FINANCIAL CONDUCT AUTHORITY

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FINAL NOTICE

To:	**Interactive Brokers (UK) Limited**
Address:	**Level 20 Heron Tower** **110 Bishopsgate** **London** **EC2N 4AY**
Firm Reference Number:	**208159**
Date	**25 January 2018**

1. ACTION

1.1 For the reasons given in this Notice, the Authority hereby imposes on IBUK a financial penalty of £1,049,412, pursuant to section 206 of the Act.

2. SUMMARY OF REASONS

2.1 The Authority has decided to take this action because IBUK breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems in relation to the detection and reporting of potential instances of market abuse from 6 February 2014 to 28 February 2015 (inclusive).

2.2 This heightened the risk of IBUK failing to submit suspicious transaction reports ("STRs") to the Authority in accordance with the rules in SUP 15.10. During the Relevant Period, prior to being notified of the Authority's concerns, IBUK failed to submit any STRs in relation to insider dealing and the Authority has identified three occasions on which IBUK breached SUP 15.10.2R by failing to report suspicious trading by IBUK clients in advance of three separate RNS announcements.

2.3 Market abuse is serious and undermines confidence in the integrity of the UK financial services sector and, as such, detecting it is a high priority of the Authority. Firms must establish appropriate systems and controls to identify and manage the particular market abuse risks to which they are exposed.

2.4 A cornerstone of the regime in place to protect markets from abuse is the requirement on firms to identify where there are reasonable grounds to suspect market abuse has occurred and to submit STRs to the Authority. STRs are a critical source of intelligence for the Authority in identifying possible market abuse. To conduct effective monitoring for suspected market abuse, firms need appropriately designed trade monitoring systems, staff with sufficient training and guidance to make appropriate judgements about the use of those systems, and robust oversight of the process.

2.5 IBUK is an online broker which arranges and executes transactions in certain instruments directly for its UK clients, including CFDs, index futures and index options. It also executes transactions in other products, including UK stocks, stock options, bonds and warrants, on behalf of other entities in the Interactive Brokers Group.

2.6 During the Relevant Period, IBUK failed to maintain an adequate control environment in respect of market abuse. IBUK did not take reasonable care to ensure that the post-trade surveillance systems on which it relied were effective in identifying potentially suspicious transactions by its clients in that it failed to:

(1) have adequate policies and procedures in place during the Relevant Period;

(2) provide adequate input into the design and calibration of those systems;

(3) test the operation of those systems;

(4) provide effective oversight of the review of the Post-Trade Surveillance Reports, which were generated by those systems; and

(5) provide adequate guidance or training to those carrying out that review.

2.7 IBUK relied entirely on post-trade surveillance systems which were designed for the whole Interactive Brokers Group and which operated on a global basis, across multiple jurisdictions, for all Group entities. Although IBUK was entitled to use the Group systems, IBUK failed to take adequate steps to satisfy itself that potential market abuse by its clients was effectively captured by the Post-Trade Surveillance Reports, which were not tailored in any way for the specific business of IBUK.

2.8 IBUK delegated the conduct of its initial post-trade surveillance to IBLLC Compliance, a team from a US-based affiliate company. IBUK's oversight of that

team's conduct of the reviews of the Post-Trade Surveillance Reports was inadequate, and in particular it failed to monitor the quality of the reviews that were conducted. It also failed to ensure that members of the team had adequate guidance or effective training. All these failures increased the risk that potentially suspicious trading would go undetected.

2.9 As a result, IBUK was unable to identify some potentially suspicious transactions by its clients that ought to have been identifiable, had it been in compliance with its regulatory obligations.

2.10 IBUK's failure to ensure that it had appropriate systems and controls to identify and manage the particular market abuse risks to which it was exposed had direct and serious consequences, in that it failed to alert the Authority to suspicious transactions by its clients in breach of SUP 15.10.2R, on three occasions, as follows:

(1) on two occasions, the Post-Trade Surveillance Reports failed completely to identify highly profitable trading by an IBUK client in close proximity to RNS announcements, as a result of which no investigation was carried out; and

(2) on a third occasion, even though highly profitable trading in close proximity to an RNS announcement was picked up by a Post-Trade Surveillance Report, it was not investigated by IBLLC in any detail and therefore was not escalated to IBUK.

2.11 All of these occasions of crystallised risk related to possible insider dealing in one particular type of instrument: CFDs. However, IBUK's failure to oversee effectively the outsourcing of its post-trade monitoring to IBLLC undermined its ability to manage any of its market abuse risks effectively.

2.12 The Authority views IBUK's failings as serious. The Authority therefore imposes a financial penalty on IBUK in the amount of £1,049,412, pursuant to section 206 of the Act.

3. DEFINITIONS

3.1 The definitions below are used in this Notice:

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

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

"CFD" means contract for difference, an agreement between a customer and a broker, where the difference in the value of a specified asset at the beginning and end of the contract is exchanged. To trade in these products a customer need only deposit a small percentage of the value of the contract. In the case of equities, these products allow customers to speculate on share price movement without the need to purchase the underlying shares;

"Daily Stats Reports" means the Interactive Brokers Group Daily Retail Account Statistics Reports, a subset of the Post-Trade Surveillance Reports;

"DEPP" means the Decision Procedure and Penalties Manual, part of the Handbook;

"EG" means the Authority's Enforcement Guide;

"GBP" means Pounds Sterling;

"Handbook" means the Authority's Handbook of Rules and Guidance;

"IBUK" means Interactive Brokers (UK) Limited;

"IBLLC" means Interactive Brokers LLC, a subsidiary of IBG LLC based in the United States;

"IBLLC Compliance" means the team within IBLLC responsible for compliance;

"IBLLC Reviewer" means a member of IBLLC Compliance who reviewed the Post-Trade Surveillance Reports;

"Insider Trading Report" means the Interactive Brokers Group's daily Insider Trading Report, one of the Post-Trade Surveillance Reports;

"Interactive Brokers Group" or "Group" means the group of companies headquartered in Greenwich, Connecticut which conducts broker/dealer and proprietary business, which contains IBUK, its parent company IBG LLC, and other subsidiaries in the United States and other countries;

"MS&F" means the Authority's Market Surveillance and Forensics team;

"MS&F Review" means the review carried out by MS&F in late 2014 into CFD and spread bet providers and their provision of STRs, as further described in paragraph 4.5;

"Policy" means IBUK's internal document entitled "Market Abuse Directive and Market Conduct Procedures";

"Post-Trade Surveillance Reports" means the Interactive Brokers Group automatically-generated suite of reports which are intended to detect market abuse including insider dealing;

"Principle" means one of the Authority's Principles for Businesses;

"the Relevant Period" means the period from 6 February 2014 to 28 February 2015 inclusive;

"RNS" means Regulatory News Service;

"STR" means a suspicious transaction report through which (pursuant to SUP 15.10.2R) a firm, which arranges or executes a transaction for a client, and which has reasonable grounds to suspect that the transaction might constitute market abuse, must notify the Authority;

"SUP" means the Supervision Manual, part of the Handbook;

"Transaction One" means the transaction described at paragraphs 4.28 to 4.30;

"Transaction Two" means the transaction described at paragraphs 4.31 to 4.33;

"Transaction Three" means the transaction described at paragraphs 4.34 to 4.36;

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber); and

"USD" means United States Dollars.

4. FACTS AND MATTERS

Background to IBUK

4.1 IBUK is, and was during the Relevant Period, an online brokerage firm authorised by the Authority that provides its clients with a trading platform allowing them to trade on various worldwide exchanges. As an online-only brokerage firm, IBUK does not have a front office function. IBUK has approximately 31,000 retail and institutional clients.

4.2 IBUK is based in London and is part of the Interactive Brokers Group, which also includes IBLLC, a sister company incorporated in the United States which is the largest and longest-established of the trading entities within the Interactive Brokers Group.

4.3 IBUK arranges and executes transactions in certain instruments directly for its UK clients, including CFDs, exchange traded index futures and options, and certain commodities that are not exchange listed. IBUK also executes transactions in other products, for example UK stocks, stock options, bonds and warrants, on behalf of other entities in the Interactive Brokers Group.

4.4 IBUK's Compliance team during the Relevant Period comprised five individuals.

MS&F visit

4.5 In late 2014 the MS&F Review was carried out into CFD and spread bet providers and their submission of STRs. The aim of the MS&F Review was to assess firms' systems and controls for identifying market abuse and to highlight the importance of STR reporting to the Authority.

4.6 As a part of this review, on 11 December 2014, MS&F visited IBUK.

Market abuse control framework

4.7 IBUK delegated the conduct of its initial post-trade surveillance to IBLLC Compliance, so IBUK had no role in the monitoring unless a trade was specifically referred to IBUK for consideration by IBLLC Compliance. However, IBUK was responsible for ensuring that the surveillance systems operated on a global basis by IBLLC were effective in addressing the market abuse risks that IBUK was subject to, in particular in identifying potentially suspicious transactions by its clients.

Policies and procedures

4.8 IBUK's policies and procedures in relation to market abuse were set out in the Policy, drafted by IBUK. There were three versions of the Policy in place at different times during the Relevant Period, dated 10 September 2009, 27 February 2014 and 10 November 2014.

4.9 The Policy was made available to IBLLC on the Interactive Brokers Group intranet, but IBUK failed to draw it to the attention of all members of IBLLC Compliance (who were responsible for reviewing Post-Trade Surveillance Reports on IBUK's behalf). IBUK relied upon occasional emails and undocumented, ad hoc telephone conversations to follow up on the Policy and its implementation. IBUK Compliance did not carry out training or other checks to ensure IBLLC Reviewers had read and understood the Policy.

4.10 All three versions of the Policy contained sections which covered: (1) the law relating to market abuse and the seven types of market abuse behaviour as defined by section 118 of the Act; (2) IBUK's systems and operational controls; and (3) the Legal & Compliance personnel within the Interactive Brokers Group responsible for market abuse regulation. In respect of each of these three sections it is relevant to state the following:

(1) The law relating to market abuse

a) The Policy restated the law without any consideration of IBUK's own market abuse risks;

b) The Policy did not provide any IBUK-specific guidance on how to apply SUP 15.10.2R.

(2) IBUK's systems and operational controls

a) The Policy made it clear that IBLLC Compliance generated Post-Trade Surveillance Reports and would review their contents;

b) The Policy included systems and procedures that IBLLC Compliance would use for identifying potentially suspicious transactions. All three versions listed two of the Post-Trade Surveillance Reports that were to be reviewed: a "Cross Trading Report", and a daily "Insider Trading Report";

c) Additionally, for the majority of the Relevant Period, the Policy included details of "Pre-Execution Compliance Checks" that IBLLC would use, and included details of additional post-trade "Daily Stats Reports" that IBLLC would review. These reports are described in paragraph 4.16(1) below. However it was only in the version of the Policy dated 10 November 2014 that any guidance was given on how these reports should be reviewed. In particular, it provided that the IBLLC Reviewer must take into consideration the facts and circumstances of the account and trading activity involved, which might include whether the profit and loss was out of line with the account's regular pattern of trading;

d) The Policy did not describe the circumstances in which IBLLC Reviewers should escalate potentially suspicious transactions to IBUK for further consideration;

e) The Policy reflected that IBLLC Reviewers were not required to consult with IBUK, including for any "close calls";

f) The Policy reflected that IBLLC Reviewers were not required to document reviews;

g) The Policy did not include a process whereby IBUK would check the quality of the reviews and/or obtain assurances from IBLLC Compliance to ensure that effective reviews were being carried out by the IBLLC Reviewers.

(3) Legal & Compliance personnel

a) The Policy stated that IBUK personnel were responsible for "*Reporting to FSA/SOCA* [later "*FCA and/or NCA*"] *or other European regulator or legal body or authority*".

b) The Policies dated 10 September 2009 and 27 February 2014 stated that IBLLC was responsible for reporting to IBUK "*…any IBUK client issues."* The Policy dated 10 November 2014 specified members of the IBUK Compliance staff who were "*responsible for Reviewing* [sic] *individual suspicious transaction* [sic] *as reported by IBLLC Compliance*".

4.11 There is no evidence of consideration or challenge by IBUK's Board or senior management as to the extent to which the Policy met UK legal and regulatory requirements.

Training provided to IBLLC's Compliance Team

4.12 IBUK did not provide training to all members of IBLLC Compliance, based in the US, who were responsible for reviewing the Post-Trade Surveillance Reports, on the relevant laws of the United Kingdom and their application, or on how to conduct reviews of transactions by UK clients. A member of IBUK Compliance sent regulatory updates to an individual within IBLLC Compliance on an ad hoc basis, and then discussed the material on the phone; however, IBUK carried out no checks to ensure the regulatory updates had been passed on to, or discussed with, those reviewing the Post-Trade Surveillance Reports. IBUK thus delegated the training of the IBLLC staff involved in reviewing Post-Trade Surveillance Reports to IBLLC, without maintaining any oversight.

4.13 Nor did IBUK's Compliance team undertake any testing or checking of the training conducted by IBLLC. In fact, IBUK's Compliance team never checked whether any training had been provided to IBLLC Compliance in relation to how to carry out a review of the Post-Trade Surveillance Reports. Accordingly, IBUK Compliance was not in a position to assess whether the training, if provided, was adequate to enable them effectively to review the Post-Trade Surveillance Reports and identify and escalate trades which contained indicators of potential market abuse. IBUK relied upon the IBLLC Reviewers being experts in the work they carried out.

Post-trade surveillance systems

4.14 IBUK's lack of a front office function meant it was solely reliant on automated systems in order to identify possible market abuse. These surveillance systems were operated at Group level in the US by IBLLC Compliance. The post-trade surveillance systems were based on the automatic generation of approximately 50 Post-Trade Surveillance Reports. The Post-Trade Surveillance Reports were run globally for all entities in the Interactive Brokers Group. IBLLC was responsible for the design and calibration of these reports. IBUK did not provide adequate input in relation to their design and calibration, and did not test their operation to ensure they were effective in identifying potentially suspicious transactions by its clients. IBUK did not generate or request any specific or tailored reports in respect of its own clients.

4.15 Where transactions did not meet the criteria to be captured on the Post-Trade Surveillance Reports, there was no mechanism for them to be reviewed, and it was therefore important that the criteria were effective in identifying potentially suspicious transactions by IBUK's clients.

4.16 In the Relevant Period the Post-Trade Surveillance Reports which IBUK considered capable of capturing potential insider dealing were the Daily Stats Reports and the daily Insider Trading Report:

Daily Stats Reports

(1) There were 12 Daily Stats Reports, entitled as follows:

a) Customers With 40 Highest Equity

b) Customers With 40 Highest P&L [Profit and loss]

c) Customers With 40 Lowest P&L

d) Top 100 Customer Holdings

e) MTD [Month-to-date]: Customers With 40 Highest P&L

f) MTD: Customers With 40 Lowest P&L

g) YTD [Year-to-date]: Customers With 40 Highest P&L

h) YTD: Customers With 40 Lowest P&L

i) Top 40 Highest Percentage Gains

j) Top 40 Lowest Percentage Gains

k) Customers who Made or Lost 45% of their Total Balance

l) Customers with New Negative Balances.

(2) These reports were generated at a global level from clients' trading carried out by all entities in the Interactive Brokers Group. As such, during the Relevant Period, no Daily Stats Reports were generated for IBUK clients

specifically; nor were they in any way tailored for the IBUK business. Indeed, depending on the levels of activity in other jurisdictions, it was possible for the Daily Stats Reports a) to j) in sub-paragraph (1) above to highlight no transactions relating to IBUK clients, even where substantially large, profitable and timely trading by IBUK clients occurred.

(3) The Daily Stats Reports identified clients of Interactive Brokers Group entities whose trading fell within certain criteria, pre-set by IBLLC programmers, with no input from IBUK. IBUK took no steps to test the operation of the Daily Stats Reports to ensure they were effective in identifying potentially suspicious transactions by its clients.

(4) As set out in paragraphs 4.28 - 4.33 below, the Authority has identified that, during the Relevant Period, the Daily Stats Reports failed to identify two highly profitable CFD transactions by an IBUK client which took place in close proximity to RNS announcements.

The Insider Trading Report

(5) The Insider Trading Report was also generated on a daily basis for all Interactive Brokers Group client trading carried out globally. It was used to identify trades by clients who traded in relation to stocks for which they had a confirmed connection. A trade would appear on the Insider Trading Report only if:

a) the client had confirmed at account opening that it held 10% or more of the available shares, or that it was a director or officer, of the traded stock; or

b) if this had been determined as a result of open source checks carried out by IBUK at account opening.

The Insider Trading Report therefore relied on the fullness of the information provided by the client at account opening, the client's honesty, what was in the public domain and IBUK and/or IBLLC identifying publicly available information.

(6) IBUK took no steps to test the operation of the Insider Trading Report to ensure it was effective in identifying potentially suspicious transactions by its clients.

Review of the Daily Stats and Insider Trading Reports by IBLLC

4.17 IBUK relied on IBLLC's Compliance team to: (1) maintain the post-trade surveillance systems; (2) review the Post-Trade Surveillance Reports to identify possible market abuse; and (3) inform IBUK of instances indicating possible market abuse by an IBUK client.

4.18 After the Post-Trade Surveillance Reports were generated, they were reviewed by the IBLLC Reviewers. Where the IBLLC Reviewer decided that a transaction was suspicious, it would be referred to IBUK for consideration. However, IBLLC Reviewers were not required to document their review unless they considered further action was warranted.

4.19 The Policy did not state until late in the Relevant Period (10 November 2014 - see paragraph 4.10(2)(c) above) that IBLLC Reviewers should take into account all relevant circumstances. Even after it did so, as set out at paragraph 4.9 above, the Policy was poorly communicated to IBLLC Compliance.

Monitoring by IBUK

4.20 IBUK was not involved in the process for the review of the Post-Trade Surveillance Reports by IBLLC Compliance staff as IBUK considered them to be the experts. No arrangements were in place to allow IBUK to undertake quality assurance checks to ensure reviewing was consistent and appropriate escalations were being made.

4.21 IBUK chose not to carry out any checks of the reviews carried out by IBLLC or the IBLLC Reviewer's determinations, on the basis that it would be duplicative of the work done by IBLLC Compliance. IBUK's checks were limited to occasionally confirming on Interactive Brokers Group's internal system whether or not a trade had been reviewed by IBLLC.

4.22 IBUK relied on occasional, informal, and undocumented phone calls between IBUK Compliance and IBLLC Compliance to keep informed of the approach IBLLC was taking to the reviews.

Submission of STRs to the Authority

4.23 Once the transactions captured on the reports were reviewed by IBLLC Compliance, any transactions which the IBLLC Reviewer considered to be potentially suspicious were escalated to IBUK. IBUK was at that stage required to review the transactions and decide whether or not to report these transactions to the Authority. In the Relevant Period, prior to the MS&F visit to IBUK, IBLLC only escalated one transaction considered to be potential insider dealing to IBUK. In the event, the transaction escalated was outside the scope of the market abuse regime. IBUK did not consider whether the extent of IBLLC's escalation of potentially suspicious trades to IBUK for consideration and reporting to the Authority was appropriate.

4.24 IBUK maintained a log of the decisions made in relation to all suspicious transactions escalated to it by IBLLC. The log was also used to record the number of STRs submitted by IBUK to the Authority. Given the lack of transactions escalated to IBUK relating to potential insider dealing, no STRs regarding potential insider dealing were submitted to the Authority by IBUK in the Relevant Period prior to MS&F's visit. This can be contrasted with the significant increase in the number of STRs submitted to the Authority by IBUK regarding potential insider dealing in the months after the visit by MS&F. The precise figures are included in the table below. During the Relevant Period, IBLLC also escalated to IBUK six transactions considered to be market manipulation, and IBUK made two STRs to the Authority.

Year	Total number of potentially suspicious transactions escalated for review from IBLLC	The number of transactions identified by IBUK as being potentially suspicious for insider dealing	Number of STRs submitted to the Authority for insider dealing
2013	5	1	0
2014	6	1	0
Jan – May 2015	15	13	12
Jun – Dec 2015	Data not available	Data not available	10

Specific transactions

4.25 The Authority has identified three occasions during the Relevant Period on which IBUK did not submit STRs to the Authority, despite having reasonable grounds to suspect the transactions constituted market abuse in the form of insider dealing. In each case IBUK executed highly profitable transactions for its clients in close proximity to an announcement of price sensitive information. None of these transactions were escalated to IBUK by IBLLC, and therefore they were not reported by IBUK to the Authority.

4.26 The three relevant transactions involved trading in CFDs. In equity trading, a client has to pay the full value of the shares; in CFD trading, while IBUK will purchase the underlying shares in the market in order to hedge its customer transaction, the customer only has to deposit a small percentage of the total value of the shares (the 'margin') to achieve the same level of exposure to price movements in the shares as if they owned the shares outright. The customer will make the same absolute profit or loss from share price movements whether they purchase the shares outright or gain the same level of exposure through a CFD; but a customer who buys a CFD will have a much higher percentage return (or loss) in relation to their initial margin payment than the percentage increase (or decrease) in the underlying share price.

4.27 None of the transactions detailed below were included in the daily Insider Trading Report. Further, two of these transactions did not appear on any Post-Trade Surveillance Reports and therefore they were not reviewed by the IBLLC Reviewers. The other transaction was reviewed by IBLLC Reviewers but was not escalated to IBUK.

Transaction One

4.28 Client A bought CFDs equivalent to approximately 1.3 million shares in Stock X on two consecutive days in November 2014. Three days later a positive RNS announcement was published, after the market closed that day, which resulted in the share price of Stock X closing nearly 6% higher on the next trading day.

Client A closed the position on the day of the share price increase, realising a profit of over £440,000. As regards this trading compared with Client A's previous trading through Interactive Brokers Group, it is relevant to note that:

(1) the absolute profit was 83%[1] higher than the profit made by Client A from the next most profitable CFD trading, and more than twice as profitable as the third most profitable CFD trading by Client A related to any other single stock in the previous 12 months; and

(2) Client A's highest exposure to this stock was 20% greater than Client A's next highest exposure to any single stock in the previous 12 months, and also more than four times greater than the average highest exposure to any single stock in all of Client A's CFD trading over the previous 12 months.

4.29 As set out, Client A's trading in Stock X was unusual in that it was significantly out of line with Client A's previous investment behaviour, and was in close proximity to a positive RNS announcement relating to Stock X.

4.30 This transaction did not meet the criteria to appear on any of the Post-Trade Surveillance Reports. Accordingly it was not reviewed by IBLLC Compliance, nor escalated to IBUK. Accordingly, IBUK did not consider whether to submit an STR in respect of this trading. In its response to MS&F's request for information related to IBUK's non-submission of an STR in relation to this transaction, IBUK said that the trading was not highlighted to IBUK by IBLLC as, among other things, the client had "*informed IB that none of its officers, directors or any 10% shareholder was affiliated with any publically* [sic] *traded company*".

Transaction Two

4.31 A few weeks later Client A bought CFDs equivalent to approximately 1 million shares in Stock Y over a period of ten days in December 2014. On the last of these days a positive RNS announcement resulted in the share price of Stock Y closing 11% higher than the closing price of the previous day. Client A closed the position over the three weeks following the share price increase, realising a profit of over £870,000. As regards this trading compared with Client A's previous trading through Interactive Brokers Group, it is relevant to note that:

(1) there had been no trading in relation to the stock by Client A over the previous 12 months;

(2) (with the exception of Transaction One) the absolute profit was more than three times the profit made by Client A from the next most profitable CFD trading, and more than four times as profitable as the third most profitable CFD trading by Client A related to any other single stock in the previous 12 months; and

[1] In relation to the transactions described in paragraphs 4.28 to 4.36, the relative exposures and profits quoted are calculated converting transactions in non-GBP currencies into GBP on the day of the transaction.

(3) (with the exception of Transaction One) Client A's highest exposure to this stock was greater than Client A's highest exposure to any single stock in the previous 12 months, and also more than five times greater than the average highest exposure to any single stock in all of Client A's CFD trading over the previous 12 months.

4.32 As set out, Client A's trading in Stock Y was unusual in that it was significantly out of line with Client A's previous investment behaviour, and was in close proximity to a positive RNS announcement relating to Stock Y. It also followed shortly after Transaction One.

4.33 This transaction did not meet the criteria to appear on any of the Post-Trade Surveillance Reports. Accordingly it was not reviewed by IBLLC Compliance, nor escalated to IBUK, and IBUK did not consider whether to submit an STR in respect of this trading.

Transaction Three

4.34 Client B bought CFDs equivalent to approximately 500,000 shares in Stock Z on two consecutive days in November 2014. In the period between market close eight days later and market opening on the following day, positive news was published which resulted in the share price of Stock Z closing nearly 22% higher than its closing price on the day before the share price increase. While Client B sold a small amount a few days before the announcement after a 33% increase in the share price, 80% of the position was retained until after the positive news was published, with the sale realising a total profit of over £1,000,000. As regards this trading compared with Client B's previous trading through Interactive Brokers Group, it is relevant to note that:

(1) there had been no trading by Client B in relation to the stock over the previous 12 months;

(2) the absolute profit was 50% more than the profit made by Client B from the next most profitable CFD trading, and more than six times as profitable as the third most profitable CFD trading by Client B related to any other single stock in the previous 12 months; and

(3) Client B's highest exposure to this stock was in the top 15% of Client B's highest exposure to any single stock in the previous 12 months, and also almost three times greater than the average highest exposure to any single stock in all of Client B's CFD trading over the previous 12 months.

4.35 As set out, Client B's trading in Stock Z was unusual in that it was significantly out of line with Client B's previous investment behaviour, and was in close proximity to a positive RNS announcement relating to Stock Z.

4.36 This transaction was flagged on a Daily Stats Report and was therefore reviewed by IBLLC. However, the transaction was not escalated to IBUK. The IBLLC Reviewer recorded that the increase in share price explained the profitability of the client's trading; no consideration of the pattern of trading by this client or the timeliness of this trading is recorded.

5. FAILINGS

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

Principle 3

5.2 Principle 3 requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

5.3 IBUK breached Principle 3 because it failed to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems in relation to the identification and reporting of possible market abuse.

5.4 On the basis of the facts and matters set out above, IBUK failed to maintain an appropriate control environment in order effectively to detect and report potential instances of market abuse. This increased the risk that market abuse would occur. The control environment was inadequate because:

(1) IBUK failed to have adequate policies and procedures in place during the Relevant Period as throughout the Relevant Period the Policy in place did not:

a) provide sufficient guidance to IBLLC Reviewers detailing how to carry out a review of the Post-Trade Surveillance Reports, which created a risk that reviews would be inadequate and suspicious transactions would not be identified;

b) require IBLLC Reviewers to document their reviews of the Post-Trade Surveillance Reports which created a risk that reviews would not be carried out consistently;

c) provide for specific circumstances in which IBLLC Reviewers should escalate potentially suspicious transactions to IBUK Compliance for further consideration or consultation;

d) require IBUK Compliance to monitor IBLLC Compliance and/or IBLLC Reviewers to ensure the reviews being carried out for IBUK were done effectively; or

e) state, until late in the Relevant Period (10 November 2014 - see paragraph 4.10(2)(c) above), that IBLLC Reviewers should take into account all relevant circumstances. Even after it did so, as set out at paragraph 4.9 above, it was poorly communicated to IB Compliance.

(2) IBUK delegated the training of the IBLLC staff involved in reviewing surveillance reports to IBLLC, without maintaining any oversight. IBUK thereby failed adequately to supervise and monitor the training given to IBLLC Reviewers of the Post-Trade Surveillance Reports.

(3) IBUK failed to have adequate input into the design and calibration, or test the operation, of the post-trade surveillance systems, to ensure they were effective in identifying potentially suspicious transactions by its clients and enabling it to comply with its obligations to report to the Authority. The

Insider Trading Report relied upon the client diligently and honestly providing full information at account opening, and what was in the public domain. As such this report was not a robust control which could be relied upon by IBUK to identify insider dealing; this increased the need for the Daily Stats Reports to be calibrated effectively to identify potential insider dealing.

(4) The Post-Trade Surveillance Reports, which were intended to identify suspicious transactions, were generated for all clients' trading carried out globally by entities in the Interactive Brokers Group. This global approach and insufficient focus on the UK market abuse regime created the risk that too few IBUK clients would be identified in the Post-Trade Surveillance Reports, and potentially suspicious trading could therefore be missed and not escalated by IBLLC to IBUK. The crystallisation of this risk is shown by the fact that two of the three suspicious transactions referred to above were not picked up by the Post-Trade Surveillance Reports.

(5) IBUK failed to consider whether the extent of IBLLC's escalation of potentially suspicious trades to IBUK for consideration and reporting to the Authority was appropriate.

(6) IBUK did not supervise or effectively monitor the reviews conducted, or the decisions made, by IBLLC Reviewers to ensure the reviews being carried out were effective in identifying and escalating potentially suspicious transactions. IBUK placed undue reliance on the IBLLC Reviewers being experts in the work they carried out. The crystallisation of this risk is shown by the fact that although one transaction was identified by the Post-Trade Surveillance Reports, it was not escalated to IBUK and the record made by the IBLLC Reviewer merely states that the profit made was due to the increase in share price, without considering other factors.

SUP 15.10.2R

5.5 SUP 15.10.1R and 15.10.2R in force during the Relevant Period provided that a firm (carrying out activities from an establishment in the UK) which arranged or executed transactions with or for a client, and which had reasonable grounds to suspect that the transaction might constitute market abuse, must notify the Authority without delay i.e. submit an STR. As stated above, IBUK remained responsible for the submission of STRs even where the post trade review and surveillance had been delegated to IBLLC.

5.6 Further guidance was provided in SUP 15 Annex 5G of the Handbook, which gave examples of indications of possibly suspicious transactions. These included "*a transaction significantly out of line with the client's previous investment behaviour*" and "*unusual trading in the shares of a company before the announcement of price sensitive information*". IBUK included this guidance in the versions of its Policy of 27 February 2014 and 10 November 2014.

5.7 The Authority takes the view that the obligation under SUP 15.10.2R to notify the Authority arises once the firm possesses the information giving rise to reasonable grounds to suspect market abuse, even if no actual suspicion has in fact been formed.

5.8 STRs are a crucial asset in the detection of market abuse and are key to the Authority's ability to protect and enhance the integrity of the UK financial system.

5.9 The Authority has made public statements about the standards that are expected of firms in relation to market abuse, and their obligation to submit STRs to the Authority, for example:

(1) In 2005, Issues 12 and 14 of 'Market Watch' (a newsletter published by the Authority on its website) highlighted:

a) firms' obligations to submit STRs, with firms being referred to guidance by the Committee of European Securities Regulators on this issue;

b) that identifying suspicious transactions is not an easy task and it is not realistic to expect that every possible case will be picked up, but firms must have the necessary systems and procedures to meet the requirement;

c) that, when deciding what transactions to report, firms should apply the key test of whether "*there are reasonable grounds for suspecting the transaction involves market abuse*";

d) that firms are required to report transactions of which they retrospectively become suspicious, although there is no requirement to go back and retroactively review transactions in the run-up to an event which had a significant effect on the price of a security;

e) that the quality of an STR is improved when detailed client information is provided and when a thorough explanation of why trades are considered to be suspicious is given; and

f) that if the Authority identified a trade that it would expect a firm to have notified it about, then the Authority's first step would be to ask what systems and controls the firm had in place to identify suspicious transactions, then to ask the firm why it did not identify the relevant trade (the example was given that, if this was due to a lack of staff training about market abuse and the STR requirements, then the Authority could take action).

(2) In December 2006, Issue 18 of Market Watch reminded firms of their obligations under the STR regime and the obligation on management to interpret and apply the rules on STRs. Issue 18 of Market Watch also referred to the need for firms to have in place appropriate and robust monitoring systems.

(3) In March 2007, Issue 19 of Market Watch contained further emphasis on the importance of STRs and included a number of case studies on STRs. One of the case studies related to a firm trading in CFDs and the factors that may strike a compliance officer as being suspicious when viewed together with the timeliness of trading. The factors included: monitoring the previous day's trades against regulatory announcements; the change in share price; the client's previous trading history; and KYC ('know your customer') documentation.

(4) In August 2009, Issue 33 of Market Watch reiterated the obligation for firms who arrange or execute securities transactions and that the test firms should apply is "reasonable grounds to suspect that the transaction might constitute market abuse".

5.10 On three occasions during the Relevant Period, IBUK executed transactions for its clients but failed to identify that it had reasonable grounds to suspect that these transactions might constitute market abuse in the form of insider dealing; and hence failed to submit an STR to the Authority. On two of these occasions, the Post-Trade Surveillance Reports failed completely to identify the transactions, as a result of which no investigation was carried out. On the third occasion, even though the transaction was picked up by a Post-Trade Surveillance Report, it was not investigated by IBLLC in any detail and therefore was not escalated to IBUK.

5.11 On each occasion, the transaction was:

(1) highly profitable in absolute terms and in relation to the client's normal trading activities; and

(2) carried out in close proximity to an announcement of information that led to significant and rapid changes in the share price.

5.12 A comparison of the particular transaction with the client's trading history should have led IBUK to conclude that the transaction was unusual for the client concerned, in terms of both profits made and amount invested, and therefore suspicious. The timeliness and the profitability of the three suspicious CFD transactions were factors that should have given rise to suspicion that they might constitute insider dealing.

5.13 Therefore on each occasion IBUK breached SUP 15.10.2R, by having reasonable grounds to suspect that the client's trading might constitute market abuse but failing to notify the Authority.

5.14 All of these occasions of crystallised risk related to possible insider dealing in one particular type of instrument: CFDs. However, IBUK's failure to oversee effectively the outsourcing of its post-trade monitoring to IBLLC undermined its ability to manage any of its market abuse risks effectively.

6. SANCTION

Financial penalty

6.1 The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

6.2 In deciding the penalty, the Authority has had regard to all the circumstances of the case and the financial resources of IBUK.

6.3 Given that the breaches of SUP 15.10.2R occurred within the period of the Principle 3 breach and are based on similar facts, the Authority considers it

appropriate to impose a combined financial penalty for the Principle 3 and SUP 15.10.2R breaches.

Step 1: disgorgement

6.4 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.

6.5 The Authority has not identified any financial benefit that IBUK derived directly from its breach.

6.6 Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.7 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.

6.8 The nature of IBUK's business is executing and arranging transactions in certain instruments directly for its UK clients, and executing transactions in other products on behalf of other entities in the Interactive Brokers Group. The Authority considers the revenue generated from this business area is indicative of the harm or potential harm caused by the firm's breaches. The Authority considers that total revenue generated by IBUK in connection with qualifying investments, or investments which are related investments, is indicative of the harm or potential harm caused by its breach.

6.9 On this basis, the relevant revenue during the Relevant Period is £20,988,249.

6.10 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%

6.11 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. DEPP 6.5A.2G (11) lists factors likely to be

considered 'level 4 or 5 factors'. Of these, the Authority considers the following factor to be relevant:

(1) The breach revealed serious or systemic weaknesses within IBUK's procedures.

6.12 DEPP 6.5A.2G (12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factors to be relevant:

(1) There were no profits made or losses avoided as a result of the breach, either directly or indirectly.

(2) There was limited risk of loss caused to individual consumers, investors or other market users.

(3) The breach was committed negligently.

6.13 The Authority also considers that the breach could have had an adverse effect on the market, in that it increased the risk that financial crime, in the form of market abuse, could occur undetected. The submission by firms of STRs is essential to the detection and prevention of all types of market abuse, including insider dealing. Market confidence is put at risk if firms have ineffective systems and controls in place and do not submit STRs, as this reduces the Authority's ability to protect the market from potential market abuse.

6.14 The Authority has had regard to the fact that neither the firm's senior management, nor any of its other staff, were aware that its systems and controls fell short of required standards until the visit by MS&F.

6.15 Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 3 and so the Step 2 figure is 10% of £20,988,249, which is £2,098,824.

6.16 DEPP 6.5.3G(3) states that the Authority recognises that a penalty must be proportionate to the breach. The Authority may decrease the level of the penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breach concerned. In this case the Authority does consider that the Step 2 figure is disproportionately high and should be adjusted. In order to achieve a penalty that (at Step 2) is proportionate to the breach, the Step 2 figure is reduced by 50% to £1,049,412.

Step 3: mitigating and aggravating factors

6.17 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.

6.18 The Authority considers there are no aggravating or mitigating factors in this case.

6.19 Step 3 is therefore £1,049,412.

Step 4: adjustment for deterrence

6.20 The Authority considers that the Step 3 figure of £1,049,412 represents a sufficient deterrent to IBUK and others, and so has not increased the penalty at Step 4.

6.21 Step 4 is therefore £1,049,412.

Step 5: settlement discount

6.22 The Authority and IBUK have not reached agreement to settle so no discount applies to the Step 4 figure.

6.23 The total financial penalty is therefore £1,049,412.

7. REPRESENTATIONS

7.1 Annex B contains a brief summary of the key representations made by:

(1) IBUK; and

(2) IBLLC, a third party identified in the reasons set out in the Warning Notice issued to IBUK on 25 July 2017, and to whom in the opinion of the Authority the matter is prejudicial;

and how they have been dealt with. In making the decision which gave rise to the obligation to give this Notice, the Authority has taken into account all of the representations made by IBUK and IBLLC, whether or not set out in Annex B.

8. PROCEDURAL MATTERS

8.1 The following paragraphs are important.

Decision maker

8.2 The decision which gave rise to the obligation to give this Final Notice was made by the Regulatory Decisions Committee.

8.3 This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for payment

8.4 The financial penalty must be paid in full by IBUK to the Authority by no later than 8 February 2018, 14 days from the date of the Final Notice.

If the financial penalty is not paid

8.5 If all or any of the financial penalty is outstanding on 9 February 2018, the Authority may recover the outstanding amount as a debt owed by IBUK and due to the Authority.

Publicity

8.6 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 these 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 IBUK or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

Authority contact

8.7 For more information concerning this matter generally, contact James Pender (direct line: 0207 066 5114) of the Enforcement and Market Oversight Division of the Authority.

Mark Francis

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND AUTHORITY GUIDANCE

1. STATUTORY PROVISIONS

1.1. The relevant section of the Act is section 118, which concerns market abuse, which during the Relevant Period stated as follows:

(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which—

(a) occurs in relation to—

(i) qualifying investments admitted to trading on a prescribed market,

(ii) qualifying investments in respect of which a request for admission to trading on such a market has been made, or

(iii) in the case of subsection (2) or (3) behaviour, investments which are related investments in relation to such qualifying investments, and

(b) falls within any one or more of the types of behaviour set out in subsections (2) to (8).

(2) The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question.

(3) The second is where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties.

(4) The third is where the behaviour (not falling within subsection (2) or (3))—

(a) is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and

(b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

(5) The fourth is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which—

(a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or

(b) secure the price of one or more such investments at an abnormal or artificial level.

(6) The fifth is where the behaviour consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.

(7) The sixth is where the behaviour consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.

(8) The seventh is where the behaviour (not falling within subsection (5), (6) or (7))—

(a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying investments, or

(b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment,

and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

(9) *Subsections (4) and (8) and the definition of "regular user" in section 130A(3) cease to have effect on 31 December 2014 and subsection (1)(b) is then to be read as no longer referring to those subsections.*

1.2. With the exception of the subsections mentioned in (9) above (to the extent set out there), the section as stated above was in force throughout the Relevant Period.

2. REGULATORY PROVISIONS

2.1. In exercising its power to issue a financial penalty, the Authority must have regard to the relevant provisions in the Handbook.

2.2. In deciding on the action set out in this Notice, the Authority has had regard to guidance published in the Handbook and set out in the Regulatory Guides, in particular the Decision Procedure and Penalties Manual and the Enforcement Guide.

3. PRINCIPLES FOR BUSINESSES

3.1. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Handbook. They derive their authority from the rule-making powers as set out in the Act and reflect the Authority's regulatory objectives.

3.2. The relevant Principle is as follows:

Principle 3 provides: *"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems".*

4. SUPERVISION MANUAL

4.1. SUP sets out the relationship between the Authority and authorised persons (referred to in the Handbook as firms). The provisions of SUP set out in this Annex are those in force during the Relevant Period.

4.2. The relevant rule is as follows:

SUP 15.10.1R provides: *"This section applies in relation to activities carried on from an establishment maintained by the firm or its appointed representative in the United Kingdom."*

SUP 15.10.2R provides: *"A firm which arranges or executes a transaction with or for a client and which has reasonable grounds to suspect that the transaction might constitute market abuse must notify the [Authority] without delay."*

4.3. SUP 15 Annex 5G provides indications to be used as a starting point for consideration of whether a transaction is suspicious. These include:

"A transaction is significantly out of line with the client's previous investment behaviour (e.g. type of security; amount invested; size of order; time security held)"; and

"There is unusual trading in the shares of a company before the announcement of price sensitive information relating to the company".

5. ENFORCEMENT GUIDE

5.1. The Authority's approach to taking disciplinary action is set out in Chapter 2 of EG. The Authority's approach to financial penalties and public censures is set out in Chapter 7 of EG. EG 7.1.1 states: "*…the effective and proportionate use of the Authority's powers to enforce the requirements of the Act, the rules …and the Statements of Principles for Approved Persons… will play an important role in the [Authority's] pursuit of its statutory objectives. Imposing disciplinary sanctions shows that the [Authority] is upholding regulatory standards and helps to maintain market confidence and deter financial crime. An increased public awareness of regulatory standards also contributes to the protection of consumers.*"

6. DECISION, PROCEDURE AND PENALTIES MANUAL

6.1. Guidance on the imposition and amount of penalties is set out in Chapter 6 of DEPP. The Authority has determined the appropriate financial penalty pursuant to the framework set out in DEPP 6.5A.

ANNEX B

REPRESENTATIONS

Representations of IBUK

1. IBUK's representations (in italics), and the Authority's conclusions in respect of them, are set out below.

No breach of Principle 3

2. *The obligation under Principle 3 is broad and unspecific. The Authority has provided only very limited guidance on how it might be interpreted in relation to STRs and expressly declined to identify the criteria it considers establish reasonable grounds for suspicion. It has accepted that it is for firms to determine those criteria and how they might be identified in relation to any given transaction. Firms have discretion as to how to achieve this and the Authority should not substitute its own judgement in deciding whether the firm's arrangements are acceptable.*

3. Principle 3 imposes a duty on firms to take reasonable care to organise their affairs responsibly and effectively, with adequate risk management systems. The duty requires firms to design systems appropriate to fulfil this duty in relation to their own business; it does not confer on them a discretion to adopt a lower standard.

4. *Given the volume of its trading, IBUK adopted a reasonable approach in designing and operating a system that incorporated pre-trade filters and post-trade surveillance to narrow down the transactions requiring review. Post-trade surveillance included the generation of automated reports which identified transactions of interest by reference to the size (calculated in a variety of ways) of profits generated. IBUK made sure the reports were built appropriately and notified IBLLC of any improvements that it thought ought to be made. These were calibrated by what IBUK reasonably considered the appropriate criteria to identify transactions of interest without creating large numbers of false positive results. Although the Authority states that it was possible for no transactions for UK clients to appear on a number of the reports on any given day, this was in fact unlikely.*

5. The Authority does not criticise the use of post-trade surveillance reports in themselves, or say that trade size (expressed in different ways) was not a relevant criterion for review. However, the Post-Trade Surveillance Reports were operated on a global basis and IBUK did not input adequately into their design and calibration, or conduct testing, so as to ensure that they were appropriate to identify potentially suspicious transactions by IBUK's own clients. There is in fact no evidence of significant input into the design and calibration of the reports, or

of any requests by IBUK for changes to be made. While contending that it was unlikely that any of the Post-Trade Surveillance Reports would ever highlight no transactions by its clients, IBUK provided no evidence to demonstrate this, and did not dispute that this was possible. In any event, the identification of one or more transactions each day would not of itself indicate that the filters used in the reports were adequate.

6. *As well as operating its own compliance department in the UK, IBUK also incorporated into its systems the expertise of a substantial and well-trained team of compliance officers engaged by its US sister company to identify market abuse from a US and UK perspective. The IBLLC Reviewers were skilled and familiar with market abuse, which is not specific to the UK but a generic problem for all financial markets. Transactions identified in an automated report were further scrutinised by reference to proximity to an announcement, duration of holding, previous patterns of trading and known connections.*

7. *IBLLC Reviewers had their own detailed internal guidance so it was not necessary for the Policy to set out exhaustive guidance on how the Daily Stats Reports should be reviewed. Nor was it necessary to set out procedural matters of which IBLLC Reviewers were well aware, such as the need to escalate potentially suspicious matters to the UK, to consult IBUK where necessary, and to document reviews. It did set out the UK legal position, as this would be less familiar to US-based reviewers.*

8. Although the Policy referred to the UK legal position, it restated the law without any consideration of IBUK's own market abuse risks, and contained no IBUK-specific guidance on how to apply SUP 15.10.2R. Only the final version of the Policy contained any guidance on how to review the reports. While it was not unacceptable, in itself, for IBUK to outsource the review, this did not discharge IBUK's own obligations in relation to the review process. It was inappropriate for IBUK to rely on IBLLC Reviewers to identify suspicious transactions without meaningful guidance on the UK legal and regulatory position or how this might apply to the specifics of IBUK's business. While market abuse regulatory regimes in other countries including the US might, to a greater or lesser extent, be similar to that of the UK, it was not appropriate to proceed on an assumption that there were no material differences. Nor was it appropriate for the Policy to omit reference to important procedural steps such as the requirement to report to, or consult with, IBUK or to document reviews, on the assumption that the reader would realise they were required.

9. Reviews were not, in fact, adequately documented by IBLLC. IBUK stated that IBLLC provided only a brief note stating the reason for the profit or loss made, in relation to transactions that required further review, the purpose being just to record that a transaction had been reviewed and that it was thought to require further review. The reason given for this was to maximise the time spent carrying out reviews, rather than documenting them. To the extent that reviews were not documented, it is not possible to say whether the review in any given case was adequate.

10. IBUK accepts that it did not conduct formal quality assurance checks of the IBLLC reviews, but the Authority wrongly downplays the regular engagement between IBUK and IBLLC Compliance which enabled an assessment of quality to take place.

11. The Authority does not accept that there was such regular engagement; there were only occasional, undocumented telephone conversations between IBUK and IBLLC Compliance, and there is no evidence of any checks conducted.

12. The Authority inappropriately relies on an increase in submission of STRs by IBUK after the MS&F visit as demonstrating that its previous approach was in breach of Principle 3. This does not follow: IBUK enhanced its standards and took a highly cautious approach to reporting after the visit, in response to the feedback from the Authority. The Authority has indicated that firms should not submit "defensive" reports, which suggests that firms should err on the side of not filing STRs unless the "reasonable grounds for suspicion" test is clearly met.

13. The STR figures before and after the MS&F visit are not determinative in the Authority's assessment of the adequacy of the systems and controls in place during the Relevant Period. However, the Authority has assessed all of IBUK's more recent STRs to be "good" (subject only to reservations about timeliness in certain cases) and this suggests that "defensive" reporting has not been taking place since the MS&F visit. While it is possible that there were very few suspicious transactions occurring prior to the MS&F visit and substantially more afterwards, this proposition is weakened by the existence, during the Relevant Period, of the three unreported transactions referred to in paragraphs 4.28 to 4.36 of this Notice, and the Authority considers it a reasonable inference that the material increase in reporting following the MD&F visit was due to the improvement of IBUK's systems and controls.

No breach of SUP 15.10.2R

14. There were not reasonable grounds to suspect insider dealing in relation to any of the three transactions identified by the Authority. This is the conclusion reached after applying formal and informal guidance from the Authority on the matters to be taken into account. In each case the relevant transactions were within the client's normal range, albeit at the higher end of that range in terms of size; they were not of a different kind to the relevant client's previous trading.

(a) Transaction One:

i. If the currency variations introduced by the Authority's conversion of profits into GBP at different times are removed (and there is no reason to convert into GBP transactions that took place in USD), the realised profit was in fact 60% higher than the next most profitable CFD trading (not 83%), and Client

A's highest exposure to this stock was 10% greater than its next highest exposure to any stock (not 20%).

ii. *The highest exposure is a more appropriate measure of a client's behaviour than the profit made, as the former is more in the client's control. The fact that the highest exposure was 10% higher than the previous highest exposure does not make this trade significantly out of line with Client A's previous investment behaviour. Client A regularly put on large bets on stocks and made or lost large amounts doing so. As for the comparison with the average exposure, where a client places a wide variety of different trade sizes, the larger trades will inevitably be larger than the average, and this is not in itself suspicious.*

(b) Transaction Two:

i. *Removing currency variations, Client A's highest exposure to Stock Y was between four and five times greater than the average highest exposure (not more than five times greater).*

ii. *The fact that there had been no trading by Client A in Stock Y over the previous 12 months is not significant. Like many clients who use online brokers such as IBUK, Client A traded in a large number of stocks. In the previous 12 months, it had traded in 37 different underlying stocks, of which it had never traded 35 (95%) before. (Stock X in Transaction One was notable in being a stock it had traded before.)*

iii. *The same points apply regarding highest and average exposures as set out in relation to Transaction One.*

(c) Transaction Three:

i. *Removing currency variations, Client B's absolute profit was approximately 41% more (not 50% more) than for its next most profitable CFD trading on its IBUK account, and 4.9 times (not six times) as profitable as the third most profitable CFD trading. The IBLLC reviewers also had access to Client B's trading on its IBLLC account, and its trading in other instrument types, and would rightly have considered its trading on a global basis. Client B's profit in Stock Z was only 11% more than its profit from the next most profitable trading.*

ii. *The fact that there had been no trading by Client B in Stock Z over the previous 12 months is not significant. In the previous 12 months, it had traded in 293 different underlying stocks, of which it had never traded 234 (almost 80%) before.*

iii. In terms of trade size, there were other exposures of similar or greater size. The same point applies regarding average exposure as set out in relation to Transaction One.

15. The Authority should be wary of relying on its own detailed forensic analysis ex post facto, as it would have been completely unrealistic for a reviewer to carry out this level of analysis in real time.

16. The Authority converted all transactions into one currency in order to carry out a comparison, and chose GBP because this was the currency of most of the transactions compared. However, the figures relied on by IBUK in USD are not materially different for the purposes of the conclusions which the Authority draws from the comparison, as set out in this Notice.

17. IBUK's analysis of Transaction One, Transaction Two and Transaction Three, summarised above, is unduly narrow in focusing on whether the transactions were different in kind from previous trading by the client concerned, in considering whether they were suspicious. The analysis fails to engage with the full range of applicable factors and, so far as it suggests that particular factors identified by the Authority are to be given no weight, is wrong. Nevertheless, in each case the trading involved a very significantly greater exposure, and generated very substantially higher profits, than was usual for the client.

18. The Authority's analysis of the relevant trading used information available to IBLLC Reviewers and was the kind of analysis that could have been carried out by them in order to determine whether or not there were reasonable grounds to suspect that transactions might constitute market abuse.

Enforcement action not appropriate

19. Even if IBUK was in breach of Principle 3 or SUP 15.10.2R, enforcement action was not appropriate. The Authority's work on STRs was primarily intended to be collaborative with industry and educational in nature, with enforcement action reserved for the most egregious cases. The alleged misconduct could have been much worse (eg complete ignorance of the relevant requirements) and IBUK co-operated with the Authority and adopted a proactive approach when provided with feedback by the Authority.

20. This Notice is concerned only with the position of IBUK and not with that of any other firm. The Authority acknowledges that the misconduct could have been worse but does not agree that IBUK's misconduct was insufficiently significant to merit enforcement action in this case; indeed, it considers the misconduct was serious. While co-operation by a firm is a relevant factor for the Authority in deciding whether or not to take action against it, it does not consider that the co-operation shown by IBUK in this case was exceptional, or otherwise such as to justify not taking action.

Financial penalty

21. If there were a breach of Principle 3 and/or SUP 15.10.2R, and a financial penalty were considered appropriate, the calculation of the financial penalty should take account of the following matters:

(a) The relevant revenue taken at Step 2 should not include any revenue attributable to index options and futures, which are by nature not susceptible to insider dealing. Accordingly, revenue from these products is not "indicative of the harm or potential harm" that the breach may cause (as set out in the guidance at DEPP 6.5A.2). This accounts for the majority of IBUK's trading income.

(b) The relevant revenue figure should also exclude a substantial sum attributable to "other income", which is income from sources other than client trading and inter-company brokerage, execution and clearing fees ie interest income and foreign exchange gains.

(c) The breach in this case should be assessed as, at most, level 2 in seriousness rather than level 3, in view of the preponderance of "level 1, 2 or 3 factors" in this case (set out at paragraph 6.12 of this Notice).

(d) In light of IBUK's profit figures, the Authority should make a substantial proportionality reduction, in line with DEPP 6.5.3(3), to a penalty of no more than £250,000.

(e) A 20% discount is appropriate at Step 3 in recognition of the following mitigating factors:

i. IBUK reacted quickly and proactively when it first received feedback in the approach the Authority wished it to take in reporting and conduct surveillance for insider dealing;

ii. IBUK's senior management were not aware of the issues until the MS&F visit;

iii. IBUK co-operated with the Authority's investigation; and

iv. IBUK has a clean disciplinary record.

22. As to these matters:

(a)

i. These proceedings relate to failures in IBUK's systems and controls for detecting market abuse of all kinds, not only insider dealing. The Authority has not made any specific findings as to the adequacy of those Post-Trade Surveillance Reports which were intended to capture types of market abuse other than insider

dealing. However, the Authority's findings in all other respects as to the adequacy of IBUK's systems and controls in relation to the detection of market abuse – notably the design of its outsourcing of post-trade surveillance to IBLLC and the failure in its oversight of those outsourcing arrangements – apply to all types of market abuse. It is also the case that the Authority has only identified occasions of crystallised risk in relation to possible insider dealing in relation to CFDs, but that does not mean that the risk did not exist in relation to trading in other instruments, or other types of market abuse.

ii. IBUK's argument that index options and futures were not susceptible to insider dealing was based on evidence which, in fact, went no further than to support an argument that insider dealing in relation to such instruments was, putting it at its highest, very unlikely rather than impossible. Further, IBUK did not argue that index options and futures were less susceptible than CFDs to other types of market abuse. Accordingly, the Authority considers that revenue from index options and futures forms part of the relevant revenue at Step 2.

(b) The Authority considers that the "other income" should be included in the penalty calculation because it is income that would not have accrued to IBUK but for its main business of executing and arranging transactions for clients.

(c) The assessment of a level of seriousness on the level 1 to 5 scale is not a question of adding up the number of factors that are likely to be considered "level 1, 2 or 3 factors" on the one hand (which in any event point only towards a seriousness of level 1, 2 or 3, not to any particular level within that range) and those that are likely to be considered "level 4 or 5 factors" on the other hand; rather, it is necessary to weigh all the relevant factors in terms of their significance in the particular case. Paragraphs 6.7 to 6.15 of this Notice explain how the Authority has reached its assessment that the breach in this case is level 3.

(d) The Authority considers that the figure reached at Step 2 of the financial penalty calculation was, without adjustment, disproportionately high for the breach concerned; accordingly, it has made an appropriate reduction, but it does not agree that a reduction of the amount suggested by IBUK is appropriate.

(e) The Authority has taken the matters listed by IBUK into account in concluding that there are no mitigating factors such as to justify a reduction of the penalty in this case (nor any aggravating factors such as to justify its increase).

23. The Authority should not describe the breach as having been committed "negligently", because that term has a specific legal meaning which is not supported by the evidence in this case.

24. The Authority is using the term "negligently" in the sense in which that term is used in DEPP 6.5A.2(12).

Representations of IBLLC

25. IBLLC's representations (in italics), and the Authority's conclusions in respect of them, are set out below.

26. IBLLC adopts the representations of IBUK.

27. Additionally, the conclusion should not be drawn that IBLLC has objectively poor systems and controls or is non-compliant with US regulatory rules. On the contrary, IBLLC Compliance staff have been instrumental in notifying US authorities and assisting various exchanges and regulators in relation to suspicious trading activity, in particular insider dealing.

28. The Authority repeats its comments in relation to the representations of IBUK.

29. The Authority has not investigated IBLLC's processes and systems for detecting market abuse, other than to the extent it was acting as an outsource provider to IBUK, and makes no finding as to whether they are compliant with US law.