
FINAL NOTICE

To: Commerzbank AG

Of: 30 Gresham Street, London EC2P 2XY

Dated 27 April 2010

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) gives you final notice about a requirement to pay a financial penalty:

1. THE PENALTY

- 1.1. The FSA gave Commerzbank AG (the “Firm”) a Decision Notice on 22 April 2010 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA had decided to impose a financial penalty of £595,000 on Commerzbank, in respect of breaches of rules set out in chapter SUP 17 of the FSA Handbook, which occurred between 5 November 2007 and 20 November 2009 (“the Relevant Period”).
- 1.2. Commerzbank is an incoming EEA branch passporting into the UK under Article 32 of the MiFID Directive. Commerzbank is authorised by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), the German regulator. The FSA is taking action in accordance with the jurisdictional powers assigned to it in Article 32(7) of the MiFID Level 1 Directive. The FSA takes no action in respect of Commerzbank’s systems and controls (which are a matter for the home state regulator under MiFID).

- 1.3. The Firm has confirmed that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.4. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on the Firm in the amount of £595,000.
- 1.5. This penalty is discounted by 30% pursuant to Stage 1 of the early settlement discount scheme. Were it not for this discount, the FSA would have imposed a financial penalty of £850,000 on Commerzbank.

2. REASONS FOR THE ACTION

Summary

- 2.1. Accurate and complete transaction reporting is essential to enable the FSA to meet its statutory objectives of maintaining market confidence and reducing financial crime. The primary function for which the FSA uses transaction reports is to detect and investigate suspected market abuse, insider trading and market manipulation.
- 2.2. A transaction report is a data set submitted to the FSA relating to an individual financial market transaction which includes (but is not limited to) details of the product traded, the firm that undertook the trade, the trade counterparty and the trade characteristics such as buy/sell identifier, price and quantity.
- 2.3. In the Relevant Period Commerzbank breached rules contained in Chapter 17 of the Supervision Manual, which is part of the FSA Handbook (SUP 17) in that it failed to submit correct transaction reports in respect of approximately 1.03 million transactions, an estimated 94% of the Firm's reportable transactions during that period.
- 2.4. The FSA considers these failings to be serious because:
 - (1) the errors affected almost all of Commerzbank's reportable transactions during the Relevant Period, across all of its asset classes, and took place over a period of two years;
 - (2) despite individuals within Commerzbank being aware from MiFID implementation of shortcomings in the Firm's transaction reporting system (Mitre), these issues were not escalated to management. Nor was any action taken in response to requests by the FSA that the Firm carry out internal checks, following the FSA's discovery of errors in the Firm's data. The individuals aware of the shortcomings and the FSA's requests did not appreciate the regulatory implications resulting, and the urgency with which the Firm should have addressed those issues. As a result the Firm did not begin to address the deficiencies until it decided to carry out

a review of transaction reporting in January 2009, and reported on that review in June 2009;

- (3) Commerzbank's failure to submit accurate transaction reports could have a serious impact on the FSA's ability to detect and investigate suspected market abuse and consequently could affect the FSA's ability to maintain market confidence and reduce financial crime. In addition, the failures have impaired the FSA's ability to provide accurate transaction reporting data to overseas regulators; and
 - (4) Commerzbank's failures occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of the Markets in Financial Instruments Directive ("MiFID") and public statements by the FSA.
- 2.5. Commerzbank took a number of steps after errors were identified by the FSA and the Firm which mitigate the seriousness of the failings. These include:
- (1) carrying out a review of the Firm's transaction reporting arrangements and producing a report in June 2009;
 - (2) producing a more detailed report in August 2009 to answer the transaction reporting concerns which the FSA raised with Commerzbank during a meeting to discuss the findings from the June 2009 report;
 - (3) allocation of substantial resources to rectify the Firm's transaction reporting architecture and misreporting after the review was carried out; and
 - (4) cooperating fully with the FSA in the course of its investigation.

Relevant statutory and regulatory provisions

- 2.6. The FSA is authorised pursuant to section 206 of the Act, if it considers that an authorised person has contravened a requirement imposed on him by or under the Act, to impose on him a penalty in respect of the contravention, of such amount as it considers appropriate.
- 2.7. Maintaining market confidence and the reduction of financial crime are statutory objectives for the FSA under section 2(2) of the Act.
- 2.8. The transactions which are required to be reported to the FSA are defined in SUP 17.1.4R which states:

"A firm which executes a transaction:

- (1) *in any financial instrument admitted to trading on a regulated market or a prescribed market (whether or not the transaction was carried out on such a market); or*
 - (2) *in any OTC derivative the value of which is derived from, or which is otherwise dependent upon, an equity or debt-related financial instrument which is admitted to trading on a regulated market or on a prescribed market;*
- must report the details of the transaction to the FSA.”*

2.9. The time period for making reports is stipulated in SUP 17.2.7R:

“A firm must report the required details of the transaction to the FSA as quickly as possible and by not later than the close of the working day following the day upon which that transaction took place.”

2.10. SUP 17.4.1EU provides:

“Reports of transactions ...shall contain the information specified in SUP 17 Annex 1 EU which is relevant to the type of financial instrument in question and which the FSA declares is not already in its possession or is not available to it by other means.”

2.11. SUP 17.4.2R provides:

“The reports referred to in SUP 17.4.1 ... shall, in particular include details of the names and the numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the firms concerned.”

2.12. Annex 1 to SUP 17 provides lists of fields and mandatory information to be provided as the minimum content of a transaction report.

2.13. The FSA’s approach to exercising its enforcement powers is set out in the Decision Procedure & Penalties Manual (“DEPP”) and Enforcement Guide (“EG”).

Facts and matters relied upon

Background

2.14. SUP 17 requires transaction reports containing mandatory details to be submitted to the FSA by the end of the next business day following the day on which the firm entered into the transaction. At the end of each working day, transaction reports received by firms are loaded onto the FSA’s transaction monitoring system.

- 2.15. The implementation of MiFID across all European Economic Area (“EEA”) Member states on 1 November 2007 (effective on 5 November for transaction reporting) introduced changes to the list of products in which transactions had to be reported and standardisation of the list of fields which were required to be included in the reports. SUP 17 was amended from 1 November 2007 to reflect these changes. Whilst the changes required to be implemented by firms were significant in respect of their MiFID transaction reporting obligations the mandatory content of the transaction reports for many products remained largely unaffected by the MiFID changes.
- 2.16. The FSA has provided regular and detailed information to firms in its “Market Watch” publication on transaction reporting issues prior to and during the Relevant Period. In order to assist firms with transaction reporting generally and with respect to changes introduced by MiFID, the FSA issued a Transaction Reporting User Pack (TRUP) in July 2007.
- 2.17. Reminders were given by the FSA in Market Watch in March 2007 and June 2008 (Issues 19 and 28 respectively) and TRUP, that firms should regularly review the integrity of transaction report data.
- 2.18. Issue 28 of the Market Watch in June 2008 stated:

“Firms must report transactions to us accurately to help us monitor for market abuse and maintain market confidence. Accuracy in transaction reports also reduces the number of requests for clarification that we need to make to firms.

Therefore, we encourage all firms to review the integrity of their transaction report data regularly. Our Transaction Monitoring Unit is happy to provide firms a sample of reports we have received so that firms can check those transaction reports against their own records...

We will be undertaking regular reviews of the quality and completeness of firms’ submissions. We expect firms now to be fully compliant with the transaction reporting requirements set out in SUP 17. Where we identify problems with transaction reporting we will consider the use of our enforcement tools. In doing so, we will take into account the appropriateness of the firm’s systems and controls, including its monitoring programme around transaction reporting.”

The Commerzbank MiFID implementation project

- 2.19. As a branch of an EEA authorised firm Commerzbank was not required to comply with the FSA transaction reporting requirements prior to MiFID. Commerzbank’s Group MiFID project was run out of Germany and comprised designated business line teams responsible for implementing the changes required by MiFID. Local teams were also set up, including one in London (the “London MiFID project

- team”). The London MiFID project team formed MiFID sub-projects including a London MiFID transaction reporting sub-group.
- 2.20. In July 2007, at a relatively late stage of the Group MiFID project, the London MiFID project team identified that, contrary to its understanding and expectations based on the Group MiFID project’s Terms of Reference, the Firm’s FSA transaction reporting arrangements had not been addressed by the Frankfurt Central MiFID project team. Up to this point, the London MiFID project team assumed that a central solution was being developed by the Group MiFID project team, although no attempt had been made to obtain progress updates as part of the London MiFID project team’s monthly meetings since December 2006.
- 2.21. When the London MiFID project team identified the issue, the transaction reporting sub-group started to define and build a Transaction Reporting system, called Mitre, to meet the new regulatory requirements. The majority of transaction reporting problems which arose during the Relevant Period resulted from deficiencies in the Mitre build, including the following:
- (1) the requirements to which Mitre was built were inaccurate and not approved by the designated reviewers prior to implementation of them; as a result Mitre was built without adequate functionality to ensure the full inclusion of reportable transactions and the accuracy of reports; and
 - (2) User Acceptance Testing conducted in respect of Mitre did not check for the completeness and accuracy of the transaction reporting data sent to the FSA against the SUP 17 requirements.
- 2.22. Individuals within the London MiFID transaction reporting sub-group were aware following User Acceptance Testing that approximately 30% of transaction reports submitted by the Firm would be rejected. At MiFID implementation the Firm did not have a satisfactory method of correcting and resubmitting these rejected reports.
- 2.23. The transaction reporting errors which occurred during the Relevant Period were in part attributable to a lack of involvement and technical challenge from the Compliance department in the build of Mitre.

Inadequate transaction reporting process post-MiFID implementation

- 2.24. The breaches of SUP 17 continued throughout the Relevant Period, due in part to the following factors:
- (1) Commerzbank viewed transaction reporting as an area of low risk. It was therefore not subject to the detailed risk assessments, reviews and monitoring that other areas were;

- (2) at the start of the Relevant Period approximately 30% of the transaction reports submitted by Commerzbank each day were automatically rejected due to errors, and returned to the Firm. The transaction reporting sub-group attempted to resolve these errors manually and through system upgrades over the following months. This resulted in some reduction in the numbers of rejections, though without resubmitting the rejected transactions to the FSA on a timely basis. This led to a backlog of rejected transaction reports that were not reported or were reported late by the Firm. The backlog continued to grow for eight months after MiFID implementation, and it persisted until the end of the Relevant Period;
- (3) there was considerable delay in resolving the issue of rejections due to a lack of appreciation of the importance of transaction reporting, and consequent failure to escalate to Compliance and management;
- (4) Commerzbank did not implement any formalised, regular transaction reporting monitoring until December 2008. This was despite the FSA's encouragement to carry out monitoring in Market Watch Issues 19 and 28 and TRUP and the FSA's stated willingness to provide firms with sample reports so that firms could check those transaction reports against their own records. Had the Firm monitored its transaction reporting submissions, it could have established the extent of the errors earlier in the Relevant Period; and
- (5) in August and September 2008 Commerzbank requested extracts from the FSA of the data that the Firm had submitted. The FSA supplied this data and noted that it contained a number of anomalies, including the use of internal codes for the Counterparty field and a zero unit price for some transactions. The FSA requested that Commerzbank check its records and address these anomalies as soon as possible. On both occasions the requests were not treated with the required seriousness and urgency and were not escalated to Compliance or management. As a result the Firm took no substantive action at the time.

Identification of transaction reporting problems

- 2.25. In December 2008 Commerzbank identified that transactions submitted since June 2008 had been reported incorrectly with the buy/sell indicator reversed. The Firm reported the error to the FSA and arranged for the resubmission of all affected transactions.
- 2.26. In January 2009, those involved in Mitre improvement projects decided to carry out a review of known transaction reporting issues (including those identified by the FSA in August and September 2008) and necessary remedial action.

- 2.27. Commerzbank informed the FSA that this work was underway during the ARROW risk assessment in March 2009, and the FSA requested a full report into Commerzbank's transaction reporting arrangements in the Risk Mitigation Programme issued following the visit.
- 2.28. In May 2009 an interim presentation was made to management which specified ten main transaction reporting issues, including the large queue of rejected transactions which the Firm had not resubmitted to the FSA.
- 2.29. In June 2009, the outcome of the above transaction reporting review, which in total encompassed 35 transaction reporting issues, was communicated to Compliance and management and shortly afterwards to the FSA. These issues related to transaction reports not being submitted to the FSA, a failure to manage and resubmit transactions which were sent to the FSA and subsequently rejected, and the submission of transactions with inaccuracies as set out in more detail below.
- 2.30. In late June 2009 during a meeting between the FSA and Commerzbank regarding the Firm's June 2009 review, the FSA requested further information regarding the June 2009 review, including why the transaction reporting errors had occurred, and in particular why transaction reports which were sent to the queue of rejected transactions were not addressed. In response to the FSA's requests, Commerzbank provided a further report to the FSA in August 2009.

Description of transaction reporting problems

- 2.31. Commerzbank failed to report transactions to the FSA in instances where transaction reports were incorrectly filtered by Mitre and therefore not submitted to the FSA. In particular:
 - (1) some Commerzbank London trading books were incorrectly flagged as Frankfurt trading books and therefore not identified for FSA reporting purposes;
 - (2) all futures were assumed to be reported by the relevant exchange and thus not reported by the Firm; and
 - (3) not all of the Commerzbank systems were generating Market Identifier Codes (MICs) for the Venue Identification field in transaction reports, and some systems were generating non-MICs which resulted in these transaction reports failing validation and thus not being submitted to the FSA.
- 2.32. Some transaction reports were rejected due to errors in reporting fields. Commerzbank placed these transaction reports in a queue of rejected transactions

and did not resolve and resubmit them on a timely basis or in some cases at all, during the Relevant Period.

2.33. Other errors that resulted in inaccurate reporting to the FSA included:

- (1) the use of multiple internal codes for the same counterparties so that it was not possible for the FSA to allocate individual transactions to the same client;
- (2) incorrectly reporting the time field, and
- (3) incorrectly populating the Unit Price field.

Analysis of Breaches

Breaches of SUP 17

2.34. During the Relevant Period Commerzbank was in breach of SUP 17.1.4 R since it failed to report transactions either because transaction reports were incorrectly filtered by Mitre and therefore not submitted to the FSA, or transaction reports were submitted and returned with errors:

Description	Estimated Number of transactions <i>not reported</i> in the Relevant Period
Transactions incorrectly filtered out by Mitre	67,122
Transactions returned to the rejections queue and not resolved	47,485
Total number of transactions not reported in the Relevant Period	114,607
Percentage of reportable transactions not reported in the Relevant Period	10%

2.35. During the Relevant Period Commerzbank was in breach of SUP 17.4.1 EU because the Firm inaccurately reported transactions:

Description	Estimated Number of transactions <i>inaccurately reported</i> in the Relevant Period
Total number of transactions	919,787

inaccurately reported due to data field completion errors in the Relevant Period	
Percentage of reportable transactions inaccurately reported in the Relevant Period	84%

2.36. Overall Commerzbank failed to report or misreported approximately 94% of its reportable transactions in the Relevant Period.

3. SANCTION

3.1. The FSA's policy on the imposition of financial penalties and public censures is set out in DEPP and EG. In determining the financial penalty, the FSA has had regard to this guidance. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.

3.2. The FSA considers that the seriousness of this matter merits the imposition of a significant financial penalty.

3.3. The FSA has had regard to the following factors:

- (1) the errors affected almost all of Commerzbank's reportable transactions during the Relevant Period, across all of its asset classes, and took place over a period of two years;
- (2) despite individuals within Commerzbank being aware from MiFID implementation of shortcomings in the Firm's transaction reporting system (Mitre), these issues were not escalated to management. Nor was any action taken in response to requests by the FSA that the Firm carry out internal checks, following the FSA's discovery of errors in the Firm's data. The individuals aware of the shortcomings and the FSA's requests did not appreciate the regulatory implications resulting, and the urgency with which the Firm should have addressed those issues. As a result the Firm did not begin to address the deficiencies until it decided to carry out a review of transaction reporting in January 2009, and reported on that review in June 2009;
- (3) Commerzbank's failure to submit accurate transaction reports could have a serious impact on the FSA's ability to detect and investigate suspected market abuse and consequently could affect the FSA's ability to maintain market confidence and reduce financial crime. In addition, the failures

have impaired the FSA's ability to provide accurate transaction reporting data to overseas regulators; and

- (4) Commerzbank's failures occurred during a period of heightened awareness around transaction reporting issues as a result of the implementation of the Markets in Financial Instruments Directive ("MiFID") and public statements by the FSA.
- 3.4. The FSA has also had regard to the following steps taken by Commerzbank which mitigate the seriousness of its failings:
- (1) carrying out a review of the Firm's transaction reporting arrangements and producing a report in June 2009;
 - (2) producing a more detailed report in August 2009 to answer the transaction reporting concerns which the FSA raised with Commerzbank during a meeting to discuss the findings from the June 2009 report;
 - (3) allocation of substantial resources to rectify the Firm's transaction reporting architecture and misreporting after review was carried out; and
 - (4) cooperating fully with the FSA in the course of its investigation.

4. CONCLUSIONS

- 4.1. The FSA considers in all the circumstances that the seriousness of the breaches merits a financial penalty. In determining the financial penalty the FSA has considered the need to deter Commerzbank and other firms from committing similar breaches. The FSA has also had regard to penalties in other similar cases.
- 4.2. The FSA considers that a financial penalty of £850,000 is appropriate, discounted to £595,000 after the applicable Stage 1 discount for early settlement.

5. DECISION MAKERS

- 5.1. The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers on behalf of the FSA.

6. IMPORTANT

- 6.1. This Final Notice is given to the Firm in accordance with section 390 of the Act.

Manner of and time for Payment

- 6.2. The financial penalty must be paid in full by the Firm to the FSA by no later than 11 May 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 6.3. If all or any of the financial penalty is outstanding on 12 May 2010, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

Publicity

- 6.1. 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 FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.
- 6.4. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate..

FSA contacts

- 6.5. For more information concerning this matter generally, Commerzbank should contact Celyn Armstrong (020 7066 2818) at the FSA.

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Tracey McDermott

Head of Department

FSA Enforcement and Financial Crime Division