

- **Disclosure Challenges**: The Director recognised the difficulties the agency faces on disclosure, describing it as "a tough nut to crack" and called for pragmatism in finding a way through. He also referred to the use of 'Technology Assisted Review' (TAR), which uses machine learning to automate parts of the disclosure review process and said he hoped it will address some of the challenges.

- **Collaborator of choice:** Ephgrave also said he wants the SFO to be the "collaborator of choice" for other law enforcement agencies both in the UK and abroad.

Former aide to the president of Madagascar found guilty of bribery

On 20th February, Romy Andrianarisoa, former chief of staff to the president of Madagascar, was found guilty of bribery by a jury at Southwark Crown Court, for attempting to solicit bribes from UK mining company, Gemfields. Andrianarisoa came into contact with Gemfields executives in 2021. Gemfields reported concerns about corruption to the NCA who launched an investigation which made use of surveillance and other covert tactics. Andrianarisoa was found guilty of one count of bribery, for offering to help the company obtain mining rights in Madagascar in return for large sums of money.

FCA and PRA Update: Goldman Sachs analyst found guilty of insider trading; Investment Scheme Manager Admits Fraud; FCA issues information request on non-financial misconduct; PRA publishes Policy Statement on Enforcement; FCA opens consultation on its approach to enforcement investigations

A former Goldman Sachs analyst, Mohammed Zina, has been found guilty of six offences of insider dealing and three offences of fraud following a 12-week trial at Southwark Crown Court brought by the FCA. At the trial the FCA contended that, through his role, Mr Zina came into possession of inside information about potential mergers and acquisitions that Goldman Sachs was advising on. Mr Zina used this information to trade in stocks in companies including the semiconductor designer, Arm Holdings plc and pub company Punch Taverns plc. The trial originally included Mr Zina's brother, Suhail Zina, a former Clifford Chance lawyer. Suhail Zina was acquitted of all counts against him.

Former Investment Scheme Manager, Guy Flintham, has pleaded guilty to fraud, following a prosecution brought by the FCA. The FCA claimed that Mr Flintham defrauded 240 investors by

making false representations to persuade them to invest approximately £19m in an investment scheme he operated. Sentencing will take place on 26 April 2024.

On 6th February 2024, the FCA issued a letter, to Lloyd's Managing Agents & London Market Insurers, under section 165 (1) of FSMA. The letter requests information about incidents of non-financial misconduct (NFM) occurring within the firms from 2021 – 2023. The letter does not request detailed information on specific allegations or investigations, but rather requests high-level aggregated statistics on the number of NFM incidents recorded (by type/category), how those incidents were detected and the outcomes. Firms are required to report all instances of NFM, regardless of whether they were previously disclosed to the FCA. Responses must be provided by 5 March 2024.

The Bank of England and the PRA have published a Policy Statement (PS1/24) on their approach to enforcement, following consulting on their proposals last year. Respondents to the consultation generally welcomed the Bank's proposals to enhance clarity and accessibility of its enforcement policies. In light of the comments received, the Bank has made several changes to its proposed enforcement approach, including clarifying the application of the Early Account Scheme and Enhanced Settlement Discount, and clarifying the scope of the senior management attestation which will need to supplement any early account provided by a firm. The Bank said that there is unlikely to be a material uplift in penalties despite changes to the methodology for the calculation, although the Bank said it cannot rule out that the size of the financial penalty may increase for certain firms.

The FCA have opened a new consultation CP24/2 setting out its proposals to publish more information about its enforcement investigations and proposed changes to its Enforcement Guide. The FCA currently publishes information about enforcement investigations when these lead to outcomes. However, it does not currently publicise that it is investigating at an earlier stage, except in exceptional circumstances. Under the proposals, the FCA will publish information on enforcement investigations when they are opened, as well as appropriate updates and when cases have been closed with no enforcement outcomes. This will include publishing the identity of the subject of the investigation where the FCA considers that it is in the public interest and there are no compelling legal or other reasons not to. They will not generally announce that they are investigating a named individual. The consultation paper also proposes making changes to streamline the FCA's Enforcement Guide. These changes are not wide-ranging. The FCA's stated aim of the reforms are to increase the deterrent impact of their enforcement actions. The deadline for responding to CP24/2 is 16 April 2024.

ICO Update: Reprimand for South Tees Hospitals NHS Foundation Trust

The ICO has reprimanded South Tees Hospitals NHS Foundation Trust for a data breach which resulted in a disclosure containing sensitive information to a unauthorised family member. In November 2022, a Trust employee sent a letter to inform the father of a patient of an upcoming appointment, but the appointment letter was sent to the wrong address. Although the disclosure was a result of human error, the ICO found no evidence that the Trust fully and appropriately prepared staff for their role in dealing with correspondence that was particularly sensitive.

Power Without Responsibility – New Report by Spotlight on Corruption

On 7th February, Spotlight on Corruption published a new report which raised concerns that UK enforcement authorities are struggling to successfully prosecute senior executives for economic crime. The report reveals that:

- Directors from small and medium sized enterprises (SMEs) are far more likely to face conviction, regulatory fines and bans than senior executives in large firms.
- Only 6% of investigations under the FCA's Senior Managers and Certification Regime (SMCR), have resulted in any enforcement action.
- The Competition and Markets Authority (CMA) failed to prosecute any board-level senior executives in large firms following 11 prosecutions. The SFO has achieved just two convictions of individuals, following 20 corporate enforcement actions and only one regulatory action was taken by the FCA following 17 fines on banks.

In light of the findings, the report recommends that the government should undertake a full review of the legislative and enforcement barriers to holding senior executives to account. The report also suggests that the FCA and PRA should conduct and publish a review of the roadblocks to regulatory enforcement of the SMCR and should have more consistent and transparent data about their enforcement. The report also recommends giving the SFO and FCA stronger powers to impose and incentivise clawback on directors and granting the SFO powers to disqualify directors for economic crime.

OFSI Update: Guidance Published on Ransomware and Sanctions

HM Treasury and OFSI have published guidance on ransomware and financial sanctions at a time when ransomware has evolved into a serious cybercrime threat to the UK. The guidance makes it clear that the UK government does not condone making ransomware payments and promotes the strengthening of cyber resilience measures (in particular, those advised by the National Cyber Security Centre, which are flagged in the guidance) to prevent and mitigate the effects of ransomware attacks. The guidance further outlines the relationship between ransomware payments and financial sanctions, and how individuals and entities can mitigate the risks of a financial sanctions breach.

Sanctions Litigation Update: Two Designation Challenges Dismissed; New Criminal Sanctions Evasion Case; Supreme Court to hear appeal in ownership and control case

In two separate cases the High Court and Court of Appeal have dismissed challenges by individuals seeking to be removed from the UK's sanctions list. These cases demonstrate the robust approach the courts are taking to sanctions designations and the high bar required to successfully challenge them.

- In *Khan v Secretary of State for Foreign Commonwealth and Development Affairs [2024] EWHC 361 (Admin)*, the Court dismissed the challenge by Ms Khan, a British citizen, to her designation under the Russia sanctions regime. Ms Khan was sanctioned on the basis that she was "associated with" her husband, Mr German Khan, a Russian businessman who is on the board of a company which owns Alfa Bank, Russia's largest private bank. Ms Khan challenged her designation on the grounds that it was *Padfield* improper (i.e. contrary to the purposes and principles of the legislation), in breach of

her Article 8 rights to private and family life and based on ultra vires regulation. Ms Khan's claim was dismissed on all grounds.

- A few days later, on 27th February, the Court of Appeal dismissed a request by Eugene Shvidler to be removed from the UK's sanctions list. Mr Shvidler was designated in March 2022 over his ties to Roman Abramovich. The Court of Appeal found that the UK government had struck a fair balance between the human rights of Mr Shvidler and the goals of the UK's sanctions regime when making the designation. In his judgment Lord Justice Singh said that "if sanctions are to be effective a serious price has to be paid by those who are within the definition of people to be designated."

The CPS has charged Dmitry Ovsyannikov (former Russian deputy trade minister) with seven counts of breaching UK sanctions and two counts of money laundering. Ovsyannikov was designated under the Russia sanctions regime in 2020 for undermining Ukraine's territorial integrity. The CPS allege that he has violated sanctions by opening a bank account and depositing funds into the account. The case is significant as it is the first-time prosecutors have charged a suspect with criminal sanctions evasion since the introduction of the UK's autonomous post-Brexit sanctions regime in 2018. The last criminal sanctions evasion case was in 2011.

As noted in the Horizon Scanning section below, permission has been granted for the Supreme Court to hear arguments in the case between Boris Mints and PJCS National Bank.

Environment Agency launches Economic Crime Unit

The UK Environmental Agency has announced the launch of a new Economic Crime Unit, which will tackle serious financial offences in the waste sector. The unit builds on the work of the Financial Investigations Team in targeting money laundering and carrying out financial investigations in the waste sector. The unit will be comprised of two teams: the Asset Denial Team and the Money Laundering Investigations Team. The Asset Denial Team will focus on account freezing orders, cash seizures, pre-charge restraints and confiscations. The Money Laundering Investigations Team will enable the Environment Agency to conduct dedicated money laundering investigations targeting environmental offences.

Horizon Scanning

- Volkswagen have announced that they will seek permission to appeal the recent Court of Appeal decision, which required overseas companies to comply with information requests from the CMA. For more on the Court of Appeal's decision see our January edition of the Bulletin.

- The Supreme Court is also set to hear arguments in the ongoing litigation between Boris Mints and PJSC National Bank and others. The latest decision was the Court of Appeal judgment in October 2023, finding that a sanctioned person can pursue a civil claim thorough UK courts. The outcome of the Supreme Court's decision may help define the test for ownership and control under the UK's sanctions regime.