Neutral Citation: **[2024] UKUT 00352 (TCC)**

Case Number: UT-2022-00097

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Hearing venue: The Rolls Building, London

FINANCIAL SERVICES – financial penalty – whether the FCA correctly followed its policy in the setting of the penalty imposed on the Applicant in relation to the breach by the Applicant of Principles 2 and 3 of the FCA's Principles for Business

Heard on 16 and 17 September 2024
Judgment date: 11 November 2024

Before

JUDGE TIMOTHY HERRINGTON
(Sitting in Retirement)
MEMBER GARY BOTTRIELL
MEMBER ADAM SAMUEL

Between

ARIAN FINANCIAL LLP

Applicant

and

THE FINANCIAL CONDUCT AUTHORITY

Respondent

Representation:

For the Applicant: Jason Mansell and Thomas Coke-Smyth, Counsel, instructed by Charterhouse Law, Solicitors

For the Respondent: Philip Hinks, Counsel, instructed by the Financial Conduct Authority

DECISION

Introduction

1. On 5 August 2022 the Financial Conduct Authority ("the Authority") through its Regulatory Decisions Committee ("RDC") issued a decision notice (the "Decision Notice") to Arian Financial LLP (the "Applicant").

2. In the Decision Notice, the Authority decided that, between 29 January 2015 and 29 September 2015 (the "Relevant Period"), the Applicant (i) had inadequate systems and controls to identify and mitigate the risk of being used to facilitate fraudulent trading and money laundering in relation to business introduced by four authorised entities known as the Solo Group, thereby breaching Principle 3 of the Authority's Principles for Businesses ("Principle 3") and (ii) breached Principle 2 of the Authority's Principles for Businesses ("Principle 2") as it did not exercise due skill, care and diligence in applying its Anti-Money Laundering policies and procedures, and failed properly to assess, monitor and mitigate the risk of financial crime in relation to the Solo Clients. The Authority decided to impose on the Applicant a financial penalty of £744,745 in respect of such breaches.

3. The Applicant acted as an interdealer broker. It was introduced to and onboarded 166 clients (the "Solo Clients") and, on behalf of those clients, it executed extremely high volumes of purported over-the-counter equity trades to the value of approximately £37 billion in Danish equities and £15 billion in Belgian equities. The purpose of the purported trading was to enable the Solo Group of companies (the "Solo Group") to make withholding tax reclaims from the Danish and Belgian tax authorities. Those reclaims led to those tax authorities making payments of almost £900 million. There was no evidence of ownership or custody of the shares in question by the Solo Clients, or of settlement of the relevant trades. Together with the high volumes of shares which were purportedly traded, the Authority considers this to be suggestive of sophisticated financial crime on an enormous scale.

4. On 1 September 2022, the Applicant referred the Decision Notice to the Tribunal. The Applicant does not dispute that it breached Principles 2 and 3, as described above, but it contests the amount of the financial penalty sought to be imposed by the Authority. The Applicant contends that the Authority has failed to apply the Authority's own policy for the calculation of financial penalties set out in DEPP 6.2 of the Authority's Handbook or its previous decisions and overstated the seriousness of the breaches committed by the Applicant. As a result, the Applicant contends that the penalty sought by the Authority is disproportionate, unfair and unjust.

Applicable law and regulatory provisions

5. Principle 2 requires authorised persons to conduct their business with due skill, care and diligence.

6. Principle 3 requires firms to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.

7. Other rules in the Authority's Handbook provide more detailed requirements on the need for firms to create and implement policies and procedures to prevent and detect money laundering, and to counter the risk of being used to facilitate financial crime. Notably, SYSC 6.3.1 R says:

> "A firm must ensure the policies and procedures established under SYSC 6.1.1 R include systems and controls that:
>
> (1) enable it to identify, assess, monitor and manage money laundering risk; and

(2) are comprehensive and proportionate to the nature, scale and complexity of its activities."

SYSC 6.3 contained other important provisions in the relevant period, notably:

SYSC 6.3.4 G

> "A firm may also have separate obligations to comply with relevant legal requirements, including the … Money Laundering Regulations. …"

SYSC 6.3.5 G

> "The FCA, when considering whether a breach of its rules on systems and controls against money laundering has occurred, will have regard to whether a firm has followed relevant provisions in the guidance for the United Kingdom financial sector issued by the Joint Money Laundering Steering Group."

SYSC 6.3.6 G

> "In identifying its money laundering risk and in establishing the nature of these systems and controls, a firm should consider a range of factors, including:
>
> (1) its customer, product and activity profiles;…
>
> (3) the complexity and volume of its transactions;
>
> (4) its processes and systems; and
>
> (5) its operating environment."

SYSC 6.3.7 G

> "A firm should ensure that the systems and controls include:
>
> (1) appropriate training for its employees in relation to money laundering;
>
> (3) appropriate documentation of its risk management policies and risk profile in relation to money laundering, including documentation of its application of those policies (see SYSC 9);
>
> (4) appropriate measures to ensure that money laundering risk is taken into account in its day-to-day operation, including in relation to:
>
> (b) the taking-on of new customers; and
>
> (c) changes in its business profile; …."

8. Firms like the Applicant needed adequate systems and controls to identify, assess and monitor money laundering risk, as well as conducting customer due diligence and ongoing monitoring of business relationships and transactions.

9. Under section 206 of the Financial Services and Markets Act 2000 ("FSMA") the Authority may impose a financial penalty on an authorised person if the Authority considers that the authorised person has contravened a "relevant requirement". Principles 2 and 3 are "relevant requirements" for this purpose.

10. The Authority's policy on imposing a financial penalty is set out in that part of the Authority's Handbook known as DEPP.

11. DEPP 6.1.2 states that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

12. DEPP 6.2.5 states that when considering whether to impose a financial penalty or censure in respect of a breach of the Authority's rules on systems and controls against money laundering it will have regard to whether a firm has followed relevant provisions in the guidance for the

UK financial sector issued by the Joint Money Laundering Steering Group ("JMLSG"). This is in line with SYSC 6.3.5 G quoted above.

13. DEPP 6.5.2 states that the FCA's penalty-setting regime is based on the following principles:

(1) Disgorgement - a firm or individual should not benefit from any breach;

(2) Discipline - a firm or individual should be penalised for wrongdoing; and

(3) Deterrence - any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.

14. As set out in DEPP 6.5A, the Authority applies a five-step framework to determine the appropriate level of financial penalty. So far as relevant, this framework is set out as follows.

Step 1: *Disgorgement*

The FCA will seek to deprive a firm of the financial benefit derived directly from the breach (which may include the profit made or loss avoided) where it is practicable to quantify this. The FCA will ordinarily also charge interest on the benefit.

Step 2: *The seriousness of the breach*

(1) The Authority will determine a figure that reflects the seriousness of the breach. In many cases, the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, and in such cases the Authority will determine a figure which will be based on a percentage of the firm's revenue from the relevant products or business areas.

(2) In those cases where the Authority considers that revenue is an appropriate indicator of the harm or potential harm that a firm's breach may cause (as it is common ground is the position in this case), the Authority will determine a figure which will be based on a percentage of the firm's "relevant revenue". "Relevant revenue" will be the revenue derived by the firm during the period of the breach from the products or business areas to which the breach relates.

(3) Having determined the relevant revenue, the Authority will then decide on the percentage of that revenue which will form the basis of the penalty. In making this determination the Authority will consider the seriousness of the breach and choose a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach. The more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

(a) level 1 - 0%;

(b) level 2 - 5%;

(c) level 3 - 10%;

(d) level 4 - 15%; and

(e) level 5 - 20%.

(4) The Authority will assess the seriousness of a breach to determine which level is most appropriate to the case.

(5) In deciding which level is most appropriate to a case involving a firm, the FCA will take into account various factors, which will usually fall into the following four categories:

(a) factors relating to the impact of the breach;

(b) factors relating to the nature of the breach;

(c) factors tending to show whether the breach was deliberate; and

(d) factors tending to show whether the breach was reckless.

(6) Factors relating to the impact of a breach committed by a firm include:

(a) the level of benefit gained or loss avoided, or intended to be gained or avoided, by the firm from the breach, either directly or indirectly;

(b) the loss or risk of loss, as a whole, caused to consumers, investors or other market users in general;

(c) the loss or risk of loss caused to individual consumers, investors or other market users;

(d) whether the breach had an effect on particularly vulnerable people, whether intentionally or otherwise;

(e) the inconvenience or distress caused to consumers; and

(f) whether the breach had an adverse effect on markets and, if so, how serious that effect was. This may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk.

(7) Factors relating to the nature of a breach by a firm include:

(a) the nature of the rules, requirements or provisions breached;

(b) the frequency of the breach;

(c) whether the breach revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business;

(d) whether the firm's senior management were aware of the breach;

(e) the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the breach;

(f) the scope for any potential financial crime to be facilitated, occasioned or otherwise occur as a result of the breach;

(g) whether the firm failed to conduct its business with integrity; and

(h) whether the firm, in committing the breach, took any steps to comply with the Authority's rules, and the adequacy of those steps.

(8) In following this approach factors which are likely to be considered 'level 4 factors' or 'level 5 factors' include:

(a) the breach caused a significant loss or risk of loss to individual consumers, investors or other market users;

(b) the breach revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business;

(c) financial crime was facilitated, occasioned or otherwise attributable to the breach;

(d) the breach created a significant risk that financial crime would be facilitated, occasioned or otherwise occur;

(e) the firm failed to conduct its business with integrity; and

(f) the breach was committed deliberately or recklessly.

(9) Factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors' include:

(a) little, or no, profits were made or losses avoided as a result of the breach, either directly or indirectly;

(b) there was no or little loss or risk of loss to consumers, investors or other market users individually and in general;

(c) there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the breach;

(d) there is no evidence that the breach indicates a widespread problem or weakness at the firm; and

(e) the breach was committed negligently or inadvertently.

Step 3: *Mitigating and aggravating factors*

(1) The Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach. Any such adjustments will be made by way of a percentage adjustment to the figure determined at Step 2.

(2) The following list of factors may have the effect of aggravating or mitigating the breach:

(a) the conduct of the firm in bringing (or failing to bring) quickly, effectively and completely the breach to the Authority's attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of cooperation the firm showed during the investigation of the breach by the Authority, or any other regulatory authority allowed to share information with the Authority;

(c) where the firm's senior management were aware of the breach or of the potential for a breach, whether they took any steps to stop the breach, and when these steps were taken;

(d) any remedial steps taken since the breach was identified, including whether these were taken on the firm's own initiative or that of the Authority or another regulatory authority; for example, identifying whether consumers or investors or other market users suffered loss and compensating them where they have; correcting any misleading statement or impression; taking disciplinary action against staff involved (if appropriate); and taking steps to ensure that similar problems cannot arise in the future. The size and resources of the firm may be relevant to assessing the reasonableness of the steps taken;

(e) whether the firm has arranged its resources in such a way as to allow or avoid disgorgement and/or payment of a financial penalty;

(f) whether the firm had previously been told about the Authority's concerns in relation to the issue, either by means of a private warning or in supervisory correspondence;

(g) whether the firm had previously undertaken not to perform a particular act or engage in particular behaviour;

(h) whether the firm concerned has complied with any requirements or rulings of another regulatory authority relating to the breach;

(i) the previous disciplinary record and general compliance history of the firm;

(j) action taken against the firm by other domestic or international regulatory authorities that is relevant to the breach in question;

(k) whether Authority guidance or other published materials had already raised relevant concerns, and the nature and accessibility of such materials; and

(l) whether the Authority publicly called for an improvement in standards in relation to the behaviour constituting the breach or similar behaviour before or during the occurrence of the breach.

Step 4: *Adjustment for deterrence*

If the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches then the Authority may increase the penalty. Circumstances where the FCA may do this include:

(a) where the FCA considers the absolute value of the penalty too small in relation to the breach to meet its objective of credible deterrence;

(b) where previous FCA action in respect of similar breaches has failed to improve industry standards;

(c) where the FCA considers it is likely that similar breaches will be committed by the firm or by other firms in the future in the absence of such an increase to the penalty; and

(d) where the FCA considers that the likelihood of the detection of such a breach is low.

Step 5: *Settlement Discount*

The FCA and the firm on whom a penalty is to be imposed may seek to agree the amount of any financial penalty and other terms. In recognition of the benefits of such agreements, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm concerned reached an agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

Role of the Tribunal

15. Section 133(4) FSMA provides that, on a reference, the Tribunal may consider any evidence relating to the subject matter of the reference whether or not it was available to the decision-maker at the material time. This is not an appeal against the Authority's decision on each of the references but a complete rehearing of the issues which gave rise to the decision and which the applicant wishes the Tribunal to consider. Section 133(5) to (7) FSMA, provides as follows:

> "(5) In the case of a disciplinary reference or a reference under section 393(11), the Tribunal must determine what (if any) is the appropriate action for the decision-maker to take in relation to the matter, and on determining the reference, must remit the matter to the decision-maker with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination.
>
> (6) In any other case, the Tribunal must determine the reference or appeal by either-
>
> (a) dismissing it; or
>
> (b) remitting the matter to the decision-maker with a direction to reconsider and reach a decision in accordance with findings of the Tribunal.
>
> (6A) The findings mentioned in subsection (6)(b) are limited to findings as to-
>
> (a) issues of fact or law;
>
> (b) the matters to be, or not to be, taken into account in making the decision; and
>
> (c) the procedural or other steps to be taken in connection with the making of the decision.
>
> (7) The decision-maker must act in accordance with the determination of, and any direction given by, the Tribunal."

16. Here, the Applicant does not contest the Authority's findings on liability, as set out in the Decision Notice. It only seeks to challenge the quantum of the financial penalty that the Authority seeks to impose. A reference of a decision to impose a financial penalty is a "disciplinary reference" and accordingly, the Tribunal has the power to determine at its discretion what (if any) is the appropriate action for the Authority to take, including a determination as to whether or not to impose a financial penalty and, if so, the amount of such penalty.

17. As this Tribunal indicated in *Tariq Carrimjee v FCA* [2015] UKUT 0079 (TCC) the Tribunal is not bound by the Authority's policy when making an assessment of a financial penalty on a reference, but it pays the policy due regard when carrying out its overriding objective of doing justice between the parties. In so doing the Tribunal looks at all the circumstances of the case.

18. Similarly, in *Westwood Independent Financial Planners v FCA* [2013] WLUK 630, the Tribunal held at [181]:

> "In considering the appropriate level of a penalty we are not bound by the Authority's tariff for particular misconduct, or even the factors the Authority takes into account, but may reduce or increase a penalty which is the subject of a reference on any grounds we think fit, within the parameters of the proper exercise of judicial discretion. In practice, the Tribunal respects the Authority's tariff, in the interests of consistency between applicants, while departing from it in an appropriate case."

19. This approach was followed by the High Court in *FCA v Da Vinci Invest Limited and others* [2015] EWHC 2401 *("Da Vinci")* where Snowden J said in the context of the imposition of a penalty for market abuse at [201]:

> "It was the FCA's submission, and I accept, that in determining any penalty under section 129, the starting point for the court should be to consider the relevant DEPP penalty framework that was in existence at the time of commission of the market abuse in question. To do otherwise would risk introducing an inequality of treatment of defendants depending upon whether the proceedings were taken against them under the regulatory route or the court route and depending upon how long the proceedings had taken to come to a conclusion. By the same token, however, in common with the Upper Tribunal, the court is not bound by that framework, or by the FCA's view of how it should be applied. But if the court intends to depart from the framework in a particular case, it should explain why it considers it appropriate to do so. It occurred to me that in this regard there is some analogy with the approach of the criminal courts to the application of the sentencing guidelines produced by the Sentencing Council."

There are other passages in *Da Vinci* which are relevant to this case, to which we will return.

Evidence

20. We had two witness statements from Mr John Meadows, the Chief Executive Officer of the Applicant ("Mr Meadows"). In his first witness statement, Mr Meadows provided an outline of the history of the Applicant, an explanation as to how the Firm came to undertake business with the Solo Group, contextual issues relating to misconduct and the benefit the Applicant obtained from the misconduct. A second witness statement was filed shortly before the hearing in response to a statement in the Authority's skeleton argument which Mr Meadows believed to be incorrect. This statement was admitted with no objection on the part of the Authority.

21. Mr Meadows was cross-examined to a limited extent by Mr Hinks. We found Mr Meadows to be an honest and reliable witness, doing his best to assist the Tribunal. Much of his evidence was unchallenged and, unless otherwise indicated in our findings of fact, we have accepted it.

22. The parties provided an agreed bundle of documents, mainly material gathered during the course of the Authority's investigation and which was available to the RDC during the regulatory proceedings.

Findings of Fact

23. The Applicant did not seek to challenge the primary facts found in the Decision Notice and the Authority did not seek to challenge in any material respect Mr Meadows's evidence. The difference between the parties lies in the evaluation of and conclusions to be drawn from the facts, and in particular the question as to how seriously the misconduct of the Applicant should be reflected in the size of the penalty.

24. From the evidence that we heard, and the documents that we saw, we make the following findings, much of which is taken from the Decision Notice, as helpfully summarised by Mr Hinks in his skeleton argument, and Mr Meadows's evidence.

Background

25. The Applicant is a limited liability partnership registered in England and Wales. During the Relevant Period the Applicant's three designated members were Mr Meadows (who held a 60% interest), Jason Lawrence ("Mr Lawrence") (who held a 20% interest) and Paul Dalton (also held a 20% interest). During the Relevant Period Mr Meadows held the CF 3, (Chief Executive), CF 4 (Partner), CF 10 (Compliance) and CF 11 (Anti-Money Laundering) controlled functions. Mr Lawrence held a CF 4 controlled function.

26. Prior to its decision to cease carrying on regulated activity in June 2022, the Applicant acted as an interdealer broker that facilitated trades between professional clients and eligible counterparties. The Applicant was never authorised to act for retail customers. Apart from the matters that are the subject of this reference, the Applicant has had a clean disciplinary history with no recorded adverse findings.

27. The Applicant's remuneration structure was entrepreneurial; the Applicant's individual brokers were self-employed consultants and would receive commissions on their broking activity which would then be paid first to the Applicant and then paid on to the broker, less any fees due to the Applicant for providing the necessary trading infrastructure. Nearly all the brokers had set up limited service companies to receive from the Applicant the commissions that they obtained from the trades they brokered. This is not an unusual structure in the industry, and Mr Lawrence was rewarded for his broking activities in this manner.

28. The size of the Applicant meant that it had no internal specialist compliance resource and relied on external compliance consultants. Mr Meadows as CF 10 relied heavily on the assistance of the Applicant's external professional compliance advisers, CPA Audit and later Compliance Asset, although Mr Meadows recognised that ultimately as CF 10 he bore the responsibility for compliance.

The Solo Business

29. The Solo Business was introduced to Mr Lawrence in August 2014. The Solo Group purported to trade in dividend arbitrage, a strategy where shares are placed in alternative tax jurisdictions around dividend dates with the aim of minimising withholding tax or generating withholding tax reclaims. The Solo Group's trading (the "Solo Trading") was characterised by a circular pattern of extremely large-scale over-the-counter equity trading, back to back securities lending arrangements and forward transactions.

30. The Applicant was one of six broker firms that participated in the Solo Trading during the Relevant Period. The combined volume of such purported trading across the six broker firms was enormous: between 15% and 61% of shares outstanding in Danish stocks and between 7% and 30% of shares outstanding in Belgian stocks. The value of Danish and Belgian withholding tax claims made, which were attributable to the Solo Group, was approximately £899.27 million and £188 million, respectively.

31. The Solo Business represented a significant departure from the Applicant's usual business. The Applicant had never previously brokered a dividend arbitrage strategy. Mr Lawrence had never previously been presented with a business proposal in which a clearing broker had approached him with a large number of clients to be serviced.

32. The Applicant onboarded 166 Solo Clients from various jurisdictions. They were all existing clients who had been previously checked by Solo for Anti-Money Laundering purposes.

33. In line with the Applicant's general trading arrangements with its brokers, the commercial opportunity for the Applicant was to receive a percentage of the commissions arising from the Solo Business. Approximately 80% of commissions invoiced by the Applicant to Solo were paid to the broker. Mr Meadows viewed the Solo opportunity as Mr Lawrence's business project and the arrangements that the Applicant agreed with him simply reflected those that the Applicant had with its other brokers who provided their services to the Applicant through limited companies. (Mr Meadows supplied the Tribunal with a written agreement with the company of another broker. The FCA did not challenge the suggestion that this reflected the Applicant's general approach to the work of all of its brokers.) The brokers were incentivised through the remuneration structure to be entrepreneurial and to introduce new opportunities from which the Applicant would also benefit. As a partner in the Applicant, in addition to the broking commissions he would receive, Mr Lawrence would also be owed a percentage of the commission which the Applicant retained through facilitating the Solo business.

34. On 10 February 2015 Mr Lawrence incorporated Hopa Financial Ltd ("Hopa") solely to receive the payment of commissions due to him from the Solo Business. No written agreement was entered into between Hopa and the Applicant. The payments were made pursuant to an oral agreement made on behalf of the Applicant by Mr Meadows and Mr Lawrence on behalf of Hopa. Mr Meadows stated in his evidence that there was no contractual basis on which any of the commission paid to Hopa could be clawed back in the event of it being found that it had been generated in breach of relevant regulatory requirements. The FCA did not dispute this.

35. During the Relevant Period the Applicant received income of £448,645 in respect of the Solo Business, after deduction of certain expenses but including the monies the Applicant was obliged to pay on to Hopa. Out of this gross sum, the Applicant paid on to Hopa £307,732.93, representing some 80% of the net revenue obtained by the Applicant from the Solo Business. The Applicant therefore retained £140,912.53 from the monies it received in respect of the Solo Business. Mr Meadows confirmed that the monies received from the Solo Group by way of commissions were not held in a separate segregated account and therefore, notwithstanding the pre-existing contractual requirement to pay 80% of the commissions to Hopa, the monies concerned were available for the Applicant's general business purposes until they were paid to Hopa. Indeed, the account into which the monies were received became overdrawn from time to time.

36. Mr Meadows's view, which we accept, was that the Applicant had been targeted and identified by Solo as a vehicle to facilitate the dividend arbitrage strategy. The fact that the clients of the scheme were introduced via an authorised firm led the Applicant and its advisers to approach the Solo Business as prima facie a legitimate business opportunity. Mr Meadows accepts that, notwithstanding this, the Applicant breached Principle 2 and Principle 3, in the manner described below.

Onboarding of the Solo Clients

37. During the Relevant Period, the Applicant had written procedures for conducting customer due diligence ("CDD"). In particular, the Applicant's Compliance Manual stated that

these measures involved identifying the customer, verifying their identity, identifying the beneficial owner and their identity, and obtaining information on the purpose and intended nature of the business relationship. The Applicant's Anti-Money Laundering Policy required the Applicant to obtain confirmation of checks undertaken on investors and an understanding of the source of funds where the client was an unregulated fund.

38. The onboarding process commenced for the Solo Clients on 29 January 2015. None of those clients had a prior relationship with the Applicant. Identical emails from each of the 166 Solo Clients were received which all read:

> "Hi,
>
> I would like to be on boarded for brokerage services I authorise Solo Capital Partners LLP to release any KYC you require.
>
> Kind regards"

39. The Applicant did not question why 166 purportedly independent entities sent identical emails requesting to be clients.

40. Mr Lawrence led the Applicant's onboarding process. He sought advice from the Applicant's compliance consultants, CPA Audit. Mr Mansell drew our attention to a number of email exchanges between Mr Lawrence and CPA Audit which show that Mr Lawrence was concerned to ensure that the Solo Business was compliant and indicated that he would do what he was advised to achieve that result. Initially, CPA Audit advised that if the Applicant were trading for Solo's underlying clients, it would need to on-board each of those clients, as elective or per se professional clients because the Applicant was not authorised to deal with retail clients. That meant that the Applicant would have to do at least the equivalent of Enhanced Due Diligence on those firms and their shareholders and directors in order to classify the clients correctly.

41. Later, Mr Lawrence became aware that other authorised firms that had established a relationship with the Applicant had provided Introduction Certificates which certified that they had carried out their own due diligence on the clients concerned. This was in the context of Regulation 17 of the Money Laundering Regulations 2007 ("MLRs"). This allows a firm to rely on another authorised firm's due diligence measures, although as that regulation makes clear, the firm seeking to place reliance remains liable for any failure to apply the necessary measures.

42. Between 10 February and 25 March 2015 the Applicant received know your customer packs ("KYC Packs") from Solo and accompanying Introduction Certificates. The Applicant reviewed the KYC Packs itself with limited guidance from CPA Audit. CPA Audit reviewed sample KYC packs for each type of client and advised that the files met the bare minimum Anti-Money Laundering requirements and allowed the Applicant to qualify those customers as professional clients as they were a business (or a pension fund) set up purely to make investments. CPA Audit went on to advise the Applicant to obtain some idea of why the clients were wanting to trade, noting that all or some of the clients appeared to be "shells" with no funds. CPA Audit remarked:

> "This all seems a little disconcerting as you are being asked to trade significant volumes of shares with shells. Suspicious, but other firms are doing it…"

CPA Audit advised that an Introductory Certificate would be sufficient as Solo would have the responsibility for completing the necessary due diligence. CPA Audit did not advise that, despite this reliance, the Applicant would remain responsible for any failure to apply the required due diligence measures. CPA Audit did, however, point out that it was the Applicant's responsibility to find out why the client was transacting the business. The Applicant says that

CPA Audit became more comfortable with the Solo Clients' business following a call with them, but there is no note or other contemporaneous record of this call and in an interview with the Authority, CPA Audit's principal gave evidence to the effect that Mr Lawrence had simply made up his mind that the understanding he had was sufficient. We are therefore not satisfied that CPA Audit gave comfort to Mr Lawrence in the manner suggested.

43. The Applicant now accepts that it erred in reviewing the packs "in silos" and recognises that a proper review would have identified red flags. The Applicant did not meet any of the Solo Clients and it did not seek any information as to the source of their funds or the reasons that they were trading. Instead, it decided to rely upon CDD purportedly carried out by the Solo Group. Guidance from the Joint Money Laundering Steering Group ("the JMLSG Guidance") makes it clear that whether a firm wishes to place reliance on a third party will be part of the firm's risk-based assessment which may include consideration of matters such as the nature of the customer, the product/service and the sort of sums involved. The guidance makes it clear that the assessment as to whether or not a firm should accept confirmation from a third party that appropriate CDD measures have been carried out on the customer will be risk-based, and cannot be based simply on a single factor. The guidance also states that the firm relying on the confirmation of a third party needs to know among other things (i) the identity of the customer and beneficial owner whose identity is being verified, and (ii) the level of CDD that has been carried out.

44. There is no evidence that CPA Audit advised on the JMSLG Guidance or Regulation 17 of the MLRs on which the relevant passage is based and the Applicant did not carry out a risk-based assessment as to whether it was appropriate to rely upon the Solo Group's purported CDD. The Applicant's Compliance Manual and Anti-Money Laundering Policy did not address the circumstances in which the Applicant was able to rely on another firm's CDD.

45. As a consequence of not conducting its own due diligence, the Applicant did not gain any understanding as to the Solo Clients' source of funds and wealth, as prescribed by the Applicant's own Anti-Money Laundering Policy and the JMLSG Guidance.

46. In his evidence, Mr Meadows accepted the Authority's assessment that there was no separate risk assessment undertaken in relation to the Solo Business and that the Applicant's policies and procedures were deficient in this respect. He did, though, explain that the Applicant sought to discharge its responsibilities by seeking advice through CPA Audit. As the Authority submitted and Mr Meadows accepted, the Applicant was not able effectively to monitor the Solo Clients' transactions following the commencement of trading.

47. Regulation 14 (2) of the MLRs required firms to implement Enhanced Due Diligence measures ("EDD") for any client that has not been physically present for identification purposes. Both the Compliance Manual and the Anti-Money Laundering Policy prescribed the implementation of EDD in the circumstances.

48. Mr Meadows accepted that the Applicant failed to carry out any EDD in respect of the Solo Clients before commencing trading with them, relying instead upon the Introduction Certificates provided by the Solo Group.

49. It was clear, however, that the Applicant did have some concerns about the Solo Trading which led it to engage a second external compliance consultant, Compliance Asset, to conduct EDD in respect of the Solo Clients. This, however, did not happen until on or about 31 March 2015, some 5 weeks after the Applicant had commenced trading with the Solo Clients. Compliance Asset reported the outcome of their file review of the Solo Client files to Mr Meadows on 2 June 2015. The report identified significant deficiencies in the information that the Applicant needed to comply with its due diligence requirements, but indicated that most of the issues identified were not time critical and could be retrospectively remediated. Compliance

Asset did not advise Mr Meadows of any red flags that would have arisen from looking across the KYC packs that they reviewed. Compliance Asset did not advise the Applicant to cease trading pending its review.

Client Categorisation

50. Mr Meadows accepts that the Applicant failed, as required at the time by COBS 3.3.1R and 3.8.2R(2) of the Authority's Conduct of Business Sourcebook, to categorise the Solo Clients before the trading commenced as either a retail client, professional client or eligible counterparty based on their level of trading, experience, risk knowledge and access to funds.

51. The Applicant decided to categorise all the Solo Clients as professional clients on the basis that they were understood to be institutional investors whose main activity was to invest in financial instruments. As was found in the Decision Notice, the Applicant had insufficient evidence to satisfy itself that all the Solo clients should properly have been categorised as professional clients.

Transaction monitoring

52. Authorised firms are required to conduct ongoing monitoring of the business relationship with their customers, including scrutiny of transactions undertaken through the course of the relationship to ensure that transactions are consistent with the firm's knowledge of the customer, its business and risk profile. This requirement was during the Relevant Period set out in Regulation 8 of the MLRs and SYSC 6.3.1R(1) and reflected in the JMLSG Guidance. The Applicant was also required to have appropriate and risk sensitive policies and procedures relating to ongoing monitoring, including procedures to identify and scrutinise (i) complex or unusually large transactions, (ii) unusual patterns of transactions which have no apparent or visible lawful purpose, and (iii) any other activity that is likely to be related to money laundering or terrorist financing: see Regulation 20 of the MLRs.

53. The Applicant's Anti-Money Laundering policy required it to monitor customer activity by reviewing transactions to ensure that they are consistent with the customer's business and risk profile. That policy also stated that a factor that could affect the level of risk that a particular client presents was "unusually large transactions compared to what might reasonably be expected of customers with a similar profile."

54. Mr Meadows accepts that, although there was some transaction monitoring, it was inadequate. Between the commencement of trading on 25 February and 6 May 2015, no transaction monitoring was undertaken in respect of the Solo Trading transactions.

55. After Compliance Asset was engaged, some transaction monitoring took place on 6 May 2015 onwards. Mr Meadows accepts that Compliance Asset was instructed by the Applicant to monitor the trading of the Solo Clients, primarily for the purposes of preventing market abuse. He observed that such monitoring involved a substantial overlap with Anti-Money Laundering and associated risks. The representative of Compliance Asset who undertook the monitoring said in interview with the Authority that he did regard it as part of his responsibility to alert the Applicant to anything which was suspicious unless it related to market abuse. The invoices provided by Compliance Asset only make mention of KYC checks and transaction monitoring in relation to market abuse. Likewise, the trade monitoring reports sent to Mr Lawrence only referred to price monitoring rather than any specific Anti-Money Laundering transaction monitoring.

56. It is clear that there was a lack of clarity regarding Compliance Asset's role. Had they been given a wider brief regarding transaction monitoring, then it may have been the case that more specific concerns would have been raised by Compliance Asset. Mr Meadows accepts that the Applicant failed to consider the trading activity within the wider context of the KYC

information received from the Solo Clients and the feasibility of the trading activity generally. He says that, had that exercise been done, the Applicant would have reassessed the business being undertaken. Solo's regulated status and the Applicant's subsequent reliance on what the Solo Group said, prevented his firm from taking a more inquiring approach.

57. During the Relevant Period, the Applicant executed trades with the Solo Clients worth approximately £52 billion. Of the Solo Clients for which the Applicant traded (24 in total) there are only 6 underlying beneficial owners. The Applicant understood the Solo Clients to be acting independently of one another. However, on any given cum dividend date, it was often the case that most of or all 6 underlying beneficial owners would be trading very large volumes of the same stock. The Solo Clients trading sizes were typically approximately £16 million of shares (or more). However, most of the Solo Clients had only recently been incorporated and, in a number of instances, were managed or beneficially owned by individuals with a connection to the Solo Group.

58. The Applicant accepts that the size and volume of transactions, in tandem with the KYC packs received from the Solo Group, were "red flags" which should have been sufficient to have generated further enquiry from a financial crime perspective.

Regulatory Failings

59. The Decision Notice summarises the regulatory failings of the Applicant in relation to its dealings with the Solo Group at paragraphs 5.3 to 5.7 as follows:

> "**Principle 3**
>
> 5.3 Principle 3 requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
>
> 5.4 Arian breached this requirement during the Relevant Period, in relation to the Solo Trading, as its policies and procedures were inadequate for identifying, assessing and mitigating the risk of financial crime as they failed to:
>
> a) set out the circumstances where reliance could be placed on an authorised firm's CDD;
>
> b) include a requirement for risk assessments to be documented, and to document the rationale for any due diligence measures the firm waived when compared to its standard approach, in view of its risk assessment of a particular customer;
>
> c) set out adequate processes and procedures for EDD;
>
> d) set out adequate processes and procedures for client categorisation; and
>
> e) set out adequate processes and procedures for transaction monitoring including how transactions were to be monitored, or with what frequency, and how to identify suspicious transactions.
>
> 5.5 The breaches revealed serious or systemic weaknesses in both Arian's procedures and the management systems or internal controls relating to Arian's governance of financial crime risk.
>
> **Principle 2**
>
> 5.6 Principle 2 requires a firm to conduct its business with due skill, care and diligence. The Authority considers that Arian breached this requirement by failing properly to assess, monitor and manage the risk of financial crime associated with the Solo Clients and purported trading activity, in that it:

a) failed properly to conduct customer due diligence prior to onboarding the Solo Clients, and consequently failed to identify that they presented a higher risk of financial crime before they started trading;

b) failed to gather information to enable it to understand the purpose and intended nature of the business that the Solo Clients were going to undertake, the likely size or frequency of the purported trading intended by the Solo Clients or the source of funds for the Solo Clients. Arian relied on its retained compliance consultants becoming "comfortable" following concerns raised by the consultants, after Arian explained some information about the trading strategy. However, Arian should have ensured that it fully understood the nature of the Solo business;

c) failed to undertake and document a risk assessment for each of the Solo Clients prior to onboarding and trading for the Solo Clients;

d) failed adequately to complete EDD for any of the Solo Clients despite the fact that none of the Solo Clients were physically present for identification purposes and a number of other risk factors were present, and despite the fact that its retained compliance consultants advised that Arian would need to undertake EDD. Although Arian had engaged its retained compliance consultants to give some limited assistance during the onboarding process, they were not instructed to provide any substantive assistance with regard to EDD prior to onboarding;

e) failed to assess each of the Solo Clients against the categorisation criteria set out in COBS 3.5.2R and failed to inform the Solo Clients prior to any provision of services of their specific client categorisation, contrary to COBS 3.3.1R;

f) failed to conduct transaction monitoring of the Solo Clients' purported trades, including assessing whether the transactions were consistent with its knowledge of the customers and their risk profile, and when instructing a second external compliance firm to undertake monitoring of the trades (after the Solo Trading had commenced) the remit of those instructions was limited and did not include trade monitoring from an AML or other financial crime perspective; and

g) failed to recognise numerous "red flags" with the purported trading, including that Arian did not consider whether it was plausible and/or realistic that sufficient liquidity was sourced within a closed network of entities for the size and volumes of trading conducted by the Solo Clients. Likewise, Arian failed to consider or recognise that the profiles of the Solo Clients meant that they were highly unlikely to meet the scale and volume of the trading purportedly being carried out, and/or failed at least to obtain sufficient evidence of the clients' source of funds to satisfy itself to the contrary."

60. We shall use these findings as a basis for our assessment of the financial penalty to be imposed in this case, subject to one clarification. In relation to the finding set out at paragraph 5.6 (f) of the Decision Notice, we accept that some transaction monitoring took place. Although Compliance Asset were instructed to undertake anti-market-abuse monitoring, there could be an overlap between such work and monitoring for wider financial crime purposes. Compliance Asset could have identified suspicious transactions where the suspicions went wider than market abuse and, if it did so, would have reported them to the Applicant.

Assessment of the financial penalty

61. We now turn to the question of assessment of the appropriate financial penalty in this case, having considered the parties' submissions, the findings of fact set out above and the failings identified in the Decision Notice.

62. We approach this assessment by reference to the 5 step framework contained in DEPP 6.5A, as set out at [14] above.

Step 1 – disgorgement

63. As DEPP 6.5.2 makes clear, there are three distinct principles which underlie the penalty regime namely:

> (1) Disgorgement - a firm or individual should not benefit from any breach;
>
> (2) Discipline - a firm or individual should be penalised for wrongdoing; and
>
> (3) Deterrence - any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.

64. Whilst there is an overlap between the discipline and deterrence principles, the disgorgement principle is of a different character. It is not designed to penalise the firm or deter the firm or others from committing the same behaviour. Its purpose is confined to ensuring that the firm does not benefit from its misconduct. Consequently, as the policy makes clear, the amount arrived at by the application of Step 1 is not to be increased or decreased by reference to any aggravating or mitigating factors. Nor is any discount for settlement applied to the disgorgement figure. It is solely a question of deciding on a case-by-case basis what, realistically, has been the financial benefit that has accrued to the firm as a result of its misconduct.

65. The phrase "financial benefit" should not be construed in an overly legalistic fashion. The policy should not be construed in the same way as a statutory provision and should be capable of being applied flexibly, depending on the facts. Therefore, for instance, in a case where the firm is legally entitled to receive the full amount of the income it derives from the misconduct in question in circumstances where it is obliged to meet certain expenses out of the amount received, the fact that it had a legal entitlement to the whole amount should not be decisive as to the amount of the financial benefit. Whether the "financial benefit" is the gross amount, or a lesser amount to take account of expenses, needs to be considered on a case-by-case basis.

66. This was recognised by Snowden J in *Da Vinci*. That case was concerned with the provisions of s129 FSMA which gives the High Court the power to impose a penalty for market abuse. The DEPP framework also applies to such penalties. Traders had traded shares on the London Stock Exchange under an arrangement with Da Vinci, a company which used direct market access facilities provided by Goldman Sachs as a broker for share trading on the exchange. Da Vinci supplied financial resources and market access in return for half the profits of their trading. Market manipulation was carried out under this arrangement.

67. Snowden J held at [219] to [221] that, for the purposes of a financial penalty, Da Vinci should be given credit for the costs it incurred in committing the market abuse as follows:

> "219. Mr. Beauchamp's evidence was that at step 1 (disgorgement) when applying DEPP 6.5A.1 the FSA would have regarded it as inappropriate that those who have committed market abuse should be given any credit for any costs incurred in committing that market abuse. On that basis, Mr. Beauchamp gave evidence that the FSA would have considered it appropriate to require DVI to disgorge its gross profits from trading during 2010, which the FCA had calculated were £688,730.
>
> 220. I disagree with this approach – or at least I disagree with it as broadly as it was stated by Mr. Beauchamp. On the basis that step 1 – disgorgement – is designed to ensure "the removal of any financial benefit derived directly from the breach". I do not accept that a person who has engaged in market abuse should be required to disgorge benefits that they have not received. That would amount to a penalty, which is dealt with at steps 2–3.

> 221. The point can most readily be illustrated in relation to the dealing costs and commissions which were directly referable to the trading in question and which were payable by DVI to Goldman Sachs. As might be expected, those costs and commissions were simply deducted by Goldman Sachs from DVI's account, and DVI therefore never received or became entitled to them I can see that there might be more merit in an argument that a defendant who has committed serious market abuse should not be able to claim credit for his general business overheads, but that issue does not arise on the facts of this case, and so I express no view upon it."

68. In *Ford and others v FCA* [2018] UKUT 358 (TCC), the Tribunal made the following statement of principle in relation to disgorgement at [684]:

> "We accept that the principle of disgorgement is to deprive the wrongdoer of the benefit of their wrongdoing. That principle does not look to the source of the benefit (in particular if that source is also the product of misconduct) nor is it concerned with whether or how the sums in question have been disbursed or otherwise applied."

69. The Authority has taken disciplinary action against a number of other brokers who carried on similar activities to the Applicant with the Solo Group. One such broker was Sapien Capital Limited ("Sapien"), who challenged the Authority's findings before the RDC but did not refer its decision to the Tribunal.

70. In the Authority's Final Notice given to Sapien on 6 May 2021, at paragraph 4.24 the Authority found that in 2014 Sapien took on a new trading desk. The individuals working on the desk reported directly to Sapien management. The new trading desk was taken on to conduct futures derivatives trades for Sapien. While at prior firms, these individuals had acted as brokers for the Solo Group. Upon joining Sapien, they were keen to continue their prior relationship with the Solo Group.

71. In that case, after representations from Sapien, the RDC decided that the figure for financial benefit that should be disgorged was £178,000, a figure which was arrived at after deducting custody and consultant fees from the gross revenue received by Sapien from the Solo Group. In its Warning Notice, the Authority had sought disgorgement in the sum of £297,000, that figure being what the Authority said were the financial benefits derived directly from Sapien's breaches. In its representations to the RDC, as recorded in Annex D to the Final Notice Sapien said:

> "While £297,000 of revenue technically came into Sapien from the Solo business by way of commissions, most was instantly paid out, under pre-agreed contractual terms, in fees of £94,000 to the team of individuals working on the trading desk, and custodian and consultant fees of €40,000 to Solo."

72. Referring to *DaVinci* for support, Sapien contended that the sum should not be required to be disgorged because it could not be said that Sapien received a benefit from the funds that were paid out straightaway.

73. This argument was accepted by the RDC. It said in its response to the representations:

> "The Authority considers that while the gross commission from the Solo business is the starting point for the appropriate figure for disgorgement, in all the circumstances of this case, Sapien's financial benefit ought to be calculated as that amount minus the sums paid out in respect of fees to the brokers and the custodian and consultant fees to Solo. The Authority is satisfied that the net figure is appropriate in this case because of Sapien's particular business structure, notably its contracts with independent, self-employed brokers which were specifically introduced on this business model, which predated the Solo clients, under which they were entitled to recoup their commission share. The Authority accepts Sapien's argument that it did not receive a benefit from those funds, notwithstanding the fact they were technically received by Solo before being paid

on. It considers a similar approach should be taken in this case to the custodian and consultant fees…."

74. In our view, this Decision illustrates how the concept of "financial benefit derived directly from the breach" which is the test to be applied under DEPP in considering the amount to be disgorged, must be considered on a case-by-case basis. In *Da Vinci,* Snowden J accepted that fees which were deducted from the revenue earned before it was passed on to the recipient should not be regarded as being part of the financial benefit because they were never received by the person concerned, but left open the question as to whether other costs and expenses might also in an appropriate case be deducted. In the case of Sapien, the RDC did accept that deductions could be made in respect of sums that, although technically received were subject to a pre-existing contractual obligation to pass them on straightaway. Correctly, in our view, the RDC was not seeking to construe the words of the relevant provision in DEPP strictly and was able to conclude that the firm concerned should not be regarded as having received a benefit "directly" in circumstances where it was under an obligation to pass the sums concerned on to another person straightaway.

75. In our view, the RDC's decision offers support for the proposition that it is, in appropriate cases, correct to deduct expenses which are directly referable to the generation of the revenue concerned. That, in our view, was the basis on which Snowden J was able to agree that custody and brokerage fees should be deducted in *Da Vinci*. It is true that Snowden J put some emphasis on the fact that the sums representing the deductions concerned had not been received by Da Vinci.

76. Consequently, we do not consider that Snowden J was intending to limit the meaning of the word "received" in this context. Likewise, we do not consider that the passage in *Ford* quoted above should be construed as meaning that one should always take into account as a financial benefit received, sums which were "disbursed" immediately on receipt. It does not appear to us that that point was in issue in that case.

77. It is common ground that the Authority's decisions which relate to matters which have not been referred to the Tribunal are not judicial decisions; they are administrative decisions and do not create a legal precedent. However, in the case of a Final Notice which has been through the Authority's contested decision-making process before the RDC, we should pay due regard to the decision of the RDC, particularly where it is applying the Authority's policy on financial penalties. The Decision should be regarded as an expression of the policy of the Authority in relation to the point of concern, and therefore, as the case law shows, in relation to the setting of financial penalties, we should not depart from the Authority's policy unless there is a good reason to do so.

78. Furthermore, there is great merit in consistency of decision-making when it comes to the setting of financial penalties, both as between decisions made through the Authority's administrative decision-making process as well as between such decisions and those of the Tribunal.

79. In this case, the Applicant contends that the Authority has applied the disgorgement principle incorrectly by not deducting from the gross revenue received the amount of commission paid to Hopa. Mr Mansell submitted that where commission was paid to Hopa there was no proper basis for treating money received by Hopa as the Applicant's benefit. The monies paid to Hopa were an expense of the Applicant and the Decision Notice has already acknowledged that expenses should, as a matter of principle, be deducted from the Firm's disgorgement figure in respect of custodian or clearing fees.

80. Therefore, whilst Mr Mansell accepts that fixed business overheads may not be deductible, he submits there is no reason why such a concept should be extended to commission

payments contractually owed and calculated by direct reference to the specific underlying business transactions subject to disgorgement. In this instance whilst gross monies were initially paid into the Applicant's accounts, commission payments to Hopa, like custodian or clearing fees (already deducted), were then paid out pursuant to the Applicant's contractual obligations. In this way, Mr Mansell submits, the physical receipt of payment does not alter the analysis in *Da Vinci* where no benefit was in fact physically received by the firm.

81. Mr Hinks, for the Authority, contends that these submissions should not be accepted. In summary, he submits:

(1) The starting point for the appropriate Step 1 figure is the amount of revenue (less custody and consultant fees) which the Applicant received from brokering the Solo Clients' purported trades. That amount represents "the financial benefit derived directly from the breach."

(2) The Applicant remunerated its brokers by way of the commission structure instead of paying them a salary. That same structure applied to clients brought to the firm by Mr Lawrence, save that he chose to receive his commission payments through Hopa. Accordingly, in common with all the other brokers, Mr Lawrence was remunerated through the payment of the flat commission rate of 80%. Such remuneration was essentially a general expense of the Applicant and, as was recognised in *Da Vinci*, should not be deductible in calculating the financial benefit received. Receipts which allow firms to remunerate their own staff constitute "financial benefits" to the firms concerned. If the brokers (including Mr Lawrence) had been remunerated by salary payments there would be no question of the Applicant being given credit for the salary payments it made.

(3) Further or alternatively, given Mr Lawrence's position as one of three designated members with a 20% equity interest in the firm, remuneration paid to him fell within the scope of the firm's financial benefits.

(4) The custody and consultancy fees incurred by the Applicant comprise clearing costs incurred by the firm in favour of independent third parties which were directly referable to the purported trading in question. That is not the case in relation to the commission payments made to Hopa.

(5) In *Da Vinci*, the agreement entitled Goldman Sachs to deduct certain costs before the firm had access to those funds such that, in Snowden J's view, the firm "never received or became entitled to" that money. In the present case, the Applicant started receiving commission into its bank account from the Solo trades on 8 June 2015 and did not make any payments to Hopa until 23 October 2015 and 22 December 2015. During the intervening period, there is no question that the Applicant was entitled to the monies it had received, which it applied for its general business uses.

82. We prefer the submissions of Mr Mansell on this issue for the following reasons.

83. First, we see no reason in principle to distinguish the custody and consultancy fees from the commission paid to Hopa. In our view, the commissions payable to Hopa are expenses directly referable to the trading in question and, consistent with the reasoning in *Da Vinci*, to be deducted from gross revenue to which the Applicant was entitled.

84. Secondly, we agree with the analysis of the RDC in Sapien. In that case, the commissions were paid out pursuant to pre-agreed contractual terms and, as we have said, were commissions that were directly referable to the trading undertaken with Solo. We do not accept that they are of the same character as salary payments. In Sapien, the RDC relied on the firm's particular business structure, notably its contracts with independent self-employed brokers under which they were entitled to recoup their commission share. As Mr Meadows's evidence demonstrates,

the Applicant followed the same business structure. All of its brokers, in accordance with common industry practice, were self-employed and were remunerated on the basis of commission, payable out of the commissions payable to the firm. Mr Lawrence, through Hopa, was engaged on the same basis.

85. Thirdly, we do not consider that the fact that there was some delay in the payments being made to Hopa after their receipt by the Applicant makes any difference. As Mr Meadows's evidence demonstrates, there was no written agreement between the Applicant and Hopa, but there is nothing to suggest that the payment terms were anything other than that the 80% share was payable to Hopa immediately upon the sums out of which it was to be paid were received by the Applicant. That would be an obvious implied term in the circumstances. It may well be the case that as a matter of law it was open to the Applicant to use the sums received for general business purposes, but that would not have affected its pre-existing legal obligation to pass them on immediately upon receipt. The sums received were in essence earmarked funds, 20% payable to the Applicant, and 80% to Hopa.

86. Fourthly, we do not consider the fact that Mr Lawrence was an equity partner in the Applicant makes any difference. Mr Lawrence has benefitted from the 20% share of the commission payable to the Applicant because of his status as an equity partner in the Applicant. He has received his full entitlement to his share of that sum as an equity partner in the firm. None of the 80% share paid to Hopa was paid to him in his capacity as a partner in the Applicant, but under a separate contractual arrangement. There is no reason therefore to put Mr Lawrence in a different position to any of the other brokers in the firm who were remunerated on the same basis.

87. Fifthly, to seek to disgorge the full amount of the commissions payable to the Applicant would in our view amount to the imposition of a further penal sanction beyond that arrived at by the application of Steps 2 to 4 of the policy framework. Had the Applicant thought of it, it might have included in the contractual arrangements with Hopa provisions to the effect that it could claw back the commission payments made in the event that the Applicant was obliged to disgorge them as a result of any misconduct caused by the broker concerned to take the view that the failure of the Applicant to include such a provision in the contractual arrangements was a reason for treating the sums concerned as a financial benefit to the Applicant would, in our view, clearly be a sanction of a penal nature which, as discussed above, is not permitted when considering the amount to be disgorged under Step 1, as recognised in *Da Vinci*. Whilst we make no criticism of the Authority for not having done so, it would have been open to the Authority to take regulatory proceedings against Mr Lawrence if they considered that he was personally culpable for the misconduct that occurred, and sought disgorgement from him of the amounts paid to Hopa.

88. We therefore conclude that the Step 1 figure should be £140,912.53, that is the 20% share of the net commission retained by the Applicant after making the payments it was obliged to make to Hopa.

Steps 2 to 5 - General

89. The essence of Mr Mansell's submissions on the remaining Steps in the framework, were that:

(1) There is a good and proper basis for the Tribunal to differentiate the assessment of seriousness in the Applicant's case to that assessed by the Authority in the other cases where disciplinary action had been taken against firms who also participated in the Solo Business. Accordingly, at Step 2, the firm's misconduct should be assessed at Level 3 rather than, as is contended for by the Authority, at Level 4.

(2) There is no justification for the Authority's decision, at Step 3, to aggravate the Applicant's penalty by 10% on the basis that the Applicant had not followed the JMLSG guidance. On the contrary, the penalty should be mitigated by 10% at Step 3 on the basis that it involved compliance consultants to provide it with expert assistance.

(3) There is no justification to apply a multiplier of 4 at Step 4 based solely on the basis that the absolute value of the penalty is too small in relation to the breach in order to meet the Authority's objective of credible deterrence. On the contrary, the Authority's actions against the other brokers demonstrates an inconsistency in the Authority's treatment as between firms with regard to the imposition of a multiplier and the disproportionate treatment of the Applicant compared to those firms. In the circumstances, there is no justification for the application of a multiplier at all and the penalty without any multiplier is not as disproportionate as that currently proposed. Such a penalty is not small and credible deterrence is achieved both on its own merits and by reference to comparator cases.

(4) Were the Tribunal to conclude that the Authority did not in the Decision Notice apply its own policy as set out in DEPP, and/or failed to follow precedent, the Tribunal may conclude that the Applicant has been denied the opportunity to settle the case on the terms which the Authority should have offered it and the Applicant has been put to unnecessary legal expense, inconvenience and considerable stress and anxiety over the course of a number of years.

90. At our request, Mr Mansell's junior, Mr Coke-Smyth, helpfully provided a table setting out various calculations as to the result that would follow if we were to accept some or all of Mr Mansell's submissions.

91. As set out in the Decision Notice, the application of Step 2, at Level 4, produced a figure of £67,296, being 20% of the Applicant's relevant net revenue in the Relevant Period. The application at Step 3 of an aggravating factor of 10% increased the Step 2 figure to £74,025. The application of a multiplier of 4 at Step 4 produced a figure of £296,100 for the penal element of the overall penalty.

92. If we were to accept Mr Mansell submissions, the result would be a figure of £44,864 at Step 2, being 10% of the Applicant's relevant net revenue in the Relevant Period. The application at Step 3 of a mitigating factor of 10% would decrease the Step 2 figure to £40,000. As a result of applying no multiplier at Step 4, the penal element of the overall penalty would remain at £40,000. No further reduction was proposed in relation to the loss of opportunity to settle the case.

93. Against that background, we now turn to consider Mr Mansell's submissions on Steps 2 to 5.

Step 2 - ***The seriousness of the breach***

94. In our view, the Authority was fully justified in deciding that at Step 2 the financial penalty should be calculated on the basis that there was a Level 4 breach, as set out at paragraphs 6.7 to 6.27 of the Decision Notice.

95. As regards paragraph (2) of DEPP 6.5A, the Authority decided that revenue was an appropriate indicator of the harm or potential harm in this case. The figure for "relevant revenue" in this case was £448,645, being the revenue derived by the Applicant during the period of the breach from the product or business area to which the breach related (in this case the gross commission payable by the Solo Group). This point was common ground and we agree with it.

96. In deciding that the breach was at Level 4, the Authority correctly considered the factors set out in paragraph (5) of DEPP 6.5A, namely:

(a) factors relating to the impact of the breach;

(b) factors relating to the nature of the breach;

(c) factors tending to show whether the breach was deliberate; and

(d) factors tending to show whether the breach was reckless.

97. As regards the impact of the breach, the Authority placed no emphasis on the factors listed in paragraph (6) of DEPP 6.5A, and in particular did not consider that the orderliness of, or confidence in, the markets in question have been damaged or put at risk.

98. As regards the nature of the breach and the factors set out in paragraphs (7) and (11) of DEPP 6.5A, as set out at paragraph 6.13 of the Decision Notice, the Authority correctly identified the following Level 4 factors:

(1) the breach revealed serious or systemic weaknesses in the firm's procedures or in the management systems or internal controls relating to all or part of the firm's business; and

(2) the breach created a significant risk that financial crime would be facilitated, occasioned or otherwise occur.

99. The Authority does not appear to have placed an emphasis on one of the factors referred to at paragraph (7), namely whether the firm, in committing the breach, took any steps to comply with the Authority's rules, and the adequacy of those steps.

100. The Applicant does not dispute the seriousness of the failures in the firm's procedures and controls nor does it dispute the fact that the breach created a significant risk that financial crime would be facilitated. That is clearly self-evident from the findings of fact that we have made, as set out above and we do not need to repeat any of those matters here. The Solo Trading clearly gave the opportunity for the Solo Clients to make large numbers of tax reclaims to which they were not entitled. The Applicant recognised that if it had been more diligent in investigating the reasons why these particular Clients were trading in the vast volumes that they did and more diligent in investigating the profiles of those clients it may well have declined to take on the business.

101. As regards the Level 3 factors, as set out at paragraph (12) of DEPP 6.5A, the Authority only considered, at paragraph 6.14 of the Decision Notice, that one factor was relevant, namely that the breach was committed negligently or inadvertently. It did not specifically consider another of the Level 3 factors, namely that there was no, or limited, actual or potential effect on the orderliness of, or confidence in, markets as a result of the breach. In our view, that was a relevant factor to be considered, but we do not consider that had the Authority done so it would have, or should have, made any difference to its decision, bearing in mind the seriousness of the matters referred to at [100] above.

102. It is to be noted that in all the other disciplinary cases relating to the Solo Trading that we were referred to the penalty assessment was made at Level 4 at Step 2. The case advanced by Mr Mansell for treating the Applicant's case at Level 3 appears to be based on two factors:

(1) the fact that the breach was committed negligently rather than deliberately or recklessly; and

(2) the fact that the Applicant did make serious efforts to comply with the relevant regulatory obligations, as demonstrated by its engagement of expert assistance from

compliance consultants, notwithstanding the fact that, as the Applicant freely admitted, those efforts were ineffective and inadequate.

103. As far as the first of these two factors is concerned, in disagreement with Mr Mansell, we do regard the Applicant's negligence as being at the top end of culpability. In particular, we would expect any reasonably competent brokerage firm to appreciate that it needed to know much more about the Solo Clients. Any reasonably competent brokerage firm, even without the advice of external compliance consultants, would have appreciated that reliance on Introduction Certificates in the circumstances of this trading, particularly after the sheer volume of trading by those clients became apparent, was inappropriate. During the Relevant Period, the Applicant did not have (i) any understanding of the Solo Clients' source of funds (ii) any understanding of the reasons why each of the Solo Clients wanted to engage in the Solo Trading or (iii) undertake risk assessments for the Solo Clients prior to onboarding and the commencement of trading. Consequently, the Applicant was never in a position effectively to monitor its transactions with the Solo Clients.

104. Accordingly, in our view, the Authority was right to assess that the fact that the breach was only committed negligently did not in this case detract from the seriousness of the breach to the extent that the breach should be considered at Level 3 rather than Level 4.

105. As far as the second of these two factors is concerned, we agree with the submissions of Mr Hinks on this point. As he submitted, given that the Applicant did not have a dedicated compliance function, it is an expectation that it would engage external consultants in the matter. Further, the engagement of those consultants was inadequate in the face of the significant and ongoing risks presented by the Solo Group business:

(1) As regards CPA Audit's engagement in respect of the onboarding of Solo Clients, that consultant was not instructed to provide any substantive assistance with regard to EDD prior to onboarding.

(2) As regards the Applicant's decision to rely upon the Solo Group's purported CDD it appears that the Applicant made this decision simply because CPA Audit informed the firm that this was a possibility without itself carrying out a risk-based assessment as to whether it was appropriate to do so.

(3) It appears that the Applicant declined to follow CPA Audit's advice as to the need to understand the Solo Clients' reasons for trading.

(4) Although the Applicant engaged Compliance Asset to carry out transaction monitoring, that firm was only instructed to monitor such activity from a market abuse perspective and on a sampled basis. The fact that no one at the firm (or any external consultant) monitored the Solo Clients' trading activity from an Anti-Money Laundering perspective for the duration of the trading was a serious matter.

106. Whilst the Applicant criticises the quality of the advice given by its compliance consultants, that advice can only be as good as the instructions that are given, which are entirely the responsibility of the instructing firm. As is apparent from our findings of fact and Mr Hinks's submissions, as set out at [105] above, the instructions given were of a limited nature and were inadequate in the circumstances.

107. As support for the view that the Applicant was seeking to do its best to ensure regulatory compliance, Mr Mansell drew our attention to the fact that, unlike other brokers involved in the Solo Business, the Applicant made a suspicious activity report in relation to a matter connected with the trading. At the end of the Relevant Period, the Applicant was owed commissions from Solo Clients for whom it had executed business. It was contacted by Elysium Global (Dubai) Limited offering to pay the debt with a factoring discount. Arian

agreed to this and received from Elysium approximately £125,000. Following discussion with the retained compliance consultants, although not ultimately advised to do so, the Applicant decided to place these monies into a segregated account while it submitted a suspicious activity report ("SAR") to the National Crime Agency and awaited their clearance to process these monies. No response was received within the 7-day period and consent was deemed given. In this way Mr Mansell says, the Applicant showed at that point that it was alive to Anti-Money Laundering concerns related to the Solo Clients and acted appropriately of its own volition to inform the authorities of a payment it believed might be suspicious. In so doing it risked depriving itself of a substantial amount of the commission owed for the Solo Clients' trading.

108. However, as the Authority submitted, in the circumstances of the Elysium payment, it was incumbent on the Applicant to make a SAR. The fact that it complied in this instance with Anti-Money Laundering requirements does not make the serious instances of failure to do as found by the Authority, any less serious.

109. We therefore conclude that the Step 2 figure should be £67,296, the same figure as was set out in the Decision Notice.

Step 3 - *Mitigating and aggravating factors*

110. DEPP 6.5A (3) sets out a list of factors that may have the effect of aggravating or mitigating the breach. The only relevant factor in this regard is that set out in sub-paragraph (k) of this provision, namely whether guidance or other published materials had already raised relevant concerns, and the nature and accessibility of such materials.

111. The Authority considers that it is a factor aggravating the breach that the Authority and the JMLSG have published numerous documents highlighting financial crime risks and the standards expected of firms when dealing with those risks, in particular the JMLSG Guidance which was first published in December 2011. This guidance sets out good practice examples to assist firms, for example in managing and mitigating money laundering risk by (amongst other things) conducting appropriate customer due diligence, monitoring of customers' activity and guidance of dealing with higher-risk situations. At paragraph 6.18 of the Decision Notice, the Authority stated that given the number and detailed nature of such publications, and past enforcement action taken by the Authority in respect of similar failings by other firms, the Applicant should have been aware of the importance of appropriately assessing, managing and monitoring the risk that it could be used for the purposes of financial crime.

112. At paragraph 6.19 of the Decision Notice, the Authority stated that it did not consider there to be any mitigating factors. Mr Mansell submitted that the fact that the Applicant took expert advice from external compliance consultants should be regarded as a mitigating factor, insofar as it was not taken into account at Step 2.

113. Mr Mansell submits that the failure to take into account the JMSLG Guidance should not be a relevant factor in this case and therefore there is no aggravating factor to take into account. He submits that an aggravating feature must be a feature outside the ordinary. Non-application of the JMLSG Guidance would not be a particular feature aggravating the Applicant's misconduct; it would apply in every case of non-compliance in relation to financial crime system and controls.

114. We reject that submission. In our view, JMLSG Guidance clearly falls within the scope of sub-paragraph (k) referred to at [110] above. There is nothing in the wording of that provision which demonstrates an intention to confine its application to specific as opposed to general guidance. In any event, the JMSLG Guidance does provide specific and focused guidance on how to mitigate risk of financial crime and is directly relevant to the failings

identified by the Authority in this case. We therefore agree with the Authority that the failure to follow this guidance is an aggravating factor in this case.

115. For the reasons given above, we do not consider the Applicant's engagement of external compliance consultants to be a sufficient mitigating factor to reduce the penalty here.

116. Accordingly, we agree with the conclusions of the Authority at Step 3. We therefore conclude that the Step 3 figure should be £74,025, that is 110% of the Step 2 figure.

Step 4 - *Adjustment for deterrence*

117. As Mr Hinks submitted, this provision gives effect to the deterrence principle set out in DEPP 6.5.2(3), that any penalty imposed should deter the firm or individual who committed the breach, and others from committing further or similar breaches.

118. There is no further guidance in DEPP as to the basis on which any particular multiplier should be applied. However, on the one hand we agree with the Authority that a multiplier should be applied in cases where the absolute value of the penalty is too small in relation to the breach to meet the Authority's objective of credible deterrence. On the other hand, the application of a multiplier should not result in a penalty that is disproportionate to the breach and which is inconsistent with similar cases.

119. We were provided with Final Notices in respect of the regulatory outcomes against a number of the other brokers involved in the Solo Business. In the case of Sapien, a multiplier of 2 was applied. That gave rise to a penalty (before discount for settlement) of £58,000 in circumstances where the disgorgement figure was £178,000, so that the penal figure was approximately one third of the disgorgement figure. In other cases, the ratio between the penal figure and the disgorgement figure was much higher, sometimes above 75% of the disgorgement figure. Those figures were arrived at by the application of multiples of 4 or 5.

120. In our view, one rational approach in relation to Step 4 is to look at the ratio between the disgorgement figure and the penal element. This is not necessarily the correct approach in every case, but we think it is appropriate here when having regard to the outcomes in similar cases involving Solo Business, so as to ensure a measure of consistency.

121. The higher the ratio between the penal figure and the disgorgement figure, the more likely it is that the credible deterrence objective will be achieved. This is an approach followed in other penalty regimes, particularly those related to tax penalties, where penalties are often imposed in an amount which represents a percentage of the relevant tax at stake.

122. We agree with the Authority that if no adjustment were made at Step 4 in this case credible deterrence would not be achieved. We therefore reject Mr Mansell's submission that there should be no adjustment in this case for deterrence.

123. Having regard to the previous cases we consider that a multiplier of 4 is too high in this case. In our view, a multiplier which produces a figure which is in the region of 100% of the disgorgement amount would be both proportionate and achieve credible deterrence. We therefore consider that a multiplier of 2 would be appropriate in this case.

124. We therefore conclude that the Step 4 figure should be £148,050.

Step 5

125. We see no reason to make any further adjustment on the basis that had the Authority taken the same view on the disgorgement figure as we and the Applicant have done in this case, the Applicant may well have settled the matter at an earlier stage and obtained up to a 30% discount on the penal element of the financial penalty.

126. In our view, the Authority had a clearly arguable case on the approach to be taken in defining the "financial benefit" in this case. It was therefore appropriate that the Authority should contest the matter in the Tribunal.

Conclusion

127. We have determined that the appropriate figure in respect of the disgorgement figure to be calculated by the application of Step 1 is £140,912.53 and that in respect of the penal element to be calculated by the application of Steps 2 to 5 is £148,050. Accordingly the total financial penalty is £288,962.53.

Directions

128. We determine that the appropriate action for the Authority to take in relation to this reference is to impose on the Applicant a financial penalty of £288,962.53. Our decision is unanimous.

129. We remit the reference to the Authority with the direction that effect be given to our determination.

TIMOTHY HERRINGTON
UPPER TRIBUNAL JUDGE

Release date: 12th November 2024