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FINAL NOTICE

To: Macquarie Bank Limited, London Branch

Reference
Number: 170934

Address: Ropemaker Place
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UNITED KINGDOM

Date: 18 November 2024

1. ACTION

- 1.1. For the reasons given in this Final Notice, the Authority hereby imposes on Macquarie Bank Limited, London Branch ("MBL") a financial penalty of £13,031,400 pursuant to section 206 of the Act for breaches of Principle 3 of the Authority's Principles for Businesses.

- 1.2 MBL agreed to resolve this matter and qualified for a 30% (Stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £18,616,400 on MBL.

2. SUMMARY OF REASONS

- 2.1. MBL is a company incorporated in Australia which forms part of a global financial services group. It operates in the UK through its London Branch and has been authorised by the Authority since December 2001.
- 2.2. MBL is organised globally into a number of operating groups including the Commodities and Global Markets group ("CGM"), which includes the Commodity Markets and Finance ("CMF") division. The CMF division incorporates different trading areas, including the Metals and Bulks Trading Desk.
- 2.3. In February 2022, MBL discovered that a trader on the Metals and Bulks Trading Desk based in the London Branch ("the Trader") had recorded a large number of fictitious trades on MBL's internal systems in order to conceal trading losses he had incurred. These fictitious trades had been recorded over a period of 20 months from 17 June 2020 through to 23 February 2022 ("the Fictitious Trading"). Upon discovery of the Fictitious Trading, MBL uncovered the Trader's hidden trading losses and unwound the positions incurring a loss to MBL of approximately USD 57.8 million.
- 2.4. The Fictitious Trading had not been prevented or detected earlier due to deficiencies in MBL's systems and controls relating to oversight and monitoring of trader positions. These systems and controls were relevant to trading on the Metals and Bulks Trading Desk and thereby gave rise to the same risk across significant areas of trading activity.
- 2.5. Principle 3 of the Authority's Principles for Businesses states as follows:
- A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 2.6. MBL did not take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular:

- a. The Product Control Team's ("PC Team") daily profit and loss ("P&L") reporting process, which was in place to detect and investigate discrepancies between daily trading book positions and a trader's daily P&L estimate, was ineffective and failed to appropriately identify and deal with discrepancies.
 - b. The End of Day ("EOD") futures reconciliation process failed to ensure that breaks (*i.e.*, discrepancies) in the reconciliation process were adequately managed. The design of the control was also deficient because it excluded trades with future-dated clearing dates, with the result that such trades avoided scrutiny by this process.
 - c. The cancelled, amended and backdated trades ("CABs") post-trade reporting control was deficient in its design and relied on the flawed EOD reconciliation process as a compensating control. As a result, this control failed to adequately report on exchange cleared futures trades. The failures in this control were exacerbated by the poor functioning of the CAB Committee that had been set up to manage risks associated with CABs.
 - d. The process for independent verification of broker quotes was insufficient to prevent the use of unverified and falsified quotes. The same trader responsible for the Fictitious Trading was able to submit falsified broker quotes against which the profitability of their positions were assessed.
- 2.7. In addition to the failings set out above, the Authority considers that there were further failings in MBL's risk management framework, which contributed to the continuation of the deficiencies in MBL's systems and controls referred to in paragraph 2.6 above. In summary:
- a. The Risk and Control Self-Assessment ("RCSA") failed to adequately measure and monitor the risks identified in EOD futures reconciliations, CAB reporting, and P&L analysis in the Relevant Period. Contributing factors to this failure included how RCSA risk entries were recorded, such as aggregating multiple controls into one issue, and not containing detailed descriptions of the relevant underlying activities; and
 - b. In 2020, in response to a number of issues identified with the relevant trading controls by earlier external and internal reviews, including by the Internal Audit Division ("IAD"), a project designed to address the

recommendations from those reviews was implemented ("Project Papa"). MBL failed to ensure that Project Papa had appropriate governance arrangements in place to deliver the project's outcomes effectively. In particular, the governance structure, resourcing model and assurance processes were not appropriate for the project. Had the recommended enhancements to MBL's systems and controls in Project Papa been implemented, the ineffective systems and controls would have been resolved and the Fictitious Trading would likely have been identified earlier.

The Authority's view of the breaches and sanction

- 2.8. Notwithstanding that the Fictitious Trading had no market impact, the Authority considers these breaches to be serious. It is of fundamental importance that a firm has effective oversight of its traders and can accurately assess trading positions and corresponding P&L. The systems and controls in this case were ineffective to the extent that a relatively junior trader was able to identify them and take steps to avoid the Fictitious Trading being detected over a 20-month period. The deficiencies in the systems and controls left MBL without proper oversight and control of trading activity within the Metals and Bulks Trading Desk. It is also of fundamental importance that firms have risk management frameworks that appropriately identify, measure and monitor the risks a firm is exposed to. This extends to ensuring that projects seeking to remediate systems and controls issues have effective governance, appropriate resourcing models, and timely assurance performed over them. MBL's failures in its risk management framework contributed to the continuation of the deficiencies in MBL's systems and controls.
- 2.9. The Authority hereby imposes on MBL a financial penalty of £13,031,400 pursuant to section 206 of the Act. This action supports the Authority's statutory objective of protecting and enhancing the integrity of the UK financial system.

3. DEFINITIONS

- 3.1. The definitions below are used in this Notice:

"BORM" means the Business Operational Risk Management team;

"CAB/s" means trades that were Cancelled, Amended and Backdated and are a post-trade reporting control;

"CAB Committee" means the CAB Review Committee;

"CGM" means the Commodities and Global Markets group;

"CMF" means Commodity Markets and Finance;

"DEPP" means the Authority's Decision Procedure and Penalties Manual;

"EOD" means End of Day;

"GCS" means the MBL Global Clearing System;

"IAD" means the Internal Audit Division;

"IVT" means Independent Valuation Team;

"MBL" means Macquarie Bank Limited which is incorporated in Australia and has a branch registered in the UK;

"MGL" means Macquarie Group Limited, listed in Australia;

"MOD" means the Market Operations team within the Operations Division;

"MTS" means Macquarie Treasury System;

"P&L" means Profit and Loss;

"PC Team" means the Product Control Team;

"Project Papa" means the MBL project designed to address the recommendations from external and internal reviews into unauthorised trading controls and other controls;

"RCSA" means Risk and Control Self-Assessment;

"Relevant Period" means between 17 June 2020 and 24 February 2022;

"the Act" means the Financial Services and Markets Act 2000;

“the Authority” means the Financial Conduct Authority;

“the Bulks Desk” means the Bulks trading desk within the Metals and Bulks Trading Desk;

“the Fictitious Trading” means the recording and amending of fictitious trades, in the manner described in this Notice, by the Trader from 17 June 2020 to 23 February 2022;

“the Metals and Bulks Trading Desk” is divided into three trading areas: Precious Metals, Base Metals and Bulks;

“the Principles” means the Authority’s Principles for Businesses;

“the Trader” means the trader who conducted the Fictitious Trading; and

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber).

4. FACTS AND MATTERS

Background

- 4.1. MBL is a subsidiary of Macquarie Group Limited (“MGL”) which is a global financial services group listed in Australia operating in 34 markets in asset management, retail and business banking, wealth management, leasing and asset financing, market access, commodity trading, renewables development, specialist advice, access to capital and principal investment. MBL is incorporated in Australia and regulated by the Australian Prudential Regulation Authority. MBL operates in the UK through its London Branch and has been authorised by the Authority since 1 December 2001.
- 4.2. MGL entities employ over 1,700 people in the UK with MBL London Branch having assets of £24.3 billion.
- 4.3. MBL is organised globally into a number of operating groups including CGM, which includes the CMF division. The CMF division incorporates different trading areas, including the Metals and Bulks Trading Desk. The Metals and Bulks Trading Desk is divided into three trading areas: Precious Metals, Base Metals and Bulks. The

systems and controls relevant to this Notice apply to different trading areas within the CMF division including all of the London based trading activities of the Metals and Bulks Trading Desk.

- 4.4. On 23 February 2022, MBL discovered that a trader on the Metals and Bulks Trading Desk based in the London Branch had recorded a large number of fictitious trades on MBL's internal systems in order to conceal trading losses they had incurred. The Trader worked on the Bulks Desk. The misconduct was detected by MBL following an internal routine risk controls report which indicated a limit breach caused by a trade being closed-out on 23 February 2022, and then unclosed later that same day by the Trader. On the same day, concerns were escalated internally and a meeting with the Trader was arranged for the following day. During that meeting, the Trader admitted to the Fictitious Trading and taking steps to avoid their detection. Later that day, the Trader resigned with immediate effect.
- 4.5. According to trade analysis carried out by MBL as part of the unwinding of the Trader's loss-making positions, the Trader recorded and amended 426 fictitious trades over a period of 20 months from 17 June 2020 through to 23 February 2022. MBL's ineffective systems and controls meant that the Fictitious Trading could take place over this period of time, enabling the Trader to mask his actual loss-making positions by giving the appearance that the Trader's loss position had been lowered. The Fictitious Trading comprised trades with no external impact or economic reality and only existed as entries on MBL's internal systems. To conceal the Fictitious Trading, the Trader was able to circumvent the then existing trading controls by either cancelling, amending or backdating the trades multiple times. The Trader was able to do this without the Fictitious Trading being detected until February 2022.
- 4.6. When the Fictitious Trading was identified and the positions unwound, MBL incurred losses of approximately USD 57.8 million. No clients were impacted by these events and it did not impact the market, but the Fictitious Trading was sufficiently material that a statement was included in MBL's Annual Report for the financial year ending March 2022.
- 4.7. The Fictitious Trading was not prevented or detected for the 20 month period due to deficiencies in MBL's systems and controls relating to oversight and monitoring of trader positions, and failings in its risk management framework. The systems

and controls relating to oversight and monitoring of trader positions were relevant to all trading on the Metals and Bulks Trading Desk and thereby created the same risk across significant areas of trading activity.

The systems and controls breaches

- 4.8. Collectively, MBL's systems and controls relating to oversight and monitoring of trader positions formed part of a suite of systems and controls intended to mitigate the risk of unauthorised trading. MBL considered that unauthorised trading consisted of trading activity by a firm which is not in accordance with its internal trading policies, procedures, limits, risk tolerances and/or acceptable losses; and/or provisions that prohibit fraud, market manipulation and insider trading; and/or performed on a client's account without the client's permission. MBL defined an example of fraudulent trading activity as creating false or misleading records within or providing unauthorised amendments to databases, administration systems, or accounting records. The risk of unauthorised trading crystallised in the form of the Fictitious Trading, through the failings set out below in MBL's systems and controls.

The Product Control Team's daily P&L reporting process

- 4.9. The PC Team was responsible for ensuring all trading book positions are subject to checks of daily P&L and reconciling it with a trader's P&L estimate, which was provided at the end of each trading day. The purpose of this control was to operate as a check on P&L discrepancies and to mitigate the risk that any P&L discrepancies, which may have been generated from errors or unauthorised trading, were not detected, investigated or escalated.
- 4.10. Traders were required to provide a P&L estimate to the PC Team at the end of each trading day using Macquarie Treasury System ("MTS") positions which was then reconciled by the PC Team against the trader's estimate. The PC Team were required to ensure they understood the impact of any backdated trades on the P&L they were reconciling and comment when necessary.
- 4.11. The purpose of this control was to detect discrepancies in relation to a trader's P&L estimates (including unusual backdated P&L, as had occurred in the case of the Fictitious Trading). Where discrepancies were detected, this should have initiated further enquiries and investigation (as appropriate) by the PC Team.

4.12. During the Relevant Period, there were the following deficiencies in this control:

- a. The control only required the PC Team to request an explanation and investigate backdated trades greater than the threshold amount set at USD 50,000. This meant that multiple material backdated trades that netted to a P&L amount below investigation thresholds were not required to be analysed unless the USD 50,000 threshold was breached. This threshold was known by the Trader and therefore risked being circumvented. For example, regarding the Fictitious Trading, the Trader was informed of the USD 50,000 threshold by the PC Team and learnt that any PC Team challenge may be limited if the amount was under the threshold. The Trader was able to use this knowledge to circumvent the control and create offsetting fictitious trades to generate false P&L and keep his desk below the USD 50,000 threshold.
- b. The PC Team were not sufficiently robust in dealing with discrepancies in P&L. The process did not require sufficient review and escalation of P&L issues in order to reasonably check that any discrepancies were justified. Rather, the PC Team worked with traders to resolve issues in a way that meant the control lacked effectiveness. For example, regarding the Fictitious Trading, the Trader was able to pre-empt and prevent any potential challenge from the PC Team by alerting them to backdates and providing a brief and superficial and/or untrue explanation or justification (which the PC Team accepted with insufficient scrutiny or follow up). Furthermore, the Trader's practice was to request a holdout or adjustment to P&L for a day whilst he made an amendment signposted in the explanation, or requested an adjustment to prevent the variance exceeding the known USD 50,000 threshold. The Trader and the PC Team, having agreed the P&L position, would also on occasion agree for a clean email to be sent to the wider PC Team distribution list confirming the holdout and subsequent amendment.
- c. The PC Team were also set up in a way that allowed junior members of the PC Team to operate without due oversight, such that the control lacked effectiveness. For example, regarding the Fictitious Trading, the Trader was able to minimise potential challenges by contacting junior members of the PC Team individually with an estimate of his P&L figures and request a breakdown of the PC Team's figures.

End of Day futures reconciliation process

- 4.13. The Market Operations team within the Operations Division ("MOD") was responsible for the daily performance of EOD futures reconciliations between trades in the MTS (which was populated with data by MBL traders) and the MBL Global Clearing System ("GCS") (which contained data direct from the relevant exchanges).
- 4.14. The EOD futures reconciliation process was designed to identify instances where the details in MTS did not match those in GCS, with these mismatches called 'breaks'. Where there were any breaks in the reconciliation, this control required MOD to go to the relevant trader to resolve any breaks in the data and/or escalate to the relevant team depending on the nature and/or duration of the break.
- 4.15. There were two main design issues with this control:
 - a. First, the resolution and escalation processes within this control were manual with a reliance on judgement to be applied as to which breaks to action and escalate. This need for human judgement to determine which breaks to investigate and/or escalate in the EOD futures reconciliation presented a vulnerability in the control and meant it was not set up to be sufficiently effective. For example, in July 2020, MOD identified that a number of the Trader's trades were sitting in MTS without a matching exchange entry for several days before then being closed out. While this generated an initial discussion between MOD, the CMF Chief Operating Officer team and a CMF supervisor, the issue was not followed up through to resolution.
 - b. Second, there was a flaw in that the control was designed to exclude exchange cleared trades with future-dated clearing dates. There was no separate control process to validate trades with future-dated clearing dates. With regard to the Fictitious Trading, this weakness meant that the Trader was able to evade detection from this control by rolling the clearing date forward and therefore avoid appearing on the EOD futures reconciliation as a break which would have required follow-up.

- 4.16. These design failures were exacerbated by a lack of robust processes that meant that timeframes for resolving breaks and escalation were not necessarily followed. With regard to the Fictitious Trading, this weakness was reflected in the fact that there was an insufficient response to probe breaks with little challenge to the Trader either by MOD or by CMF supervisors. At least one MOD employee knew on 11 November 2021 that certain trades were being given a future-dated clearing date by the Trader. However, the combination of the lack of a control process to validate trades with a future-dated clearing date and the lack of robust challenge within the control resulted in the Trader continuing the Fictitious Trading undetected for a further three months.
- 4.17. Of further concern to the Authority is that these design issues had been identified by MBL prior to the start of the Fictitious Trading. However, the processes were largely unchanged and MBL failed to implement adequate systems.

CABs reporting and monitoring

- 4.18. The purpose of the CABs control, operated by CGM's Business Operational Risk Management team ("BORM"), was to effectively monitor CABs for unusual activity. Where unusual or recurring patterns were identified, these should have been escalated for further investigation.
- 4.19. A significantly high number of amended trading entries generated by a trader should have led to further escalation and investigation into what was causing a high concentration of CABs entries from them.
- 4.20. During the Relevant Period, CMF supervisors would receive a weekly email from BORM containing a report showing that week's CABs ("the weekly CABs email"). The cover email would break down the total number of CABs into three categories: (i) explained by logic, (ii) explained by BORM; and (iii) requiring explanation from a senior member of staff. A spreadsheet provided the underlying data.
- 4.21. The spreadsheet in the weekly CABs email included thousands of lines of CABs data which meant that it was not practical for the CMF supervisors to review. They therefore relied on the summary table provided at the top of the email breaking the CABs down into the three categories described above.

- 4.22. Between April 2020 and May 2021, certain trades, including exchange cleared futures trades, were subject to "*exclusion rules*" and were therefore entirely excluded from the summary table in the weekly CABs email. From May 2021, exchange cleared futures trades were included in the weekly CABs email spreadsheet, but they were subject to "*auto-explain rules*". These auto-explain rules were applied according to the flawed reasoning that these trades were thought to be subject to the MOD EOD futures reconciliation process and thereby automatically explained as having an "*internal counterparty*". As such, exchange cleared futures trades were included in the data, but never highlighted in the summary table.
- 4.23. The summarised CABs information also failed to consider trends or concentration in events to be able to effectively identify suspicious or unauthorised trading activity. This meant the system was ineffective to spot any suspicious activity as it required CMF supervisors to review thousands of lines of CABs data and look for trends.
- 4.24. Contributing to the continued ineffectiveness of this CAB reporting control during the Relevant Period was the poorly functioning CAB Review Committee (the "CAB Committee"). The CAB Committee was set up in June 2020 as a result of issues being identified with CABs reporting through Project Papa. The aim of this committee was to provide a governance forum to monitor and manage risks associated with CABs. In accordance with its Terms of Reference, the CAB Committee was required to meet quarterly and was required to sign off on CAB rules annually.
- 4.25. The CAB Committee did not adequately respond to issues identified above in relation to CAB reporting. An example of an inadequate response was the fact that it failed to meet regularly as required. In November 2020, despite there still being outstanding action points and unanswered questions regarding the effectiveness of the MOD EOD futures reconciliation process as a compensating control, the CAB Committee approved a provisional set of rules which included the CAB exclusion and auto-explain rules identified in paragraph 4.22 above as contributing to the deficiency in CAB reporting. The CAB Committee also failed to discuss the presentation and content of CAB reports sent to CMF supervisors.
- 4.26. The poor design of this CABs control, and the failure of the CAB Committee to mitigate the risk of the identified issues, crystallised with the Trader concealing

the Fictitious Trading. The Trader repeatedly amended the clearing date of their fictitious trades, which generated a significantly high number of CABs; the Trader was responsible for 9,269 CABs out of 13,311 total CABs for the entire Bulks Desk and therefore accounted for 70% of the Bulk Desk's total CABs between June 2020 and December 2021. However, this concentration was not noticed because exchange cleared CABs were not in the CAB report at all until May 2021 and then, even when they were captured, they were not highlighted. The deficiencies in the control therefore enabled the Fictitious Trading to remain undetected for 20 months.

Broker Quote Verification

- 4.27. Within the Metals and Bulks Trading Desk (and other MBL business areas) broker-provided volatility curves quotes were required to value trading positions. If working effectively, the Independent Valuation Team's ("IVT") independent broker quotes control should have ensured that market quotes were either independently sourced, or independently tested by the IVT where the quotes were sourced by the traders.
- 4.28. The objective of this control was to ensure the integrity of production marks and prevent key risks including valuation error or fraud and financial or risk misstatement.
- 4.29. A lack of robust processes in place to ensure the independent verification of broker quotes by the IVT led to certain members of the IVT obtaining volatility curves quotes directly from the Trader without subsequent verification. The Trader was able to submit false market quotes to the IVT to further facilitate the Fictitious Trading by making his positions appear more profitable than they were and further conceal his loss-making positions.
- 4.30. Certain members of the IVT did not source all the rates independently and did not always independently test or review the rates provided by traders. In relation to the Trader, this resulted in the falsification of quotes going undetected throughout the Relevant Period. From June 2020 to January 2022, the Trader was able to circumvent the independent testing requirement by simply providing 46 falsified quotes directly to the IVT (this was 63% of the total quotes provided by the Trader). The falsification took the form of altering the figures to give a false impression of the market prices for that period of time. On some occasions in

addition to this, the Trader manually changed the date the quote had been received from the broker and removed months of data manually before forwarding on to the IVT. As a direct result of falsifying the quotes, the book was incorrectly valued. On detection, when the Trader's positions were closed out in February 2022, differences between some recorded marks and the actual market rates resulted in a loss to MBL of USD 1.3million.

Risk management and assurance framework - Risk and Control Self-Assessment

- 4.31. If functioning effectively, the RCSA process should identify, measure and monitor risks consistently and comprehensively to facilitate prioritisation and management of risks within MBL's risk management framework.
- 4.32. Prior to the discovery of the Fictitious Trading, weaknesses in controls relevant to unauthorised trading had been identified in the RCSA process. These included weaknesses relevant to the EOD futures reconciliation process, CAB reporting and P&L analysis in the Relevant Period.
- 4.33. There were issues with how RCSA risk entries were recorded, such as aggregating multiple controls into one issue and not containing detailed descriptions of the relevant underlying activities, which reduced MBL's ability to measure and monitor the risks adequately. The RCSA process was ineffective in ensuring the identified risks were effectively measured, prioritised and managed. This contributed to the delay in the detection of the Fictitious Trading.

Risk management and assurance framework – Governance of Project Papa

- 4.34. Project Papa was implemented in response to two external reviews which concluded in December 2019 and January 2020 (the latter being a Skilled Person Review) that raised issues in relation to MBL's controls to prevent and detect unauthorised trading. Each review made recommendations for enhancements to MBL's trading controls and Project Papa was designed to address those recommendations.
- 4.35. Part of the role of the IAD aspect of MBL's risk framework is to provide independent and objective risk-based assurance on the compliance with, and effectiveness of, MBL's financial and risk management framework. This includes assessing whether key internal controls have been properly designed and are

operating effectively and sustainably to mitigate material risks. In February 2020, as part of a wider audit process, IAD identified issues relevant to those identified in MBL's investigation into the Fictitious Trading. These included Front Office trading supervision issues which referenced supervisory oversight, CABs and P&L reviews. IAD also identified gaps in CAB reporting resulting in a lack of effective oversight, including the absence of trending analysis being provided to CMF supervisors to assist with identifying unauthorised trading. A number of these issues corresponded with findings from the earlier reviews. As a result, the findings from IAD were taken up into Project Papa.

- 4.36. However, there were multiple issues with the governance arrangements for Project Papa including that the governance structure and resourcing model was inappropriate for a highly complex project of that type. Examples include the project having limited dedicated resources, an absence of resources from diverse skill sets, an underutilisation of project management disciplines, and a lack of clearly defined terms of reference to set out the holistic overall plan including the primary objective of the project, decision making arrangements and escalation criteria.
- 4.37. Further, there was a lack of assurance activities for Project Papa, including a lack of a clear methodology on how IAD would approach active monitoring of the progress of the project. IAD did not undertake formal assurance work of Project Papa until September 2021, which culminated in a report in January 2022. As a result, it failed to identify key risks to the project at a critical stage of its establishment.
- 4.38. As a result of the inappropriate governance, resourcing and assurance arrangements, actions within Project Papa relevant to the Fictitious Trading were not prioritised or delivered to the required depth and breadth to adequately mitigate the risk of unauthorised trading, including preventing or detecting the Fictitious Trading. Had the actions been adequately prioritised and delivered, it is likely that the Fictitious Trading would have been detected much earlier than it ultimately was.

Events post discovery of the Fictitious Trading

- 4.39. Following an internal investigation by MBL and reviews of the relevant systems and controls environment, several senior members of staff had their profit share

reduced and remediation activity was initiated by MBL. Remediation processes included, but were not limited to:

- a. Implementing a tactical exchange trade monitoring process within the CMF division and the Fixed Income and Currencies division specifically to address the deferred clearing date vulnerability in MTS;
- b. Materially reducing market risk limits for the assets in question;
- c. the IVT re-affirming its processes to ensure all broker rates are sourced directly from brokers with exceptions escalated to the Business Rates Committee; and
- d. the CAB Committee reconvening in March 2022.

5. FAILINGS

- 5.1. The regulatory provisions relevant to this Notice are referred to in Annex A.

Breach of Principle 3

- 5.2. Principle 3 of the Authority's Principles for Businesses states as follows:

A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

- 5.3. MBL breached Principle 3 because it did not take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular:

- a. The PC Team's daily P&L reporting process which was in place to monitor and investigate discrepancies in a trader's P&L estimates, was ineffective and failed to identify and deal with discrepancies.
- b. The EOD futures reconciliation process failed to ensure that breaks in the reconciliation process were adequately managed. The design of the control was also deficient as it excluded trades with future clearing dates, with the result that such trades avoided scrutiny by this system.

- c. The CAB reporting control was deficient in its design and relied on a flawed EOD reconciliation process as a compensating control. As a result, this control failed to adequately report on exchange cleared futures trades. The failures in this control were exacerbated by the poor functioning of the CAB Committee that had been set up to manage risks associated with CABs.
 - d. The process in place for independent verification of broker quotes was insufficient to prevent the use of unverified and falsified quotes. The same Trader responsible for the Fictitious Trading was able to submit falsified broker quotes against which the profitability of their positions was assessed.
- 5.4. In addition to the failings set out above, the Authority considers that there were further failings in MBL's risk management framework that contributed to the continuation of the deficiencies in MBL's systems and controls referred to in paragraph 5.3 above. In summary:
- a. RCSA failed to adequately measure and monitor the risks identified in EOD futures reconciliations, CAB reporting and P&L analysis in the Relevant Period. Contributing factors to this failure included how RCSA risk entries were recorded, such as aggregating multiple controls into one issue and not containing detailed descriptions of the relevant underlying activities; and
 - b. MBL failed to ensure that Project Papa had appropriate governance arrangements in place to deliver the project's outcomes effectively. In particular, the governance structure, resourcing model and assurances processes were not appropriate for the project. Had the recommended enhancements to MBL's systems and controls in Project Papa been implemented, the ineffective systems and controls would have been resolved and the Fictitious Trading would likely have been identified earlier.

The Authority's view of the breaches

- 5.5. Notwithstanding that the Fictitious Trading had no market impact, the Authority considers these breaches to be serious. It is of fundamental importance that a firm has effective oversight of its traders and can accurately assess trading positions and corresponding P&L. The systems and controls in this case were ineffective to the extent that a relatively junior trader was able to identify them

and take steps to avoid the Fictitious Trading being detected over a 20-month period. The deficiencies in the systems and controls left MBL without proper oversight and control of trading activity within the Metals and Bulks Trading Desk. It is also of fundamental importance that firms have risk management frameworks that appropriately identify, measure and monitor the risks a firm is exposed to. This extends to ensuring that projects seeking to remediate systems and controls issues have effective governance frameworks and appropriate resourcing models, with timely assurance performed over them. MBL's failures in its risk management framework contributed to the continuation of the deficiencies in MBL's systems and controls.

6. SANCTION

Financial penalty

- 6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

Step 1: disgorgement

- 6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.3. The Authority has not identified any financial benefit that MBL London Branch derived directly from this breach.
- 6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.5. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where 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, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

- 6.6. The Authority considers that the gross revenue generated by trading activity undertaken in MBL's London Branch by the Metals and Bulks Trading Desk is indicative of the harm or potential harm caused by MBL's breach. The Authority has therefore determined that the relevant revenue is the revenue of the Metals and Bulks Trading Desk, generated by trading activity originating from the London Branch, during the period of the breach, June 2020 to February 2022. This is because MBL's breaches relates to the deficient systems and controls which did not adequately detect and mitigate the risk of unauthorised trading within trading on the Metals and Bulks Trading Desk, and the risk management framework failings which contributed to the continuation of the deficiencies.
- 6.7. The Authority considers the relevant revenue generated by trading activity originating from the London Branch of MBL's Metals and Bulks Trading Desk for this period is £65,320,714.
- 6.8. In deciding on the percentage of the relevant revenue that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses 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:
- Level 1 – 0%
 - Level 2 – 5%
 - Level 3 – 10%
 - Level 4 – 15%
 - Level 5 – 20%
- 6.9. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. The Authority considers the following factors to be relevant:

DEPP 6.5A.2G(11)(b) - Serious or systemic weaknesses in the management systems or internal controls relating to all or part of the firm's business

- 6.10. The breach revealed serious deficiencies in the systems and controls relating to the Metals and Bulks Trading Desk and MBL's risk management framework.

DEPP 6.5A.2G(11)(d) - the breach created a significant risk that financial crime would be facilitated, occasioned or otherwise occur

- 6.11. MBL London Branch failed to take reasonable care to establish, implement and maintain adequate and effective systems and controls to mitigate the risk that its employees would undertake unauthorised trading and where such unauthorised trading was carried out, to detect the trading in a timely manner. The failure to mitigate the risks of unauthorised trading extended to the risks of financial crime being occasioned.

DEPP 6.5A.2G(12)(a) - little, or no, profits were made or losses avoided as a result of the breach, either directly or indirectly

- 6.12. The Fictitious Trading was not visible externally to MBL. The fictitious trades appeared on MBL's internal systems as exchange-listed trades but they had no corresponding external exchange position. There was no effect on the markets as a result of the Fictitious Trading. MBL suffered a loss as a result of unwinding the Fictitious Trading which amounted to approximately USD 57.8 million.

- 6.13. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 15% of £65,320,714.

- 6.14. Step 2 is therefore £9,798,107.10.

Step 3: mitigating and aggravating factors

- 6.15. Pursuant to DEPP 6.5A.3G, at Step 3 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.

- 6.16. The Authority considers that the following factor aggravates the breach:

DEPP 6.5A.3G(2)(i) whether the FCA 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.

6.17. The Authority informed firms of the risk of unauthorised trading in two Market Watch Bulletins in 2008 and the importance of establishing, implementing and maintaining adequate systems and controls to mitigate the risk that unauthorised trading could be undertaken and where such misconduct occurred, to detect unauthorised trading in a timely manner.

6.18. The Authority considers that the following factor mitigates the breach:

DEPP 6.5A.3G(2)(b) the degree of cooperation the firm showed during the investigation of the breach by the FCA, or any other regulatory authority allowed to share information with the FCA.

6.19. MBL has consistently displayed a high level of cooperation during this investigation (and this has extended into how it conducted itself during settlement). It notified the Authority immediately after discovering the Fictitious Trading; responded promptly and fully to all the Authority's information requirements without creating obstacles to the provision of the information; and it proactively brought additional information to the Authority's attention. MBL commissioned, and promptly shared with the Authority, internal investigation reports which looked at the root causes of the Fictitious Trading, including a review of its unauthorised trading controls. MBL has not asserted privilege over any material. MBL's cooperation has saved the Authority significant time and resource.

6.20. Having taken into account these aggravating and mitigating factors, the Authority considers that the Step 2 figure should be decreased by 5%.

6.21. Step 3 is therefore £9,308,201.75.

Step 4: adjustment for deterrence

6.22. Pursuant to DEPP 6.5A.4G, 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.

- 6.23. The Authority considers that the Step 3 figure of £9,308,201.75 is too small to meet its objective of credible deterrence and it is likely that similar breaches will be committed by the Firm or other firms in the future in the absence of an increase to the penalty.
- 6.24. In making this assessment, the Authority has considered the nature of the misconduct, the impact of the misconduct, and the size and financial resources of the Firm. In relation to the nature of the misconduct, combatting financial crime is one of the Authority's key priorities, and that includes the expectation that firms defend themselves against financial crime. MBL failed to adequately mitigate the risk of unauthorised trading, which included failing to prevent or detect the Fictitious Trading. The Authority has published various materials on combatting financial crime for a number of years now and, as a result, imposed substantial penalties on regulated firms for ineffective systems and controls for preventing financial crime. A failure to impose a significant penalty for breaches of this nature, may cause firms to consider that having robust systems and controls, and appropriately governed, resourced remediation programmes, with adequate levels of assurance, are not of significant importance to the Authority.
- 6.25. The Authority considers that a multiplier of two should be applied at Step 4.
- 6.26. Step 4 is therefore £18,616,403.49.

Step 5: settlement discount

- 6.27. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, 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 reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.28. The Authority and MBL London Branch reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.
- 6.29. Step 5 is therefore £13,031,400 (rounded down to the nearest £100).

Penalty

- 6.30. The Authority hereby imposes a total financial penalty of £13,031,400 on MBL London Branch for breaching Principle 3.

7. PROCEDURAL MATTERS

- 7.1. This Notice is given to MBL London Branch under and in accordance with section 390 of the Act.

- 7.2. The following statutory rights are important.

Decision maker

- 7.3. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

Manner and time for payment

- 7.4. The financial penalty must be paid in full by MBL to the Authority no later than 2 December 2024.

If the financial penalty is not paid

- 7.5. If all or any of the financial penalty is outstanding on 3 December 2024, the Authority may recover the outstanding amount as a debt owed by MBL and due to the Authority.

Publicity

- 7.6. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the Authority must publish such information about the matter to which this Notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.
- 7.7. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contacts

- 7.8. For more information concerning this matter generally, contact Hayley England-Secker at the Authority (direct line: 020 70660832; email: Hayley.England-Secker@fca.org.uk).

Allegra Bell

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1. RELEVANT STATUTORY PROVISIONS

- 1.1 The Authority's statutory objectives, set out in section 1B(3) of the Act, include the integrity objective.
- 1.2 The Authority has the power to impose an appropriate penalty on an authorised person if the Authority considers that an authorised person has contravened a relevant requirement (section 206 of the Act).
- 1.3 Section 206(1) of the Act provides:

"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act... it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate."

2. RELEVANT REGULATORY PROVISIONS

Principles for Businesses

- 2.1 The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant Principle is as follows.
- 2.2 Principle 3 provides:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems".

Other Relevant Regulatory Provisions

- 2.3 In exercising its powers to impose a financial penalty, the Authority has had regard to the relevant regulatory provisions published in the Authority's Handbook. The Handbook provisions relevant in this matter are the Principles, the Decision Procedure and Penalties Manual (DEPP) and the Enforcement Guide (EG).

- 2.4 Chapter 6 of DEPP sets out the Authority's policy for imposing a financial penalty. For conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies to financial penalties imposed on firms. The conduct that is the subject matter of this Notice took place after 6 March 2010.
- 2.5 EG sets out the Authority's approach to taking disciplinary action. The Authority's approach to financial penalties is set out in Chapter 7 of EG.