

Linear Investments Limited has agreed the facts set out in the Notice, as well as liability for the breaches identified. It disputes the penalty imposed and has referred the issue of penalty to the Upper Tribunal. The Upper Tribunal will determine what (if any) the appropriate action is for the FCA to take, and remit the matter to the FCA with such directions as the Tribunal considers appropriate.



25 The North Colonnade  
Canary Wharf  
London  
E14 SHS

Tel: +44 (0)20 7066 1000  
Fax: +44 (0)20 7066 1099  
[www.fca.org.uk](http://www.fca.org.uk)

---

## DECISION NOTICE

---

To: **LINEAR INVESTMENTS LIMITED**

Address: **8-10 Grosvenor Gardens  
Belgravia  
London  
SW1W 0DH**

Firm Reference Number: **537389**

Date: **7 June 2018**

### **1. ACTION**

- 1.1 For the reasons given in this Notice, the Authority has decided to impose on Linear Investments Limited ("Linear") a financial penalty of £409,300 pursuant to section 206 of the Act.
- 1.2 Linear agreed at an early stage of the Authority's investigation to settle all issues of fact and liability (and, specifically, it agreed the matters of fact and liability contained in sections 2 to 5 inclusive of this Notice). Linear therefore qualified for a 30% discount under the Authority's executive settlement procedures. Were it not for this discount, the authority would have imposed a financial penalty of £584,700 on Linear.

## **2. SUMMARY OF REASONS**

- 2.1 The Authority has decided to take this action because Linear breached Principle 3 of the Principles for Businesses 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 between 14 January 2013 and 9 August 2015 (the "Relevant Period").
- 2.2 Market abuse in any form 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.
- 2.3 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 Suspicious Transaction Reports ("STRs") or, after 3 July 2016, Suspicious Transaction and Order Reports ("STORs") to the Authority. These are a critical source of intelligence for the Authority in identifying possible market abuse.
- 2.4 To conduct effective monitoring for suspected market abuse firms need to have trade monitoring systems which are appropriate relative to the nature, scale and complexity of the business they are undertaking and to the market abuse risks to which that business is exposed. Firms should have adequate systems in place so that they are able to comply with their regulatory obligations at all times, including where the business model changes.
- 2.5 Linear is an FCA authorised firm offering brokerage services. It provides its customers with a range of services, including trade execution where it places orders on behalf of clients. Linear also acts as a principal for a number of Appointed Representatives ("ARs"), which operate in a number of fields including brokerage, asset management and research. As the principal firm, Linear is responsible for any authorised activity undertaken by the ARs.
- 2.6 Trading is primarily conducted via electronic Direct Market Access ("DMA"), which Linear routes to its own broker for transmission to the market.

- 2.7 Linear's business model has changed over time, with it becoming more focussed on providing trade execution services to clients from the first half of 2013 onwards. During the Relevant Period the volume of trades routed by Linear to its brokers was significant, having increased substantially in volume from mid-January 2013 onwards. On average, some tens of thousands of trades were reported per month in the Relevant Period. This number of trades had increased significantly from the levels in 2012. From 14 January 2013 to 11 May 2015 the volume of trading was at a level which meant that it was not capable of being adequately monitored by the manual only process in place at Linear during that time.
- 2.8 Up until November 2014 Linear operated on the basis that it could rely upon post-trade surveillance undertaken by underlying brokers to discharge its regulatory obligations. This was incorrect. Regardless of post-trade surveillance checks being undertaken by underlying brokers, Linear was also responsible for undertaking its own checks using information available to it. Linear was at all times responsible for ensuring that it had effective post-trade surveillance systems in place to enable it to detect and report potential instances of market abuse. Later in the Relevant Period, as a result of discussions with a broker in November 2014, Linear became aware of the need to conduct its own post-trade surveillance. Only following this did Linear take steps to source and install an automated post-trade surveillance system.
- 2.9 There was a further period of time after deployment of the system on 11 May 2015 before Linear had appropriately calibrated and tested the system so that it was operating effectively relative to the nature of its business. This included periods of time during which Linear had to disable alerts on the automated system in relation to spoofing and insider dealing, because the system had not been appropriately and correctly calibrated. When the Firm disabled these alerts it did not have suitable alternative surveillance in place. This rendered it incapable of effectively detecting spoofing and insider dealing whilst the alerts were disabled.
- 2.10 As a result during the Relevant Period Linear failed to take reasonable care to ensure that it could effectively conduct market abuse surveillance, which increased the risk that potentially suspicious trading would go undetected.

2.11 Tackling market abuse, in whatever form, remains a high priority for the Authority and it views Linear's failings as serious. The Authority has therefore decided to impose a financial penalty on Linear in the amount of £409,300 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

"DEPP" means the Authority's Decision Procedure and Penalties manual

"DMA" means direct market access and is an electronic trading facility that enables investors in financial instruments to directly place orders and trade via the order books of major exchanges

"ESMA Guidelines" means the European Securities and Markets Authority Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, effective from 1 May 2012

"Principles" means the Authority's Principles for Businesses

"the Relevant Period" means the period from 14 January 2013 to 9 August 2015

"Stage 1" means the period during an investigation by the Authority in which a settlement discount is available if a settlement agreement (which may be a focused resolution agreement) is reached, as described in DEPP 6.7.3G(1)

"STR" means a Suspicious Transaction Report through which 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 FCA

"STOR" means Suspicious Transaction and Order Reports which, from 3 July 2016 onwards, imposed an obligation on firms and trading venues to report suspicious 'orders' in addition to transactions, as well as 'attempted market abuse'

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

"the Warning Notice" means the warning notice given to Linear dated 1 March 2018

#### **4. FACTS AND MATTERS**

##### **Background to Linear**

- 4.1 Linear is, and was during the Relevant Period, a brokerage firm authorised by the Authority. It provides its customers with a range of services, including placing trades on behalf of clients with wholesale DMA providers. It also acts as a principal for a number of Appointed Representatives ("ARs"), which operate in a number of fields including brokerage, asset management and research. As principal, Linear is responsible for any authorised activity undertaken by the ARs.
- 4.2 Trading is primarily conducted via DMA, which Linear routes to its own brokers for transmission to the market. Linear does not have its own DMA capability. Linear enters into DMA agreements with the wholesale brokers and separately enters into individual contracts with clients who wish to trade so that Linear operates what it describes as a 'back to back' service. The nature of this DMA trading is that there is little, if any, contact with the Linear front office meaning that compliance-based surveillance is the primary method by which Linear can monitor trading activity.

##### **Market Abuse controls and the STR regime**

- 4.3 During the Relevant Period firms carrying out activities from an establishment in the UK which arrange or execute transactions with or for a client and which have reasonable grounds to suspect that the transaction might constitute market abuse, must notify the Authority without delay i.e. submit an STR. STRs, and now STORs, 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. The relevant provisions of the Authority's Handbook are set out in the Annex.

### **The Authority's statements on post-trade surveillance, DMA and STRs.**

- 4.4 In December 2006, Issue 18 of Market Watch referred to the need for firms to have in place appropriate and robust monitoring systems and reminded firms of their obligations under the STR regime.
- 4.5 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. This further highlighted the importance of STRs to address market abuse.
- 4.6 In August 2009, Issue 33 of Market Watch highlights that firms who offer their clients DMA should ensure that they have appropriate systems and controls in place to identify and prevent market abuse. Reference is made to the relevant provisions of FSMA and to the Code of Market Conduct (MAR) for guidance on the market abuse regime.
- 4.7 In December 2012, the Authority sent a letter to all authorised firms including Linear. It reminded firms of their obligations to have appropriate systems and controls in place as per ESMA Guidelines which became effective as of 1 May 2012. The letter also reminded DMA providers of their responsibility for the trading of their clients and the need to monitor the trading activities of clients, which involves having adequate market abuse detection systems in place.
- 4.8 In July 2014, Issue 46 of Market Watch provided an overview of price spikes caused by errors in algorithmic trading and notes that "where firms provide Direct Market Access (DMA) or Sponsored Access to other firms or clients, they are responsible for the trading of that client, which is in line with Guideline 8 of the ESMA guidelines."

### **Linear's market abuse surveillance systems and controls**

- 4.9 Prior to installation of an automated post-trade surveillance system on 11 May 2015, Linear had no post-trade surveillance system in place, and relied on limited manual oversight of transactions executed via its outsourced trading platform. When Linear's business model changed, and the volume of trading increased significantly, it failed to consider whether the risks to which they were exposed had been elevated and whether they needed to install an automated post-trade surveillance system.

4.10 It was only in November 2014 that Linear became aware of the need to conduct its own post-trade surveillance. Linear mistakenly considered prior to that time that the requirement to analyse and report suspicious trades was effectively being carried out on their behalf by underlying brokers. Linear would provide the underlying broker with information if they requested it for further analysis in the event that there were any potential suspicious transactions. Linear was mistaken in its view held prior to November 2014 that the co-operation between themselves and underlying brokers was sufficient to meet their regulatory obligations. Linear failed to realise that, regardless of post-trade surveillance checks being undertaken by underlying brokers, Linear was also responsible for undertaking its own checks using information available to it.

4.11 As soon as Linear became aware of the need to conduct its own post-trade surveillance its initial decision was to build the system in-house, but Linear later took the decision to abort the in-house project and it sourced and deployed an automated post-trade surveillance system. There was a further period of time after installation before the Firm had appropriately calibrated and tested the system so that it was operating effectively relative to the nature of its business. This included periods of time during which Linear had to disable alerts on the automated system in relation to spoofing and insider dealing because the system had not been appropriately and correctly calibrated. When the Firm disabled these alerts it did not have suitable alternative surveillance in place. This rendered it incapable of effectively detecting spoofing and insider dealing whilst the alerts were disabled.

4.12 As a result, Linear failed to take care to ensure that it could conduct post-trade surveillance adequately, which increased the risk that potentially suspicious trading would go undetected.

## **5. FAILINGS**

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

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 Linear breached Principle 3 because it failed 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, Linear failed to maintain an appropriate control environment in order to detect and report potential instances of market abuse. Linear had mistakenly relied upon underlying brokers to undertake surveillance on their behalf. They had no post-trade surveillance system in place until they introduced an automated post-trade surveillance system in May 2015, only having some limited manual oversight prior to that time.
- 5.5 Following acquisition of the post-trade surveillance system Linear had to temporarily disable the spoofing and insider dealing alerts because the system had not been appropriately and correctly calibrated. When the Firm disabled these alerts it did not arrange adequate alternative methods to identify the respective market abuse behaviours. It was not until 9 August 2015 that the automated system was effectively tested and calibrated with all alerts being active. This rendered it incapable of effectively detecting insider dealing and spoofing.

## **6. SANCTION**

### **Financial penalty**

- 6.1 The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. The principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.
- 6.2 In determining whether a financial penalty is appropriate the Authority is required to consider all the relevant circumstances of a case. Applying the criteria set out in DEPP 6.2.1G (regarding whether or not to take action for a financial penalty or public censure) and DEPP 6.4.2G (regarding whether to issue a public censure rather than impose a financial penalty), the Authority considers that a financial



penalty is an appropriate sanction, given the serious nature of Linear's breach of Principle 3.

- 6.3 In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

**Step 1: disgorgement**

- 6.4 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 Linear 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 Linear's business, relevant to the breach, is arranging and/or executing transactions in certain instruments directly for its clients. The Authority considers the revenue generated from this business area is indicative of the harm or potential harm caused by the firm's breach. The relevant revenue is therefore the total revenue derived by Linear from this business area during the Relevant Period, which is £6,497,134.
- 6.9 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%

6.10 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 in Linear's procedures relating to a key part of its business.

6.11 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; and

(3) The breach was committed negligently.

6.12 The Authority also considers that the breach could have had an adverse effect on the market, in that it increased the risk that market abuse could occur undetected. Market confidence is put at risk if firms have ineffective systems and controls in place.

6.13 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 £6,497,134.

6.14 Step 2 is therefore £649,713.

### **Step 3: mitigating and aggravating factors**

6.15 Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.16 The Authority considers that the following factor mitigates the breach:

(1) Upon becoming aware of the need to conduct its own post-trade surveillance in November 2014, Linear took steps to source and install an automated post-trade surveillance system in order to remedy the breach. Although it was not until 10 August 2015 that Linear had adequate risk management systems in place in relation to post-trade surveillance, and the breach therefore continued in the meantime, the delay in remediation was partly caused by unforeseen issues arising with the new system and so was not entirely within Linear's control.

6.17 Having taken into account this mitigating factor, the Authority considers that the Step 2 figure should be reduced by 10%. Step 3 is therefore £584,741.

### **Step 4: adjustment for deterrence**

6.18 Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, the Authority may increase the penalty.

6.19 The Authority considers that the Step 3 figure of £584,741 represents a sufficient deterrent to Linear and others, and so has not increased the penalty at Step 4.

6.20 Step 4 is therefore £584,741.

### **Step 5: settlement discount**

- 6.21 The Authority and Linear reached agreement during Stage 1 as to facts and liability by way of a focused resolution agreement (and, specifically, it agreed the matters of fact and liability contained in sections 2 to 5 inclusive of this Notice). Therefore, pursuant to DEPP 6.5A.5G and DEPP 6.7.3AG(1), a 30% discount applies to the Step 4 figure.
- 6.22 Step 5 is therefore £409,318.

### **Penalty**

- 6.23 The Authority has therefore decided to impose on Linear, in respect of its breach of Principle 3, a total financial penalty of £409,300 (rounded down to the nearest £100, in line with the Authority's usual practice).

## **7. REPRESENTATIONS**

- 7.1 Annex B contains a brief summary of the key representations made by Linear and how they have been dealt with. As the Authority and Linear reached agreement during Stage 1 in respect of the matters of fact and liability contained in sections 2 to 5 inclusive of this Notice, Linear only made representations on the financial penalty proposed in the Warning Notice. 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 Linear, whether or not set out in Annex B.

## **8. PROCEDURAL MATTERS**

- 8.1 This Notice is given under section 208 and in accordance with section 388 of the Act.

### **Decision maker**

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

### **The Tribunal**

- 8.3 Linear has the right to refer the matter to which this Notice relates to the Tribunal. Under paragraph 2(2) of Schedule 3 to the Tribunal Procedure (Upper

Tribunal) Rules 2008, Linear has 28 days from the date on which this Notice is given to it to make a reference to the Tribunal.

8.4 A reference to the Tribunal is made by way of a signed reference notice (Form FTC3) filed with a copy of this Notice. The Tribunal's contact details are: The Upper Tribunal, Tax and Chancery Chamber, Fifth Floor, Rolls Building, Fetter Lane, London EC4 1NL (tel: 020 7612 9730; email: [uttc@hmcts.gsi.gov.uk](mailto:uttc@hmcts.gsi.gov.uk)).

8.5 Further information on the Tribunal can be found on the HM Courts and Tribunals Service website. The following page includes guidance on making a reference to the Tribunal, the relevant form to complete (Form FTC3) and notes on that form:

<http://www.justice.gov.uk/forms/hmcts/tax-and-chancery-upper-tribunal>

8.6 A copy of Form FTC3 must also be sent to Natalie Birtle at the Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS at the same time as filing a reference with the Tribunal.

#### **Access to evidence**

8.7 In accordance with section 394 of the Act, Linear has the right to access:

- (1) the material upon which the Authority has relied in deciding to give this Notice; and
- (2) any secondary material which, in the opinion of the Authority, might undermine that decision. There is no such secondary material.

#### **Confidentiality and publicity**

8.8 This Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). In accordance with section 391 of the Act, a person to whom this Notice is given or copied may not publish the Notice or any details concerning it unless the Authority has published the Notice or those details.

8.9 However, the Authority must publish such information about the matter to which a decision notice or final notice relates as it considers appropriate. Linear should therefore be aware that the facts and matters contained in this Notice may be made public.

**Authority contacts**

- 8.10 For more information concerning this matter generally, contact Natalie Birtle (direct line: 020 7066 6856) or Lee Craddock (direct line: 020 7066 9882) at the Authority.

**Tim Parkes**  
**Chair, Regulatory Decisions Committee**

## **ANNEX A**

### **RELEVANT STATUTORY AND REGULATORY PROVISIONS**

#### **1. RELEVANT STATUTORY PROVISIONS**

- 1.1. The Authority's general duties established in section 1B of the Act include the strategic objective of ensuring that the relevant markets function well and the operational objective of protecting and enhancing the integrity of the UK financial system.
- 1.2. Section 206 of the Act provides that the Authority may impose a financial penalty on an authorised person, of such amount as it considers appropriate, if it considers that the authorised person has contravened a relevant requirement.

#### **2. RELEVANT REGULATORY PROVISIONS**

- 2.1. In exercising its power to issue a financial penalty, the Authority must have regard to the relevant provisions in the Authority's Handbook of rules and guidance (the "Handbook").
- 2.2. In deciding on the action set out in this Notice, the Authority has also had regard to guidance published in the Handbook and set out in the Regulatory Guides, in particular DEPP and the Enforcement Guide.
- 2.3. Unless otherwise stated, the regulatory provisions set out below were in force at all material times.

#### **PRINCIPLES FOR BUSINESSES (PRIN)**

- 2.4. 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.
- 2.5. Principle 3 provides: "*A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems*".

## **SENIOR MANAGEMENT ARRANGEMENTS, SYSTEMS AND CONTROLS (SYSC)**

- 2.6. SYSC 6.1.1R states that *"a firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime."*

## **ESMA GUIDELINES**

- 2.7. Guideline 6 provides guidance for investment firms in relation to the prevention of market abuse in an automated trading environment. Under the first 'General guideline' it states that "Investment firms should have policies and procedures in place to minimise the risk that their automated trading activity gives rise to market abuse (in particular market manipulation)". The 'Detailed guidelines' include under provision c) headed 'Monitoring Activity' 'Investment firms should monitor the activities of individuals/algorithms trading on behalf of the firm and the trading activities of clients, taking account of orders submitted, modified and cancelled as well as transactions executed. This should involve having adequate systems in place (including automated alert systems), using a sufficient level of time granularity, to flag any behaviour likely to give rise to suspicions of market abuse (in particular market manipulation), including (where the firm has sight of this) cross-market behaviour".
- 2.8. Guideline 8 refers to 'Organisational requirements for investment firms that provide direct market access and/or sponsored access'. The 'General guideline' states that "Investment firms offering DMA/SA to clients ('DMA/SA clients') are responsible for the trading of those clients. They must establish policies and procedures to ensure the trading of those clients complies with the rules and procedures of the relevant trading platforms to which the orders of such clients are submitted and enables the investment firm to meet its obligations under MiFID and other relevant Union and national law".



## **SUPERVISION MANUAL (SUP)**

2.9. SUP sets out the relationship between the FCA and authorised persons (referred to in the Handbook as firms). As a general rule, SUP contains material that is of continuing relevance after authorisation.

2.10. The relevant rules are as follows:

SUP 15.10.1 R 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 15.10.2 R provided from the start of the relevant period up to **5 February 2014**: *"A firm which arranges or executes a transaction with or for a client in a qualifying investment admitted to trading on a prescribed market and which has reasonable grounds to suspect that the transaction might constitute market abuse must notify the [FSA][FCA] without delay"*.

SUP 15.10.2 R provided from **6 February 2014** onwards: *"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 FCA without delay"*.

SUP 15.10.3R, which states that the firm *"must decide on a case-by-case basis whether there are reasonable grounds for suspecting that a transaction involves market abuse, taking into account the elements constituting market abuse."*

## **DECISION PROCEDURE AND PENALTIES MANUAL (DEPP)**

2.11. 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.

## **ENFORCEMENT GUIDE (EG)**

2.12. 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 states that 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 regulatory objectives. Imposing financial penalties and public censures 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.

## ANNEX B

### REPRESENTATIONS

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

#### **Step 2 of the penalty calculation - seriousness of the breach**

##### Relevant revenue

2. *No explanation or justification has been provided for the assertion that the amount of revenue generated by Linear is indicative of the harm or potential harm caused by its breach. It is inappropriate to use gross revenue figures as the basis for the penalty calculation and doing so leads to a disproportionate result.*
3. *It is open to the Authority to calculate the financial penalty in other ways, as demonstrated in numerous other final notices. In this case, Linear's net revenue/profits from the relevant business after deduction of third party sales/commissions would be a more appropriate and fairer metric and lead to a more proportionate penalty. This is supported by the fact that the penalty that would result from using net revenue and assessing the breach as seriousness level 2 would be similar to the cost that Linear would have incurred, had the automated monitoring system now used by Linear been in place throughout the Relevant Period.*
4. *Linear's business model in relation to execution services is different from many other ostensibly similar regulated firms, in that it involves lower sales margins and higher levels of third party brokerage commissions. As a result, any penalty based directly on gross revenue, instead of net revenue, would have a disproportionately severe impact on Linear in comparison to its competitors, who operate a higher gross margin business model.*
5. *Alternatively, the Authority should simply halve the relevant revenue figure, as it effectively did when calculating the penalty that it imposed on Interactive Brokers (UK) Limited ("IBUK"), in the final notice given to IBUK dated 25 January 2018, for also breaching Principle 3 in respect of inadequate market abuse surveillance controls.*

6. DEPP 6.5A.2G(1) provides that, where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm of potential harm that its breach may cause, the Authority will determine a figure which will be based on a percentage of the firm's revenue from the relevant products or business area. Whilst "revenue" is not defined in DEPP, the Authority ordinarily takes the revenue figure for the purposes of DEPP 6.5A.2G as being the revenue figures prepared by the firm in accordance with the firm's accounting policies, and the Authority has used the revenue figures provided by Linear (described by Linear as "gross revenue") in calculating Linear's penalty. The Authority considers that the revenue generated by Linear from its business of arranging and/or executing transactions is indicative of the harm or potential harm caused by its breach of Principle 3 as there is a clear link between Linear's revenue and the potential harm caused by its breach: an increase in the number of transactions that Linear arranged and/or executed would lead to both the generation of more revenue and, as a result of Linear's breach, a greater risk that a suspicious transaction would be undetected and unreported, and therefore an increase in potential harm. The Authority therefore considers it appropriate to use Linear's revenue figures as the basis for the penalty calculation and, for the reasons set out in paragraphs 25 to 27 below, does not agree that this leads to a disproportionate result.
7. The Authority acknowledges that its penalty policy gives it the discretion to take an alternative approach where revenue is not an appropriate indicator of the harm or potential harm that a firm's breach may cause. There have been other cases the facts of which have led to the exercise of that discretion. However, as explained above, the Authority considers that revenue is an appropriate indicator in this case and that it would not be consistent with its penalty policy to use an alternative metric, including net revenue or profit. Using revenue is also consistent with the approach taken by the Authority when calculating the penalty imposed on IBUK, which Linear has cited as a comparator case. Further, the Authority notes that, when it introduced the five-step penalty framework in March 2010, following consultation, it explained in the Policy Statement (PS 10/4) that it had rejected calculating a firm's penalty based on its profit because, among other reasons, it is difficult to attribute profit for a particular breach whereas, in contrast, revenue is a more objective metric. The Authority does not consider the

possible cost to Linear, had it used the automated monitoring system throughout the Relevant Period, to be relevant to the appropriateness of using revenue, and notes that the penalty might not be a suitable deterrent if it were merely equivalent to the cost that Linear would have incurred, had an effective trade monitoring system been in place.

8. The fact that calculating the penalty on the basis of revenue might, as a result of Linear's business model, lead to Linear being more severely impacted than its competitors would be in similar circumstances, does not mean that it is inappropriate to use revenue. As explained above, the Authority has applied its penalty policy in concluding that it is appropriate to base the penalty on Linear's relevant revenue. Further, the Authority notes that there is a range of reasons why net revenue or profit may vary widely, even between firms offering similar services. For example, this may occur as a result of the business model of the firm, its size, its efficiency or how it attributes costs. The Authority does not consider that Linear's operation of a different business model should affect the basis of the penalty calculation.
9. The Authority's usual approach at Step 2 of the penalty calculation is: first, to decide whether revenue is an appropriate indicator of the harm or potential harm and, if not, what alternative approach to calculating the penalty should be used; secondly, to calculate the relevant revenue (or alternative figure); thirdly, to decide on the seriousness level of the breach; fourthly, to calculate a figure (the Step 2 figure) which reflects the seriousness of the breach by taking a percentage of the relevant revenue figure (or alternative figure); and finally, to consider whether the Step 2 figure should be reduced on the ground that it is disproportionately high for the breach concerned. The assessment of whether the Step 2 figure is disproportionate is therefore separate from, and takes place after, the consideration of whether it is appropriate to use revenue and the calculation of the Step 2 figure. This was the approach taken in the IBUK case, where the Authority concluded that revenue was the appropriate indicator of harm or potential harm, but that the Step 2 figure arrived at, using the revenue figure and after assessing the breach as seriousness level 3, was disproportionate. It was therefore the Step 2 figure which was reduced by 50% rather than the revenue figure. The reason why the Authority has decided not to reduce the Step 2 figure

for disproportionality reasons in this case is explained at paragraphs 25 to 27 below.

#### Seriousness level

10. *Linear's breach is not as serious as alleged, and should be assessed at worst as level 2 rather than level 3. Few of the Step 2 factors in DEPP apply as a negative factor in respect of Linear's breach, whereas a number highlight the less serious nature of this case, which shows that Linear's conduct should properly be seen at the lower end of the scale. The breach did not cause any harm or loss, resulted in no additional profits, was not deliberate or reckless, and carried minimal risk given the surveillance activity that was being undertaken by the underlying brokers, as well as by Linear's own manual process.*
11. *Linear did not fail to appreciate that there was a requirement for post-trade surveillance and did not underestimate the importance of such monitoring. The breach was inadvertent rather than negligent, as at all material times up to November 2014 Linear genuinely believed, albeit mistakenly, that it was entitled to rely upon its underlying brokers' post-trade surveillance activity.*
12. *A speech in March 2013 by Patrick Spens, who at the time was the Authority's Head of Market Monitoring, suggests that the underlying brokers were solely responsible for post-trade monitoring, and demonstrates that Linear had some justification in assuming the post-trade monitoring was being conducted to an appropriate regulatory standard by the underlying brokers.*
13. *Linear was not in any better position than its underlying brokers to carry out post-trade monitoring. Therefore, if an appropriate system had been in place, there is no reason to think it would have made any material difference.*
14. *The Authority's approach to assessing the seriousness of Linear's breach is inconsistent with its approach to assessing seriousness in the IBUK case. Linear's failings were limited, whereas IBUK had multiple failings which were far more serious, yet the Authority has applied seriousness level 3 in both cases.*
15. *In particular, IBUK's failings led to occasions of crystallised risk in relation to possible insider dealing as the Authority identified three occasions on which IBUK*

*breached SUP 15.10.2R by failing to report suspicious trading by its clients. In contrast, the Authority is not alleging that there were instances where Linear failed to submit an STR when it should have done, so no crystallised risk has been identified resulting from Linear's failings.*

16. The Authority has taken into account all relevant factors in assessing Linear's breach to be seriousness level 3. As mentioned at paragraph 6.11 of this Notice, a number of these factors point towards a lower level of seriousness. However, as the surveillance activity that was being undertaken was inadequate, the Authority does not agree that the breach carried minimal risk. As the Market Watch publications referred to in this Notice emphasised, STRs are a very important part of the Authority's approach to tackling market abuse, and so the breach increased the risk that market abuse could occur undetected. Further, the breach revealed serious or systemic weaknesses in Linear's procedures relating to its execution services business, which DEPP 6.5A.2G(11) states is likely to be considered a level 4 or 5 factor. The Authority considers that these matters indicate that Linear's breach is more serious than a level 2 breach.
17. In assessing seriousness, the Authority has taken into account that Linear had a mistaken view that the requirement to analyse and report suspicious trades was effectively being carried out on its behalf by the underlying brokers, and also that Linear had mistakenly relied upon the underlying brokers to undertake surveillance on its behalf. The Authority therefore accepts that the breach was not committed deliberately or recklessly, but considers that Linear's failure to take care to ensure that it could conduct post-trade surveillance adequately means that the breach was committed negligently rather than merely inadvertently.
18. The Authority considers that the speech by Patrick Spens, when considered as a whole, including in conjunction with a letter dated 14 December 2012 regarding the ESMA Guidelines, which had been sent to regulated firms (including Linear) and which was referred to in the speech, supports the conclusion that Linear needed to conduct its own post-trade surveillance. Both the speech and the letter refer to obligations which apply more widely than just to DMA providers. Execution services formed a significant part of Linear's business during the

Relevant Period and Linear should have ensured that it understood its obligations before providing those services.

19. The Authority considers that Linear was in a significantly better position than the underlying brokers to carry out post-trade monitoring. For example, the underlying brokers had no relationship with the underlying clients, and did not have access to their identity or other relevant information about them, and so could not effectively assess whether manipulative trading was taking place. Therefore, if an appropriate system had been in place, there would have been a reduced risk that potentially suspicious trading would go undetected.
20. In both this case and the IBUK case, the Authority has had regard to all relevant factors in assessing the seriousness of the breach. The Authority does not agree that, because the IBUK final notice mentions a number of failings in respect of IBUK's systems, IBUK's breach was more serious than Linear's. The Authority notes, for example, that, in contrast to Linear which, other than some limited manual oversight, had no post-trade systems in place, the final notice for IBUK makes it clear that IBUK had post-trade surveillance systems and processes in place, albeit they were not sufficiently focused on IBUK itself, having been set up on a global basis.
21. The Authority acknowledges that it is unaware of any instances where Linear failed to submit an STR in circumstances in which it should have done and has taken this into account in assessing seriousness, although it notes that the Authority's investigation was focused on Linear's post-trade surveillance and controls and did not extend to seeking to identify any potential crystallised breaches of the obligation to submit a STR.

#### Proportionality

22. *The Step 2 penalty figure that results from using gross revenue and assessing the breach as seriousness level 3 is disproportionate. It would amount to 30% of net revenue across all business areas for the entire Relevant Period, whereas the trade execution activity that is the subject of the Notice accounted for only a proportion of that revenue for that period. It would thereby equate Linear's conduct to more serious behaviour of others, when it is not properly comparable. The impact on Linear's profits is much greater in respect of what is less serious*



*misconduct, and the impact of the penalty on Linear is much more significant than the impact on IBUK of its penalty.*

23. *Accordingly, the Step 2 figure should be reduced by 50% on the grounds of disproportionality, consistent with the approach taken in the IBUK case. Not doing so would be fundamentally inconsistent and irreconcilable with the approach taken in the IBUK case, in circumstances where IBUK's conduct involved more serious and extensive breaches. The Authority's proposed penalty effectively treats Linear as being twice as culpable and/or deserving of double the sanction when compared to IBUK.*
24. *The length of the breach should not be taken into account when considering proportionality, as it is already taken into account in the revenue figure used as the basis for calculating the penalty.*
25. As explained above, the Authority considers that it is appropriate to base the penalty on Linear's relevant revenue and that Linear's breach is of seriousness level 3, and so is satisfied that the Step 2 figure has been calculated correctly. As a next step, it has considered whether the Step 2 figure is proportionate, having regard to DEPP 6.5.3G(3), which states: "*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.*" This proportionality assessment may therefore be seen as a "sense-check", whereby the Authority stands back and considers whether the Step 2 penalty figure is a proportionate sanction in relation to the misconduct that occurred. Its purpose is not to ensure that each firm is impacted equally; a firm's financial position is taken into account in basing the penalty on its relevant revenue, and the Authority will also have regard to its financial position if the firm claims that the payment of the penalty would cause it serious financial hardship, which Linear has not done. Therefore, Linear's submission that the impact of the penalty on it is greater than the impact on IBUK of its penalty does not lead the Authority to conclude that the Step 2 figure is disproportionate.
26. The Authority considers that a penalty of £649,713 (the Step 2 figure) is not a disproportionate sanction for Linear's failure 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, in breach of Principle 3. Linear's breach was serious, as it revealed serious or systemic weaknesses in its procedures relating to a key part of its business, and also increased the risk that market abuse could go undetected, which put at risk market confidence. As the principal purpose of imposing a financial penalty is to deter those who have committed breaches from committing further breaches, to help to deter others from committing similar breaches and to demonstrate generally the benefits of compliant behaviour, the penalty imposed on Linear needs to be a sufficient deterrent. Whilst the Authority recognises that it reduced the penalty on IBUK by 50% following Step 2 for disproportionality reasons, it does not accept that it has to do likewise in respect of Linear's penalty in order to act consistently. The Authority notes that IBUK's Step 2 figure was over £2 million, which is far higher than Linear's Step 2 figure for comparable failings, and that IBUK's breach lasted just over 12 months, whereas Linear's breach lasted over 30 months. It also notes that the relevant revenue calculated in the IBUK case included "other income" which would not have accrued to IBUK but for its main business of arranging and executing transactions for clients, whereas Linear's relevant revenue is confined to that derived from its business of arranging and/or executing transactions. Having regard to all relevant factors, the Authority concludes that the Step 2 figure is not disproportionate relative to Linear's breach.

27. As the relevant revenue is the revenue derived over the Relevant Period, the Authority did not take the length of the breach into account in assessing the seriousness level, as it had already been taken into account in calculating the relevant revenue. However, the Authority considers it is not double counting to consider the length of the breach when assessing the proportionality of the Step 2 figure, as at that point the Authority should assess whether the penalty is proportionate for the breach concerned, which in this case is Linear's failure to comply with Principle 3 for a period of over two and a half years.

### **Step 3 of the penalty calculation – mitigating and aggravating factors**

28. *There are mitigating factors which should be taken into account and which should lead to the penalty being reduced by 50% at Step 3. In particular, Linear took*

*immediate remedial steps upon becoming aware in November 2014 that it needed to conduct its own post-trade surveillance. These steps included acquiring a third-party outsourced, industry-standard, automated monitoring system that subsequently did not function properly and which had to be recalibrated. The remediation and recalibration of this system required additional resource, which Linear readily provided, as well as extra time which was outside of Linear's control.*

29. *In addition, Linear had a reasonable (albeit mistaken) belief that its underlying brokers were at all times carrying out all of the required post-trade monitoring for suspicious activity, and the brokers were in fact carrying out appropriate post-trade monitoring. Further, Linear has implemented other improvements since the end of the Relevant Period, including increasing the number of personnel working in compliance or risk from two to five.*
30. The Authority accepts that, upon becoming aware of the need to conduct its own post-trade surveillance in November 2014, Linear took steps to source and install an automated post-trade surveillance system in order to remedy the breach. The Authority notes that it took over eight months from identification to remediation, but notes that this delay was partly caused by unforeseen issues arising with the new system and so was not entirely within Linear's control. The Authority considers that reducing the penalty at Step 3 by 50% for mitigation is excessive, but has decided that the remedial steps taken by Linear merit a reduction of 10%.
31. The Authority does not agree that the other factors mentioned by Linear merit a reduction in the penalty at Step 3. Linear's mistaken beliefs regarding the underlying brokers have been taken into account by the Authority in assessing the seriousness level, and the other improvements are less directly related to the breach and were implemented sometime after Linear first became aware of the breach.