

This decision notice has been referred to the Upper Tribunal to determine what (if any) the appropriate action is for the Authority to take, and remit the matter to the Authority with such directions as the Tribunal considers appropriate.



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DECISION NOTICE

To: **BlueCrest Capital Management (UK) LLP**

Firm

Reference

Number: **515304**

Address: **11 Bressenden Place, London, SW1E 5BY**

Date: **4 November 2021**

1. ACTION

1.1. For the reasons given in this Decision Notice, the Authority has decided to impose on BlueCrest Capital Management (UK) LLP ("BCMUK") a financial penalty of £40,806,700 pursuant to section 206 of the Act.

2. SUMMARY OF REASONS

2.1. When carrying on regulated activities, Principle 8 of the Authority's Principles for Businesses ("the Principles") requires that a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer

and another client. During the Relevant Period, firms were required to take all reasonable steps to identify such conflicts that arose or might arise in the course of providing services to customers.

- 2.2. Firms were required to have effective organisational arrangements with a view to taking all reasonable steps to prevent conflicts from constituting or giving rise to a material risk of damage to the interests of their clients. Where a firm's arrangements were not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client would be prevented, the firm was required to provide sufficient disclosure to the clients in relation to the conflicts.
- 2.3. When firms fail to manage conflicts fairly, the customer harm may include the provision of a sub-standard service whereby customers are not given enough information to make informed decisions about their financial affairs and/or do not get fair and equal access to suitable investment opportunities.
- 2.4. Asset management firms operate as the agents of their customers and make investment decisions in financial markets on their behalf. The Authority has previously emphasised that when providing services, asset managers are susceptible to conflicts of interest arising between their own interests and those of their customers. Asset managers should not let conflicts of interest interfere with their obligations to customers, as this risks customers suffering harm.
- 2.5. BlueCrest was a hedge fund management group founded in 2000. During the period from 1 October 2011 to 31 December 2015 (the "Relevant Period"), BlueCrest managed both external funds, which were open to investors outside BlueCrest, and internal funds, open only to its partners and employees. These proceedings are concerned with one particular fund of each type, namely the Internal Fund and the External Fund (together "the Funds").
- 2.6. Each of BlueCrest's funds had an appointed Investment Manager supported by a number of appointed Sub-Investment Managers, providing a varying range of investment management functions on its behalf. The largest Sub-Investment Manager was BCMUK.
- 2.7. BCMUK played an integral role in decisions concerning allocation of the Funds' capital and Portfolio Managers. Over the course of the Relevant Period, BCMUK was aware of, and ratified, the reallocation of Portfolio Managers from the

External Fund to the Internal Fund. At the same time, a significant amount of the External Fund's capital was allocated to a Semi-Systematic Capital Unit called RMT, which was a semi-automated computer trading system.

- 2.8. RMT was an important factor in the reallocation of Portfolio Managers from the External Fund to the Internal Fund. RMT sought to replicate the performance of Internal Fund Portfolio Managers for investors in the External Fund. However, RMT did not perform in the same way as the Portfolio Managers, and at times its performance fell below theirs.
- 2.9. BCMUK recognised that the allocation of Portfolio Managers to the Internal Fund gave rise to a conflict of interest. However, in breach of Principle 8, its arrangements for managing that conflict were inadequate. In particular, the primary control on which BCMUK relied to manage and mitigate this conflict was the fact that decisions concerning the allocation of Portfolio Managers to the Funds were made by senior individuals who had a regulatory (and fiduciary) duty to serve the interests of the Funds and their investors.
- 2.10. However, decisions concerning the Internal Fund's allocation of Portfolio Managers were made exclusively by the senior staff invested in it, which placed them in a situation where they stood to benefit from these decisions personally, in conflict with the duties they owed to investors in the External Fund. BCMUK failed to recognise that this control was ineffective, and indeed made the conflict of interest worse. BCMUK was aware of the material risks presented by this conflict but nevertheless approved the inadequate primary control intended to mitigate it. The Authority considers BCMUK's conduct was reckless, rather than deliberate.
- 2.11. BCMUK's systems and controls did not manage the risk that Portfolio Managers could be allocated in a way that favoured investors in the Internal Fund over those of the External Fund. Accordingly, BCMUK could not ensure that the interests of its customers would not be damaged. Moreover, investors in the External Fund paid management fees in the expectation that their investments would be managed appropriately. Against this background, BCMUK's approach to how it managed the conflict arising from its role in ratifying the allocation of Portfolio Managers was inappropriate. BCMUK's failure appropriately to manage this conflict resulted in a sub-standard investment management service being provided to the External Fund and its investors.

- 2.12. Given their nature, BCMUK's disclosures to its investors regarding the existence of the Internal Fund, and the conflicts arising, were entirely insufficient and, at times, misleading. External Fund investors were not told that a significant number of its Portfolio Managers had been reallocated to the Internal Fund and that, related to this, significant External Fund capital had been allocated to RMT.
- 2.13. Moreover, BCMUK did not give its customers adequate disclosure of the conflict of interest arising from how Portfolio Managers were being allocated between the Funds, nor how it was being managed. Investors in the External Fund accordingly did not have sufficient information to allow them to scrutinise the substance of the conflict or how BCMUK managed this conflict, and this affected their ability appropriately to consider their actions regarding the External Fund.
- 2.14. From February 2014, following a Bloomberg article which highlighted the existence of the Internal Fund and expressed concerns about it and possible conflicts, BCMUK provided limited information, on a reactive basis, in response to queries from some investors and Due Diligence Consultants. However, at no time did it tell External Fund investors about the specific conflict in relation to allocations of Portfolio Managers to the Internal Fund.
- 2.15. Investors' and Due Diligence Consultants' concerns over the continuing lack of transparency about the Internal Fund and how conflicts were being managed were sufficiently serious that many investors redeemed their subscriptions to the External Fund. From 1 December 2015, BlueCrest closed its business to new external investment.
- 2.16. Market confidence in the asset management sector relies, among other things, on public trust that asset managers will effectively manage and appropriately disclose conflicts of interest. Accordingly, the action set out in this Notice supports the Authority's operational objective of protecting and enhancing the integrity of the UK financial system. It also supports its operational objective of securing an appropriate degree of protection for consumers.
- 2.17. For the avoidance of doubt, this Notice makes no criticism of any person other than BCMUK.

3. DEFINITIONS

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

“the Act” means the Financial Services and Markets Act 2000;

“AuM” means assets under management;

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

“BCMUK” means BlueCrest Capital Management (UK) LLP;

“BCMUK ExCo” means the Executive Committee of BCMUK;

“BCMUK Rates desk” means the subset of Rates-based Portfolio Managers based at BCMUK;

“BlueCrest” means the asset management group of which BCMUK is a member;

“BlueCrest Rates desk” means the BlueCrest trading desk consisting of Portfolio Managers primarily trading in fixed income assets;

“BlueCrest Relative Value desk” means the BlueCrest trading desk consisting of Portfolio Managers primarily trading in relative value assets;

“Capital Unit” means a Portfolio Manager or Semi-Systematic Capital Unit;

“customer” means any client/investor who is not an eligible counterparty;

“DDQ” or “Due Diligence Questionnaire” means the document issued by BCMUK which provided information pertinent to the management of the External Fund including key personnel and departments, operational procedures, risk management controls and the External Fund’s investment strategy and investment processes;

“DEPP” means the Authority’s Decision Procedure and Penalties Manual;

“Due Diligence Consultant” means an organisation whose primary business is to assess the investment management and operational arrangements of an asset manager on behalf of investors;

“the External Fund” means a particular BlueCrest fund which could be subscribed to by professional investors;

“the Funds” means the Internal Fund and the External Fund together;

“Group ExCo” means the Executive Committee of the Investment Manager;

“the Internal Fund” means a particular BlueCrest fund which could only be subscribed to by BlueCrest partners and employees;

“IMA” or “Investment Management Agreement” means the formal agreement governing the management of a particular fund by the Investment Manager;

“Investment Manager” means the BlueCrest entity responsible for managing each BlueCrest fund pursuant to its stated investment objective and subject to any restrictions stipulated by the fund’s Directors;

“OAR” means the over allocation ratio, which was generally calculated as the total capital allocated to a particular fund divided by that fund’s AuM;

“P&L” means ‘Profit & Loss’ (a designation for the total profit or loss made by a Capital Unit or group of Capital Units over a certain time period);

“Portfolio Manager” means a human portfolio manager or trader allocated capital to trade with on behalf of a fund. For the purpose of this Decision Notice, where a portfolio manager or trader managed more than one trading book, whether individually or jointly with another portfolio manager or trader, each trading book has been treated as relating to a separate Portfolio Manager;

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

“Rates-based Portfolio Manager” means a Portfolio Manager based on the BlueCrest Rates desk;

"RAC" means BCMUK's Regulatory Affairs Committee;

"Relative Value-based Portfolio Manager" means a Portfolio Manager based on the BlueCrest Relative Value desk;

"Relevant Period" means the period between 1 October 2011 and 31 December 2015 inclusive;

"RMT" means the Semi-Systematic Capital Unit named Rates Management Trading;

"Semi-Systematic Capital Unit" means a semi-automated computer system allocated capital to trade with on behalf of a fund which attempted to track and replicate the trading activity of certain Portfolio Managers;

"side-by-side management" means the practice of managing separate investment funds simultaneously;

"Sub-IMA" or "Sub-Investment Manager Agreement" means the formal agreement governing the responsibilities of the Sub-Investment Manager;

"Sub-Investment Manager" means a BlueCrest entity delegated responsibility to manage a BlueCrest fund in accordance with the terms of the relevant Sub-IMA;

"SYSC" means the part of the Authority's Handbook entitled Senior Management Arrangements, Systems and Controls;

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

"Warning Notice" means the warning notice issued to BlueCrest in relation to this matter dated 30 September 2021.

4. FACTS AND MATTERS

Background

- 4.1. BlueCrest was a hedge fund management group founded in 2000 with assets under management (AuM) of US\$0.12 billion. Since 2011, BlueCrest has been fully owned and controlled by its principals, who work in its business. At its high point, BlueCrest's global AuM totalled US\$35.3 billion in 2013.
- 4.2. During the Relevant Period, BlueCrest managed both external funds, which were open to investors outside BlueCrest, and internal funds, open only to its partners and employees. These proceedings are concerned with one particular fund of each type, namely the Internal Fund and External Fund. Each of BlueCrest's funds had an appointed Investment Manager responsible for managing each fund pursuant to its investment objective and subject to any restrictions stipulated by the fund's Directors. At all material times, the Investment Manager operated from outside the UK and was not authorised by the Authority to carry on any regulated activities.
- 4.3. In discharging its responsibilities, the Investment Manager appointed Sub-Investment Managers, to which it delegated investment management functions. The largest of BlueCrest's Sub-Investment Managers, by number of staff, was BCMUK.
- 4.4. During the Relevant Period, BCMUK was authorised by the Authority to carry on various regulated activities, including managing investments and making arrangements with a view to transactions in investments. Its range of investment management and other functions included portfolio management, legal, compliance, risk, operations and investor relations.
- 4.5. BCMUK was remunerated for the various services it supplied as a Sub-Investment Manager to each fund, including the Funds. Fees generated from each fund were paid to the Investment Manager, which in turn paid a portion of this to each of the Sub-Investment Managers, including BCMUK. Within its published financial statements, BCMUK recognised sub-investment management fees (comprising management and performance fees) and a service fee.

- 4.6. Before December 2015, BlueCrest (including BCMUK) operated globally for an external customer base of institutional investors from the UK, Europe, North America, the Middle East and Asia. From 1 December 2015, BlueCrest closed its business to new external investment and, from January 2016, commenced a programme of returning capital to external investors.

The External Fund

- 4.7. The External Fund, which launched in December 2000, was a discretionary fund focussed predominantly on trading liquid securities in fixed income markets. It was regarded by BCMUK as a “flagship” external client fund, and between October 2011 and December 2015 was BlueCrest’s largest fund by AuM. Whilst the External Fund had a wide investment mandate, the majority of its capital was allocated to Capital Units based on BlueCrest’s “Rates” and “Relative Value” desks.
- 4.8. The External Fund’s total AuM during the Relevant Period reached a high of US\$14.5 billion and had decreased to US\$2.2 billion when it closed to external investment in December 2015.

The Internal Fund

- 4.9. On 1 October 2011, BlueCrest launched the Internal Fund which was not open to investment from BlueCrest’s external clients. BCMUK was appointed as a Sub-Investment Manager of the Internal Fund in the previous month.
- 4.10. Similarly to the External Fund, the Internal Fund could invest in a wide range of financial instruments. Moreover, like the External Fund, the majority of the Internal Fund’s capital was allocated to the Capital Units based on BlueCrest’s Rates desk, and with significant capital also allocated to the Relative Value based Portfolio Managers.
- 4.11. The Internal Fund’s stated purpose was to “*attract and retain senior partners and other key members of staff*”.
- 4.12. The launch date of the Internal Fund (i.e. 1 October 2011) represents the start of the Relevant Period. The conflict of interest was present from this date because it was at this point that Portfolio Managers from the External Fund could have been reallocated to the Internal Fund.

- 4.13. There were no individuals directly invested in the Internal Fund. Rather, individuals gained indirect exposure to the performance of the Internal Fund through their interests in other investing group entities. Exposure to the Internal Fund could be gained through individuals' deferred compensation or their own vested funds (or a combination of the two). Individuals could further increase their existing exposure by making additional contributions to the investing entities.
- 4.14. At the start of the Relevant Period (i.e. the Internal Fund's launch date), the Internal Fund's AuM totalled US\$0.5 billion, with 14 BlueCrest individuals exposed to it. By the end of the Relevant Period, its AuM had risen to over US\$2 billion with 55 individuals exposed to it, including Portfolio Managers who traded for the Funds. The vast majority of exposure to the Internal Fund was concentrated around a relatively small number of individuals throughout the Relevant Period.
- 4.15. An individual's eligibility to be exposed to the returns of the Internal Fund and the level of that exposure was ultimately determined by members of BlueCrest's senior management. A small minority of BlueCrest's Portfolio Managers (and not all Portfolio Managers for the External Fund) were given an exposure to the Internal Fund and, unless an individual had exposure, they would not receive a financial benefit from it.
- 4.16. Staff exposed to the Internal Fund were told they had limited rights to redeem their investment and would only receive a pay-out upon their retirement. However, in normal practice, Portfolio Managers with exposure to the Internal Fund would receive any investment returns annually, rather than further increasing their exposure. This additional payment was considered part of a Portfolio Manager's financial reward, with the aim of retaining their services.
- 4.17. During the Relevant Period, the majority of Rates and Relative Value Portfolio Managers with an exposure to the Internal Fund traded on behalf of the Internal Fund. Twenty-seven Rates and Relative Value Portfolio Managers transferred from the External Fund to the Internal Fund throughout the Relevant Period, of whom 20 had exposure to the Internal Fund. Three of the latter gained exposure before their transfer and 17 either in the year of their transfer, or in years after their transfer. Of those who gained no exposure during the Relevant Period, 6 of the 7 Portfolio Managers transferred during December 2015.

- 4.18. Three External Fund Portfolio Managers received an exposure to the Internal Fund, but were not transferred during the Relevant Period. All 3 of these had traded for the External Fund since July 2012.
- 4.19. The Internal Fund's investor base (via the indirect exposure mechanism described at paragraph 4.15 above) included other BCMUK staff. In particular, for the majority of the Relevant Period, all members of BCMUK ExCo were exposed to the Internal Fund, and many of these increased their level of exposure during that time.

Responsibilities of BCMUK as Sub-Investment Manager

- 4.20. The duties of the Investment Manager in relation to the External Fund and Internal Fund were formalised in separate IMAs.
- 4.21. The IMAs empowered the Investment Manager to delegate the performance of its overarching responsibilities and functions to one or more third parties. Specifically, each IMA provided for the appointment of one or more Sub-Investment Managers.
- 4.22. During the Relevant Period, BCMUK was appointed as a Sub-Investment Manager for all of BlueCrest's funds, including the External Fund and Internal Fund. BCMUK's responsibilities as a Sub-Investment Manager were set out in separate Sub-IMAs with the Investment Manager.
- 4.23. In particular, BCMUK was required under the Sub-IMAs to manage the Funds' underlying portfolios as a "*direct agent*" of each fund and to provide such services as to enable the Investment Manager to discharge its responsibilities under the IMA.
- 4.24. In respect of these services, the Funds and their underlying investors had professional client status.

Side-by-side management of the Funds

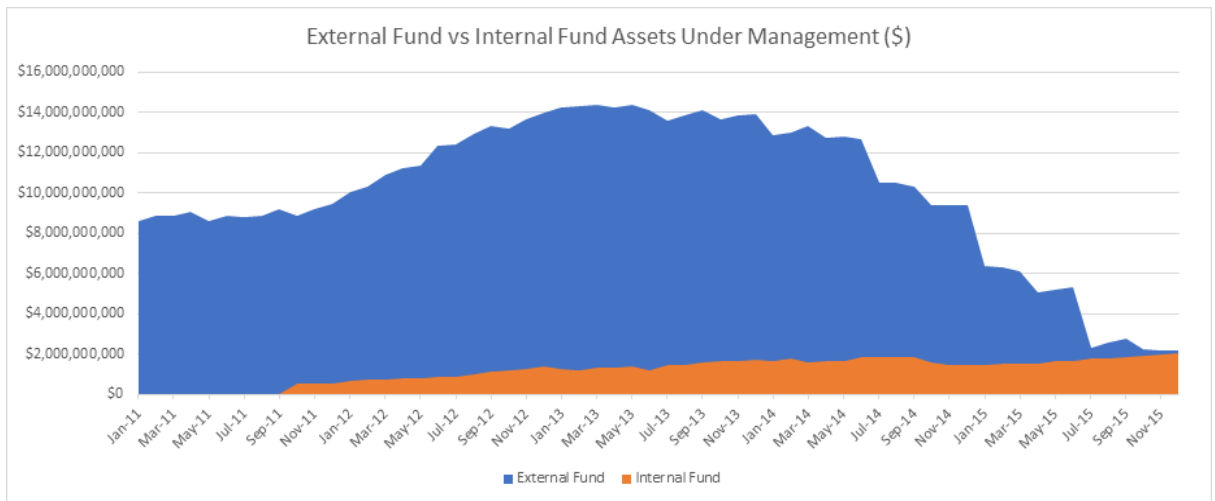
- 4.25. The Investment Manager and its Sub-Investment Managers (including BCMUK) managed multiple funds (including the Funds) on a side-by-side basis. BCMUK's

pool of Portfolio Managers could trade for more than one fund and could be re-allocated from one fund to trade for another.

- 4.26. BCMUK's view, reactively communicated to investors through its Internal Fund Q&A (see paragraphs 4.76 to 4.81 below), was that its Portfolio Managers were "A players" expected to contribute positively to the performance of all funds.
- 4.27. Throughout the Relevant Period, the majority of Portfolio Managers trading for the Funds were based on the BlueCrest Rates and Relative Value desks.

Capital allocation and the over allocation ratio

- 4.28. Large hedge fund managers employ various techniques to ensure their Portfolio Managers and investment strategies can achieve desired levels of risk across each of their funds. In order to calibrate a Portfolio Manager's or investment strategy's level of independent risk-taking for a given fund, those hedge fund managers may allocate a certain amount of notional capital to the Portfolio Manager (or investment strategy). To account for diversification effects among multiple Portfolio Managers and investments strategies, the total amount of allocated notional capital across all Portfolio Managers and investment strategies will generally exceed the fund's AuM.
- 4.29. During the Relevant Period, BlueCrest followed such an approach and used an over allocation ratio ("OAR") to measure the aggregate amount of allocated notional capital to the total AuM of certain of its funds (including the Funds). The OAR of the External Fund remained largely consistent throughout the majority of the Relevant Period, and BlueCrest had targeted an OAR of approximately 1.5 (i.e. 1.5 times capital to AuM).
- 4.30. The AuM of the Internal Fund remained below that of the External Fund throughout the Relevant Period (see chart below).



4.31. However, there was a significant difference in the proportion of capital allocated to each of the Funds. In comparison to the 1.5 OAR for the External Fund, the Internal Fund had an OAR that was on average, above 10. From January 2015, the total amount of capital allocated to the Internal Fund exceeded that of the External Fund.

Portfolio Manager and capital allocations

4.32. Group ExCo had overarching responsibility for determining the allocation of Portfolio Managers to BlueCrest funds. BCMUK was responsible for ratifying these decisions insofar as they concerned the allocation of BCMUK Portfolio Managers. This included decisions made by Group ExCo to reallocate BCMUK Portfolio Managers from one fund to another. Some members of BCMUK ExCo were also aware of and involved in these decisions by virtue of their membership of Group ExCo.

4.33. Further, Group ExCo would recommend proposed capital allocations to Portfolio Managers for its Sub-Investment Managers (including BCMUK) to approve. Group ExCo would review these allocations from time to time by reference to factors including diversification, risk, fund capital levels, investment objectives, target volatility and returns.

4.34. BCMUK ExCo would also approve and monitor the capital allocations of BCMUK's Portfolio Managers. When approving proposed capital allocations, BCMUK ExCo referred to a "Capital Allocation" paper containing the name, desk and current and historic capital allocation of BCMUK's Portfolio Managers.

- 4.35. Notwithstanding Group ExCo having some responsibilities in relation to Capital Units and capital allocation decisions, the responsibility for managing conflicts arising between BCMUK and its clients was that of BCMUK alone. By reason of Principle 8, BCMUK was not just responsible for managing conflicts between itself and its clients, but was also responsible for managing conflicts between its clients.

Portfolio Manager reallocations to the Internal Fund

- 4.36. Over the course of the Relevant Period, a significant number of Portfolio Managers were either permanently reallocated from a BlueCrest external client fund to the Internal Fund or given a split allocation of capital between an external client fund and the Internal Fund. During the Relevant Period:
- a. 44 Portfolio Managers managing an aggregated total capital of US\$12.85 billion were fully reallocated from BlueCrest external client funds (including the External Fund) to the Internal Fund; and
 - b. 32 Portfolio Managers had their capital allocations split between an external client fund (6 of which related to the External Fund) and the Internal Fund.

Those Portfolio Managers were based at various Sub-Investment Managers including BCMUK.

- 4.37. In total, 28 Portfolio Managers were reallocated from the External Fund to the Internal Fund. Of those, 24 traded for the BlueCrest Rates desk and 3 traded for the BlueCrest Relative Value Desk. In addition, 6 Portfolio Managers had their capital allocation split between the Funds.

The Funds' Rates and Relative Value new hires and leavers

- 4.38. Throughout the Relevant Period, there were 63 new hires for the Funds. Of those, 44 were placed onto the BlueCrest Rates and Relative Value desks. Of those 44, one had a capital allocation split between the Internal Fund and the External Fund, and 43 had their entire capital allocated to one of the Funds: 26 to the External Fund, and 17 to the Internal Fund. Of these new Portfolio Managers, 11 were placed on BCMUK's Rates and Relative Value desks, and all had their entire capital allocated to one of the Funds: 8 to the External Fund and 3 to the Internal Fund.

In total, 23 Rates and Relative Value Portfolio Managers left BlueCrest during the Relevant Period, 6 of whom were based on BCMUK's trading desks.

BCMUK Portfolio Managers reallocated from External Fund to Internal Fund

- 4.39. At times during the Relevant Period, up to 18 Portfolio Managers were based on the BCMUK Rates and Relative Value desks.
- 4.40. Within a month of the Internal Fund's launch, 3 Portfolio Managers on the BCMUK Rates desk were fully reallocated to it from the External Fund. Overall, a total of 11 Portfolio Managers on the BCMUK Rates and Relative Value desks were fully reallocated from the External Fund to the Internal Fund during the Relevant Period.
- 4.41. In April 2012, a BCMUK ExCo member noted that the "majority" of Rates-based Portfolio Managers were trading for the Internal Fund rather than the External Fund. They queried whether the "level of transfer" of Portfolio Managers from the External Fund to the Internal Fund was such that it should be disclosed to investors and regulators. But following this email there was no additional disclosure regarding the number of Portfolio Managers transferred from the External Fund to the Internal Fund, or how any related conflicts were managed by BCMUK.

Rates Management Trading (RMT)

- 4.42. In addition to Portfolio Managers, BlueCrest funds allocated capital to Semi-Systematic Capital Units. During the Relevant Period, the Funds allocated capital to one such Semi-Systematic Capital Unit: RMT.
- 4.43. RMT was devised a few months prior to the launch of the Internal Fund and launched in January 2012. As a Semi-Systematic Capital Unit, RMT operated through a combination of algorithmic processes and manual (i.e. human) review and intervention by staff at several Sub-Investment Managers (including BCMUK).
- 4.44. RMT was an important factor in the reallocation of Portfolio Managers from the External Fund to the Internal Fund. It was designed to replicate certain trading activities and strategies of a subset of the Portfolio Managers on the Rates and Relative Value desks. Specifically, RMT attempted to identify an optimal set of

profitable, cost-effective trades which would be executed based upon, but independently of, the trading activity of these Portfolio Managers. The subset of replicated Portfolio Managers included BCMUK Portfolio Managers that were reallocated from the External Fund to the Internal Fund during the Relevant Period.

- 4.45. Staff based at several Sub-Investment Managers were responsible for RMT, with BCMUK contributing resource to the trade execution, technology, modelling and risk & control support teams.
- 4.46. BCMUK ExCo was not responsible for deciding the allocation of capital to RMT. Certain members of BCMUK ExCo were aware of RMT's capital allocation by virtue of their membership of Group ExCo (this information being provided within the monthly Group ExCo packs). Certain BCMUK staff were responsible for monitoring the market risk specifically associated with RMT's trading during the Relevant Period.
- 4.47. The allocation of capital to RMT meant that the trading activities of reallocated Portfolio Managers continued to be a determining factor for the P&L generated by the External Fund. This was because RMT could be, and was, used to attempt to replicate the trading activities of reallocated Portfolio Managers.
- 4.48. Furthermore, when necessary, RMT was utilised as a Capital Unit to help maintain the External Fund's target OAR throughout the Relevant Period.

RMT's target portfolio

- 4.49. RMT sought to replicate Portfolio Manager trading activity by reference to a "*target portfolio*" which comprised two main components: 1) Portfolio Manager "*weights*"; and 2) asset classes and strategies which RMT could replicate. BlueCrest aimed, through such replication, to align RMT's realised P&L as closely as possible with the expected P&L of its target portfolio (the "*target P&L*"). BlueCrest measured the performance of RMT according to how closely its realised P&L and the target P&L were aligned.
- 4.50. For the purpose of constructing the target portfolio, each Rates and Relative Value Portfolio Manager was ascribed a weighting, typically between zero and 2. These identified the proportion of each Portfolio Manager's trading activity that RMT

would attempt to replicate. The complexity and costs associated with certain trading activity meant that RMT did not attempt to replicate every Rates and Relative Value Portfolio Manager.

- 4.51. Strategies connected with options, intraday, inflation and equity trading were often excluded from RMT's replication processes. RMT's ability to generate positive P&L was also affected by additional costs resulting from it operating on a T+1 basis, where trades were executed at least one day after the relevant Portfolio Manager's trading activity.
- 4.52. BlueCrest staff, including BCMUK staff, understood that RMT was not a direct substitute for the Portfolio Managers and could not capture all profitable trades and trading strategies. At times, RMT experienced "*significant slippage*" between the P&L it was able to realise compared with its target P&L.
- 4.53. In addition to this P&L slippage, deficiencies in the data input into RMT sometimes resulted in actual financial loss to the External Fund during the Relevant Period.

Capital allocations to RMT

- 4.54. Between February and May 2012, significant External Fund capital was allocated to RMT for the purpose of "*testing*" its performance. In August 2012, RMT was also allocated capital by the Internal Fund.
- 4.55. Having generated a positive return in 2012, RMT generated significant losses for the Funds during 2013. In particular, in June 2013, RMT lost approximately US\$305.5 million. This proved to be the worst trading month experienced by the Internal Fund during the Relevant Period. At this same time, the Internal Fund had also failed a cash stress test. During the following month, due to these factors, the Internal Fund substantially reduced its capital allocation to RMT by almost US\$3 billion. From August 2013, the Internal Fund ceased all trading through RMT.
- 4.56. Conversely, the External Fund continued to allocate significant capital to RMT. Indeed, by October 2013, almost 30% of the External Fund's total capital had been allocated to RMT and this steadily increased during the remainder of the Relevant Period. For the majority of the Relevant Period, RMT was the single largest Capital Unit within the External Fund, and had a significant role in ensuring the External

Fund maintained its intended OAR. This was in spite of an increase in the disparity between RMT's targeted performance and actual performance.

Disclosure of RMT

- 4.57. Investors in the External Fund were not proactively made aware of the existence of RMT, or that it was a Semi-Systematic Capital Unit, and of the significant amounts of capital allocated to it. Moreover, disclosures about the number of Portfolio Managers allocated capital by the External Fund were insufficient and misleading because BCMUK included in that number traders that were tracked by RMT despite them having been reallocated to the Internal Fund and no longer having individual capital allocations from the External Fund.
- 4.58. It appears that BCMUK first considered disclosing information about RMT to the External Fund's investors in around September 2013, when reference to RMT was included in a "Q&A" document regarding the External Fund's "trader allocations" ("the External Fund Q&A"). The External Fund Q&A stated that this information was not to be proactively disclosed, but to be provided reactively to investors who specifically questioned the External Fund's trader allocations.
- 4.59. The Q&A also directed staff to avoid discussion of how RMT worked because its process was "proprietary" (i.e. owned by BlueCrest). Consequently, this meant that External Fund investors were not told about RMT's limitations in comparison to Portfolio Managers, including its inability to replicate certain trading practices of Portfolio Managers and the exclusion of intraday trading.
- 4.60. The limited information about RMT, which BCMUK intended to disclose reactively, was insufficient and misleading, and did not provide External Fund investors with any information on the existence of the conflict relating to the allocation of Portfolio Managers, nor how it was being managed. The document did not contain any reference to the conflict of interest associated with the External Fund's trader allocations. Moreover, the document did not disclose that RMT was being used alongside trader reallocations from the External Fund to the Internal Fund. In particular, investors were to be told:
 - a. That "looking at 'individual trader allocations' no longer [made] sense". Investors were to be told this in circumstances where, between October 2011 and October 2012, 17 Portfolio Managers had

been reallocated from the External Fund to the Internal Fund and there had been 29 new hires in the External Fund between October 2011 and October 2013.

- b. That RMT was “*additive*” and “*complementary*” to the External Fund’s use of Portfolio Managers – although the Q&A directed staff not to discuss RMT’s capital allocation figures. In fact, RMT had been described internally as a tool to “*keep the [External Fund] alive with some risk in it*” whilst Portfolio Managers were reallocated to the Internal Fund;
- c. That RMT was not the “*dominant contributor*” to the External Fund – although the Q&A directed staff not to discuss RMT’s capital allocation figures. In fact, by September 2013, RMT had received the largest capital allocation of any Capital Unit in all but 3 months following its introduction and continued to receive the largest capital allocation from October 2013 onwards; and
- d. That RMT’s quantitative processes had “*contributed positively since their introduction*” - although the Q&A directed staff not to provide details of RMT’s returns. In fact, only three months earlier, in June 2013, RMT had made a loss of approximately US\$305.5 million (which included a loss to the External Fund of approximately US\$139 million). RMT’s specific performance figures were typically not included in performance information shared with investors.

Disclosures regarding the Internal Fund to External Fund investors

- 4.61. Pursuant to the master sales agent agreement (“MSA”), BCMUK was appointed by the Investment Manager to market and sell subscriptions for investment in the External Fund. This included BCMUK providing presentations and issuing marketing materials to prospective investors in the External Fund. These responsibilities were primarily carried out by BCMUK’s Sales & Marketing team.

Investor presentation

- 4.62. During the Relevant Period, prospective External Fund investors received two presentations from BCMUK as part of the investment process – a fund presentation

and a BlueCrest firm presentation. The presentations were prepared by the BCMUK Sales & Marketing team and reviewed by BCMUK's Legal and Compliance functions.

- 4.63. The External Fund presentations provided the prospective investor with an overview of the fund's portfolio and investment strategy, risk oversight controls and historic performance. The BlueCrest firm presentations provided generic information on BlueCrest, its funds and key personnel. There was significant overlap between the information provided to investors in the two presentations.
- 4.64. Both presentations explicitly highlighted that the External Fund was subject to a number of "risks" including its being subject to "*certain conflicts of interest*". However, no specific conflicts of interest were described, nor how they were being managed.

Due Diligence Questionnaire

- 4.65. An important information document issued by BCMUK to External Fund investors was the External Fund DDQ. This was an extensive document, its main purpose being to anticipate and answer various questions that investors might have.
- 4.66. Accordingly, the External Fund DDQ contained questions and corresponding answers on a wide range of topics including BlueCrest's key personnel and departments, operational procedures, total AuM, risk management controls and the External Fund's investment strategy and investment processes. The External Fund DDQ was compiled by the BCMUK Sales & Marketing team and reviewed and approved by departmental heads as well as Legal and Compliance.
- 4.67. Like the investor presentations, the External Fund DDQ stated that the External Fund was subject to conflicts of interest. In this regard, it signposted the External Fund prospectus as the document which disclosed the fund's "*current and/or potential conflicts of interest*". It also noted that Compliance and senior management worked together to eliminate or mitigate potential conflicts.

Prospectus

- 4.68. The External Fund prospectus was the main marketing document issued by BCMUK to investors and prospective investors during the Relevant Period. The

prospectus set out key information concerning the External Fund's fees, risks, key staff and service providers. The prospectus was authored by BCMUK's Legal function with input from outside counsel and was informally reviewed by Compliance.

4.69. The External Fund prospectus provided limited information about conflicts of interest. During the Relevant Period, each External Fund prospectus contained a "*Conflicts of Interest*" section which explained that Sub-Investment Managers (amongst other entities):

- a. "*may from time to time act...in relation to... other investment funds and other vehicles with similar or different objectives to those of the [External Fund]*";
- b. "*may, in the course of business, have potential conflicts of interest with the [External Fund]*";
- c. "*may... manage... other funds...[or] vehicles which invested in assets which may also be purchased... by the [External Fund]*";
- d. had no obligation to offer investment opportunities to the External Fund;
- e. would at all times have regard to their obligations to the External Fund and endeavour to ensure that conflicts were resolved fairly; and
- f. would allocate investment opportunities on an "*equitable basis*" between the External Fund and other clients/third parties.

4.70. The External Fund prospectus stated that it did not purport to provide a "*complete list of all potential conflicts of interest*" involved in investing in the External Fund. Moreover, by investing in the External Fund, investors were taken to have acknowledged the existence of "*the actual and potential conflicts of interest*" described in the prospectus and waived all claims in respect of the existence of such conflicts "*to the fullest extent permitted by applicable law*".

4.71. In July 2012, the External Fund prospectus was updated with a paragraph referring to "*proprietary investment funds*" in which only "*partners, employees,*

affiliates or other persons connected with the BlueCrest Group may invest". This additional paragraph did not expressly refer to the Internal Fund or make clear that such a proprietary investment did exist and that partners, employees and affiliates were investing in it or otherwise exposed to its returns.

- 4.72. The paragraph set out potential conflicts arising out of the existence of a proprietary investment fund, but used language which was not clear. For example, the paragraph stated that BlueCrest employees (e.g. Portfolio Managers) "*may*" provide similar services or fulfil similar roles for both the External Fund and a proprietary fund. Further, that a proprietary fund "*may compete*" with the External Fund for investments.
- 4.73. In reality, a conflict had arisen given the Internal Fund's significant use of reallocated Portfolio Managers, including BCMUK's Rates and Relative Value-based Portfolio Managers.
- 4.74. In June 2015, the last External Fund prospectus was issued. This was the first prospectus explicitly to name the Internal Fund and describe it as a proprietary investment vehicle managed by BlueCrest. However, at no point did any prospectus disclose that decisions regarding the Internal Fund's allocation of capital and Capital Units were made exclusively by senior individuals invested in it.
- 4.75. Significantly, from July 2013, all External Fund prospectuses stated: "*The Investment Manager does not have an obligation to ensure the fair treatment of investors*". This statement did not, and could not, negate the regulatory obligations owed by BCMUK to its clients during the Relevant Period, including the requirement under the Principles to manage conflicts of interest between its customers and other clients fairly.

Internal Fund Q&A

- 4.76. During the Relevant Period, BCMUK, through its Sales & Marketing team, was responsible for communicating with External Fund investors. The Sales & Marketing team's general approach to investor communications was to provide information proactively. However, in relation to the Internal Fund, the Sales and

Marketing team were instructed to *"avoid it as a conversation topic unless absolutely necessary"*.

4.77. Prior to the launch of the Internal Fund, senior personnel within BCMUK's Sales & Marketing team raised the importance of being *"out front"* with investors about its existence. BCMUK prepared a Q&A document to address questions which might be posed about the Internal Fund.

4.78. However, the Q&A was drafted on the basis that its content would not be proactively disclosed to external investors. Rather, it stated that it was only to be used in response to inquiries received about the Internal Fund.

4.79. Further, the Q&A, in the context of disclosures relating to the conflict, contained a number of statements regarding the nature of the Internal Fund and its relationship with the External Fund which lacked clarity. For example, the Q&A stated:

- a. that it was not necessary proactively to inform investors about new funds and vehicles unless they had a *"direct impact upon the fund into which they are currently invested"*;
- b. that external access to the breadth of instruments and strategies deployed by the Internal Fund *"would not fit within an investment mandate that is suitable to most investors"*;
- c. that no changes had been made to the External Fund's specific strategy in order to accommodate the Internal Fund; and
- d. that no senior Portfolio Manager responsible for managing the External Fund had stopped managing External Fund capital to trade for the Internal Fund.

4.80. These statements were unclear given:

- a. the Internal Fund's use of Rates-based Portfolio Managers had a direct impact on the External Fund. In particular, Portfolio Managers had been reallocated from the External Fund or given split allocations between the Funds;

- b. the Funds could, and at times did, have access to the same “*breadth of instruments and strategies*” during the Relevant Period:
 - i. the prospectuses of the Funds were identically worded in respect of the range of instruments which could be invested in and the high-level investment strategies that would be utilised;
 - ii. the majority of P&L made by the Funds during the Relevant Period was derived from Rates and Relative Value trading;
 - iii. both Funds allocated significant capital to RMT;
 - iv. throughout the Relevant Period Portfolio Managers were reallocated from the External Fund to the Internal Fund or had their capital allocations split between the External Fund and the Internal Fund with no indication that their trading strategies significantly changed once they began trading capital for the Internal Fund;
- c. a number of the External Fund’s senior Portfolio Managers’ capital allocations had been changed to split allocations between the Funds.

None of this information was included in the Internal Fund Q&A.

- 4.81. The Internal Fund Q&A also contained the question: “*Does this fund present you with a conflict of interest?*”. The answer to be given to investors was, simply, that BlueCrest was subject to a number of potential conflicts. In fact, the existence of the Internal Fund had given rise to an actual conflict of interest, namely that senior personnel invested in it were also the exclusive decision-makers as to which Portfolio Managers would be allocated to it, rather than the External Fund (or another BlueCrest fund) and would decide how Portfolio Managers were to be allocated (or reallocated) between the Funds.

Due Diligence Consultants

- 4.82. In addition to investors, BCMUK also communicated with and provided information to a number of Due Diligence Consultants.

- 4.83. The Due Diligence Consultants performed a combination of operational and investment due diligence reviews of BlueCrest funds (including the External Fund). The former assessment focussed on identifying operational risks in relation to a specific fund; the latter covered BlueCrest's investment process and strategy, the calibre of the investment team and risk management.
- 4.84. When undertaking such reviews, the Due Diligence Consultants would conduct on-site visits, email enquiries, calls and document reviews. Among the documents reviewed by the Due Diligence Consultants during their assessments were the investor presentation slides, the External Fund prospectus and the DDQ.
- 4.85. The reviews undertaken by the Due Diligence Consultants would culminate in periodic reports which were provided to clients. The reports would typically assign an investment rating to each BlueCrest fund based on the assessment of the Due Diligence Consultants. These ratings could be upgraded or downgraded each time BlueCrest was reassessed by a Due Diligence Consultant.

Publicity in relation to the Internal Fund

- 4.86. BCMUK did not proactively disclose the Internal Fund's existence to any Due Diligence Consultant or External Fund investor.
- 4.87. However, in January 2014, one Due Diligence Consultant was inadvertently made aware of the Internal Fund. This prompted an onsite visit to BCMUK by the Due Diligence Consultant where the existence of the fund was confirmed.
- 4.88. Following the visit, the Due Diligence Consultant sent an email to BCMUK explaining it was "*surprised [the Internal Fund] has never been disclosed in the past*". The Due Diligence Consultant stated it had previously been made aware of other BlueCrest internal funds but had "*absolutely no information*" about the Internal Fund. The Due Diligence Consultant recommended that the Internal Fund be disclosed to investors and noted that the External Fund prospectus wording on conflicts with internal funds was "*very vague*".
- 4.89. Thereafter, the Due Diligence Consultant sought further information on the Internal Fund, including details of its investors, management and Portfolio Manager allocations. BCMUK provided only limited information in response. As a

result, many of the Due Diligence Consultant's key concerns, including the lack of disclosure within marketing materials of the Internal Fund and the potential for senior management to focus more on the Internal Fund than on external investors, were not allayed.

- 4.90. Consequently, in February 2014, the Due Diligence Consultant produced a report on the External Fund with a downgraded sub-rating for "*Disclosure*". The report referred to the Due Diligence Consultant's previous attempts to gather further information about the Internal Fund, noting that key BCMUK staff had been "*unforthcoming*" and that not all of its questions had been answered. The report recommended that disclosure of the fund be enhanced and stated that the rating might be reassessed if more information was received.
- 4.91. On 27 February 2014, Bloomberg published an article entitled "*BlueCrest Internal Fund May Pose Pay Conflict*". The article was based on the Due Diligence Consultant's report and the concerns it expressed about the Internal Fund. On 29 May 2014, a further article was published by the New York Times entitled "*Fund Within a Fund Creates a Conflict*".
- 4.92. The Due Diligence Consultant's report and subsequent Bloomberg and New York Times' articles precipitated further queries from other Due Diligence Consultants and investors throughout 2014.
- 4.93. To address these queries BCMUK prepared a summary document in April 2014 which it issued to clients only "*upon request*". However, the information provided in the document failed to allay the ongoing concerns of the Due Diligence Consultant regarding inadequate disclosure of the Internal Fund.
- 4.94. In October 2014, Bloomberg published a further article in relation to guidance given by a second Due Diligence Consultant advising "*clients to pull their money because of a lack of transparency.*"
- 4.95. By the end of 2014, the Due Diligence Consultant which had discovered the existence of the Internal Fund produced a further report which retained the downgrade for "*Disclosure*". In particular, the report noted the following "*key concerns*":

- a. the “*initial lack of transparency and unforthcoming responses regarding [the Internal Fund]*”;
- b. the lack of a “*full account*” of the Internal Fund and the refusal to answer certain questions which the Due Diligence Consultant regarded as “*material*”;
- c. that BlueCrest’s own conflicts policy stipulated that investors were to be given sufficient detail to be able to make an “*informed decision*” but this had not happened in respect of the Internal Fund;
- d. that the Due Diligence Consultant was left to rely on assurances from BlueCrest that its best Portfolio Managers had not been preferentially allocated for the Internal Fund given the insufficient information provided;
- e. the insertion of wording in the External Fund prospectus regarding the Investment Manager having “*no obligation to ensure the fair treatment of investors*” was non-standard and did not accord with best practice;
- f. doubts about Compliance’s awareness and monitoring of the Internal Fund given certain statements made to the Due Diligence Consultant; and
- g. the April 2014 summary document did not provide “*adequate detail to investors*” and, further, should have been proactively made available to all investors.

4.96. Alongside discussions and interactions regarding the Internal Fund, BCMUK also disclosed some information about RMT to the Due Diligence Consultants. Prior to this, the Due Diligence Consultants had no awareness of the External Fund’s use of RMT.

4.97. In January 2015, BCMUK updated the External Fund DDQ to refer to the Internal Fund explicitly. The 2015 version of the External Fund DDQ described the Internal Fund as a “*staff managed account*” with the ability to access a broad range of investments, into which certain key staff were required or invited to invest. This

was generic information, whereas Due Diligence Consultants and External Fund investors alike had already sought more granular information from BCMUK.

- 4.98. The 2015 External Fund DDQ continued to signpost the External Fund prospectus as the document disclosing conflicts of interest relating to the Internal Fund. As detailed at paragraph 4.74 above, the External Fund prospectus was updated in June 2015 to name the Internal Fund explicitly. However, the prospectus continued to describe conflicts of interest associated with the Internal Fund in purely hypothetical terms.

Disclosure of the Internal Fund to non-investors

- 4.99. Prior to 2014, BCMUK had been willing to provide information about the Internal Fund to certain non-investors including brokers and credit officers. For example, in November 2012, information disclosed or approved for disclosure by BCMUK included:

- a. the fact that it was an "*internal vehicle*";
- b. its current AuM;
- c. that its portfolio was mainly focused on the Rates market and in liquid instruments;
- d. its leverage and expected return profile compared to the External Fund; and
- e. that the Internal Fund's performance had been "*stellar*".

Redemptions and cancellations

- 4.100. Driven by the seriousness of specific concerns over the continuing lack of transparency about the Internal Fund and how conflicts were being managed, many investors in the BlueCrest funds (including the External Fund) chose to redeem their investments throughout 2014.

- 4.101. In addition, some prospective investors in the External Fund cancelled their subscriptions following their discovery of the Internal Fund.

4.102. Investors' redemptions connected to concerns about the Internal Fund contributed to a reduction in BlueCrest's total AuM. By December 2015, the total AUM across all BlueCrest funds managed by BCMUK had reduced to US\$8 billion (from a high of US\$22.8bn), and in particular, to US\$2.2 billion for the External Fund (from a high of US\$14.5bn during the Relevant Period).

BCMUK – conflicts management

4.103. BlueCrest, including BCMUK, primarily managed conflicts of interest at a platform level (i.e. across all BlueCrest funds), rather than at an individual fund level.

4.104. BCMUK was subject to various policies governing its management of BlueCrest funds. A subset of those policies directly addressed the management of conflicts associated with the side-by-side management of BlueCrest funds. Of these, BlueCrest's Conflicts of Interest Policy ("COI Policy") and Conflicts of Interest Register ("COI Register") were the primary policies designed to enable BCMUK to identify and manage its conflicts.

4.105. During the Relevant Period, both the COI Policy and COI Register were subject to review and approval by BCMUK ExCo.

COI Policy

4.106. Throughout the Relevant Period, BCMUK was subject to the COI Policy, which expressly applied to all BlueCrest entities. The purpose of the COI Policy (insofar as it applied to BCMUK) was to identify, by reference to services provided by BCMUK, circumstances which could give rise to a conflict of interest entailing a material risk of damage to one or more clients.

4.107. The COI Policy was periodically updated and approved by Compliance staff. The COI Policy noted that Compliance would work with senior management to try to eliminate conflicts, recording the conflicts and any mitigating actions in the COI Register, and reporting the situation to Group ExCo for consideration.

4.108. The COI Policy stated that BlueCrest was required to manage conflicts to reduce the risk of harm to clients. Further, it required BlueCrest entities (including BCMUK) to disclose conflicts in sufficient detail to enable clients to take informed decisions in relation to any service being offered. The COI Policy cited "*typical*

situations” where conflicts might arise within BlueCrest to enable all staff to identify, report and assist in conflict management. Notwithstanding the fact that this policy was imposed at a group level, the responsibility for ensuring that BCMUK managed conflicts fairly was that of BCMUK.

COI Register

- 4.109. Pursuant to the COI Policy, the COI Register was in place to record conflicts generated by BlueCrest’s investment management services and activities. The COI Register was maintained and periodically reviewed by Compliance staff.
- 4.110. Responsibility for managing and monitoring each individual conflict was assigned to a member of senior management deemed “*closest to the management of the conflict*”. These assignment decisions were made by Compliance and Internal Audit. The individual conflict owners were, invariably, BCMUK senior personnel and included members of BCMUK ExCo.
- 4.111. In 2012, BCMUK established its RAC as a forum to discuss specific compliance issues including conflicts of interest. The RAC was a sub-committee of BCMUK ExCo and its membership comprised BCMUK senior managers, many of whom were conflict owners under the COI Register.
- 4.112. From at least 2013, the RAC, which met approximately quarterly, conducted a semi-annual review of the COI Register. This entailed a “*conflict by conflict*” discussion of the COI register, including whether the mitigation for a particular conflict remained applicable and whether any new conflicts had arisen.
- 4.113. In most circumstances, the RAC would initiate the process for adding a new conflict to the COI Register. Specifically, the RAC would recommend an addition to BCMUK ExCo which would in turn ratify or reject the recommendation before communicating the update to Group ExCo.

Changes to the COI Register after the Internal Fund’s launch

- 4.114. During a BCMUK ExCo meeting on 24 May 2012, it was agreed that several additions would be made to the COI Register, including adding a conflict in relation to the “*Allocation of capital and portfolio managers across asset classes and funds*”.

4.115. In July 2012, 8 months after the Internal Fund was launched, the COI register was updated to include the conflict titled "*Allocation of capital and portfolio managers across asset classes and funds*". This conflict was described as:

"Capital and portfolio managers may be allocated in a way that favours one fund over another."

4.116. The stated mitigating control for this conflict was:

"[The Investment Manager] agrees allocations of capital to the sub investment managers. Exco and desk heads allocate capital. These proposals are presented to the [Group ExCo] for approval."

4.117. Versions of the COI register between July 2012 and October 2014 explicitly noted that this conflict, although rated as "*high*", was not disclosed in any relevant fund prospectus or offering memorandum. In March 2014, the COI Register was expanded to include a description of the mitigating controls for the '*Allocation of capital and portfolio managers across asset classes and funds*' conflict:

"[Group Exco] and desk heads allocate capital taking into account: Expected use of cash, Volatility, Liquidity, Expected return on capital, Expected Sharpe ratio, Diversification, Track record, [and] Instrument type."

4.118. From July 2012 to October 2014, the COI Register stated the monitoring control as: "*[Group Exco] and local sub investment managers monitor [Portfolio Manager] and capital allocations*". From October 2014, the COI Register description of the monitoring controls for the "*Allocation of capital and Portfolio Managers*" conflict was expanded:

"Reason for movement of capital units between funds monitored by [a member of senior management] and reviewed and ratified by ExCo."¹

¹ It appears the reference to "*ExCo*" in the expanded monitoring control referred to Group ExCo. However, as set out in paragraph 4.32, BCMUK was responsible for ratifying Portfolio Manager allocation decisions insofar as they concerned the allocation of BCMUK Portfolio Managers.

4.119. In April 2015, this control was updated again to include a further step whereby a member of senior management would analyse *"the impact of the decision to move capital units between funds"*.

4.120. In August 2012, 10 months after the Internal Fund was launched, the COI Register was also updated to include a conflict of interest titled *"Management of proprietary funds"*:

"BlueCrest may advise or manage proprietary funds in which partners, employees and affiliates may invest and pursue similar investment objectives as the funds, or may pursue investment approaches that are more or less leveraged or risky."

4.121. The stated mitigating control for this conflict was:

"Allocations of traders and strategies to BlueCrest funds are made on an equitable basis by [Group ExCo] and are based on the nature of the relevant fund as well as respective investment objectives, approach and target volumes and returns."

4.122. The COI Register further noted that allocations of traders and strategies were *"reviewed by [Group ExCo]"* and conflicts were disclosed in fund prospectuses. Responsibility for monitoring the conflict was assigned in the COI Register to a member of BCMUK ExCo.

4.123. For the majority of the period between August 2012 until October 2014, the COI Register described the monitoring controls for the 'Management of proprietary funds' conflict as follows: *"Allocations are determined by local ExCo and conflicts are disclosed in each fund's prospectus."* In October 2014, this was expanded to:

"ExCo approves all business opportunities with input from the New Product Committee. Allocations of trades and/or strategies are pre-determined by local ExCo/group ExCo, as appropriate, and conflicts of interest are disclosed in each fund's prospectus... [Group ExCo] and local sub investment managers monitor PM and capital allocations. Reason for any movement of capital units between funds monitored by [a member of senior management] and reviewed and ratified by ExCo."

4.124. In April 2015, the description of the 'Management of proprietary funds' conflict was amended in the COI Register by inclusion of the statement: "*BlueCrest manages a proprietary investment fund*".

Management of Internal Fund conflicts

4.125. BCMUK's compliance manual prior to the launch of the Internal Fund, and throughout the Relevant Period, identified that:

"Disclosure of conflicts of interest to clients, in itself, will not 'cure' a (potential) conflict of interest. The Firm is required to take steps to avoid or manage the conflict, and document the process for managing the conflict in its Conflicts Policy. However, if arrangements made by the Firm to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented, the Firm must clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business for the client."

4.126. As detailed in the COI Register at all material times, Group ExCo, BCMUK ExCo and certain individuals who were members of both those committees had responsibilities in respect of monitoring and mitigating the conflicts relating to management of proprietary funds and allocation of capital and Portfolio Managers across asset classes and funds.

4.127. During the Relevant Period, all Group ExCo and BCMUK ExCo members (some of whom were also members of Group ExCo) held investments in the Internal Fund and External Fund. This included BCMUK ExCo members stated in the COI Register as having responsibility for the conflicts relating to management of proprietary funds and the allocation of capital and Portfolio Managers across asset classes and funds. Those members' exposures to the Internal Fund were substantially greater than their investments in the External Fund.

4.128. In February 2013, BCMUK attested to the Authority that its arrangements were "*sufficient to ensure that the firm manages conflicts of interest effectively and in compliance with [the Authority's] rules.*" However, despite being responsible for managing conflicts relating to the Internal Fund and the allocation decisions in respect of it, BCMUK took no steps to consider whether the collective exposure of

its senior staff to the Internal Fund presented its own conflict. In particular, the Authority has seen no evidence of consideration by BCMUK as to whether BCMUK ExCo was sufficiently independent from these conflicts to manage them properly.

4.129. Compliance's focus during the Relevant Period was on BlueCrest's external funds and considering conflicts at a platform level (i.e. across all BlueCrest funds). Compliance was not actively aware of who was exposed to the Internal Fund or the level of exposure, in circumstances where, at its peak, the total AUM of the Internal Fund was US\$2.05 billion. BCMUK did not implement sufficient compliance controls in order to monitor the conflicts of interest associated with the allocation of Portfolio Managers to the Internal Fund.

4.130. To the extent that Compliance monitored the Internal Fund, its focus was on ensuring that Portfolio Managers with a split allocation were not incentivised to trade more for the Internal Fund. Compliance considered staff investment in BlueCrest's external funds (including the External Fund) to have incentivised against allocation decisions being made in favour of the Internal Fund. However, as discussed at paragraph 4.127 above, BCMUK ExCo members with designated conflict management responsibilities had substantially greater exposure to the Internal Fund than the External Fund.

4.131. During the Relevant Period, the RAC conducted a number of conflict reviews, some of which included consideration of the 'Management of proprietary funds' conflict. In particular, in October 2014, the RAC approved the expansion of the description of the monitoring controls referenced at paragraph 4.123 above.

4.132. However, the additional description simply highlighted the fact that Group ExCo, BCMUK ExCo and the members thereof made or otherwise approved all strategic decisions in relation to the Internal Fund. At no point, given the financial interests of those members in the performance of the Internal Fund, did the RAC appear to have considered the adequacy of this as a conflict control.

5. FAILINGS

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

- 5.2. Based on the facts and matters set out above, the Authority considers that BCMUK breached Principle 8 in that it failed to manage conflicts of interest fairly, between the investors in the External and Internal Funds.
- 5.3. BCMUK's role in the management of the Internal Fund and the External Fund resulted in a conflict of interest. Decisions to transfer Portfolio Managers from one fund to another could have had a positive impact on one fund and a corresponding detrimental impact on the other. Without sufficient conflict management controls in place, it was not appropriate that those decisions were taken by individuals who held a conflicting interest in one of the Funds. BCMUK had a duty to ensure that the interests of both the Funds and sets of investors were taken into account as part of that decision-making process. However, BCMUK's systems and controls were not sufficient to mitigate the risk of Portfolio Manager allocation decisions favouring the interests of the Internal Fund and its investors over the External Fund.
- 5.4. BCMUK recognised that there was an inherent and overarching conflict arising from the existence and management of the Internal Fund, but nevertheless failed to make adequate arrangements to manage all aspects of the conflict fairly.
- 5.5. The primary control on which BCMUK relied to manage and mitigate this conflict was the fact that decisions concerning the allocation of Capital Units for the Funds were made by senior individuals who had a regulatory duty (in addition to a fiduciary duty) to serve the interests of the Funds and their investors. However, those decisions were made exclusively by the senior staff invested in the Internal Fund, which placed them in a situation where they stood to benefit from these decisions personally, potentially in conflict with the duties they owed to External Fund investors. BCMUK failed to recognise that this control was ineffective, in fact exacerbating, rather than managing, the risk of preferential Portfolio Manager allocation.
- 5.6. Over the Relevant Period, BCMUK also failed to provide sufficient disclosure to investors in the External Fund regarding: the conflict of interest arising from how Portfolio Managers were being allocated between the Funds, how the conflict was being managed and the External Fund's allocation of significant capital to RMT. The limited disclosures which BCMUK did provide were, at times, misleading. Consequently, the External Fund investors were unable to scrutinise the substance

of the conflict or assess how it was being managed by BCMUK and this affected their ability appropriately to consider their actions regarding the External Fund.

- 5.7. From February 2014, following a Bloomberg publication concerning the Internal Fund and its possible conflicts, BCMUK provided limited information in response to queries from investors and Due Diligence Consultants. However, at no time was the specific conflict related to capital allocations to the Internal Fund disclosed.
- 5.8. Accordingly, BCMUK's arrangements for managing the conflict were not sufficient to ensure, with reasonable confidence, that the interests of its clients would not be damaged. BCMUK's failure appropriately to manage this conflict resulted in a sub-standard investment management service being provided to the External Fund and its investors.
- 5.9. As outlined in the preceding paragraphs, at all material times Group ExCo, BCMUK ExCo and certain individuals who were members of both those committees had responsibilities in respect of managing the Internal and External Funds, including the allocation of capital and portfolio managers, and of monitoring and mitigating the resulting conflict of interest. Members of BCMUK's senior management plainly recognised that there was an inherent and overarching conflict of interest, but its response was inadequate, in that:
 - a. no steps were taken to consider whether the collective exposure of its senior staff to the Internal Fund (including those given certain specific responsibilities for managing any relevant conflicts) presented its own conflict;
 - b. there is no evidence of any consideration by BCMUK as to whether BCMUK ExCo, whose members had a financial interest in the performance of the Internal Fund, was sufficiently independent from the relevant conflicts to be in a position to manage them properly; and
 - c. no steps were taken to manage the conflict by providing sufficient disclosure to investors, either before or after queries were raised, by investors and Due Diligence Consultants.

- 5.10. The Authority considers that these examples, which are not exhaustive, demonstrate that the misconduct was committed recklessly.
- 5.11. Accordingly, the Authority considers that BCMUK has breached Principle 8.

6. SANCTION

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

Step 1: disgorgement

- 6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this. No direct benefit has been quantified in this case.
- 6.3. Where a firm agrees to carry out a redress programme to compensate those who have suffered loss as a result of the breach, or where the Authority decides to impose a redress programme, the Authority will take this into consideration. The Authority has decided to impose a redress programme (though BCMUK has the right to make representations to the Authority on that decision).
- 6.4. The figure at Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.5. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.
- 6.6. The Authority considers that revenue is indicative of the harm or potential harm caused by BCMUK's breach in this case. The Authority has therefore determined

a figure based on a percentage of BCMUK's relevant revenue. BCMUK's relevant revenue consists of the sub-investment management fees (comprising management fees and performance fees) and service fees derived by BCMUK during the Relevant Period (1 October 2011 to 31 December 2015) from the External and Internal Funds. The Authority considers BCMUK's relevant revenue for this period to be £236,560,676.

- 6.7. 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%

- 6.8. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. The factors that the Authority considers to be relevant to BCMUK's breaches are set out below.

Impact of the breach

- 6.9. All External Fund investors were directly impacted by the breach.
- 6.10. BCMUK's failure to manage the conflict surrounding the allocation of Portfolio Managers resulted in a sub-standard investment management service being provided to investors in the External Fund. The harm caused to customers was compounded by the insufficient detail within related disclosures, which denied investors the opportunity to make informed decisions regarding their prospective or continued investment in the External Fund.

Nature of the breach

- 6.11. Investors in the External Fund paid management fees in the expectation that their investments would be managed appropriately. BCMUK's approach to how it managed the conflict arising, through its role in ratifying the allocation of Portfolio Managers, fell short of what was required.
- 6.12. BCMUK's failure to disclose appropriately the specific conflict around allocations to the Internal Fund continued throughout the Relevant Period of over 4 years.
- 6.13. The breach revealed serious or systemic weaknesses in BCMUK's procedures or in the management systems or internal controls relating to part of BCMUK's business.
- 6.14. DEPP 6.5A.2G(11) lists factors likely to be considered 'level 4 or 5 factors'. The Authority considers the following factors to be relevant:
 - a. The breach caused a significant risk of loss to investors;
 - b. The breach revealed serious or systemic weaknesses in how BCMUK managed its conflicts of interest relating to the allocation of Portfolio Managers;
 - c. The breach was committed recklessly, in that certain members of senior management appreciated the risk that a breach could result from the conflict but failed to take sufficient steps to mitigate that risk adequately (see DEPP 6.5A.2G(9)(a)).
- 6.15. DEPP 6.5A.2G(12) lists factors likely to be considered 'level 1, 2 or 3 factors'. The Authority does not consider any of these to be relevant in this case.
- 6.16. Taking these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 15% of £236,560,676.
- 6.17. The figure at Step 2 is therefore £35,484,101.

Step 3: mitigating and aggravating factors

6.18. 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.

6.19. The Authority considers that the following factors aggravate the breach:

a. The Authority's November 2012 thematic review, documented in a report titled "*conflicts of interest between asset managers and their customers: identifying and mitigating the risks*", specifically noted that the responsibility for identifying conflicts of interest rests with the business as well as compliance, and that investors should have equal access to investment opportunities; and

b. Following on from the thematic review, and in response to a November 2012 "*Dear CEO letter*" from the Authority about "*Conflicts of interests between asset managers and their customers*", BCMUK provided an attestation to the Authority in February 2013 regarding the strength of its conflicts of interest controls, which was inaccurate and misleading given BCMUK's failure effectively to manage the Internal Fund conflict.

6.20. Having taken into account these aggravating factors, the Authority considers that the Step 2 figure should be increased by 15%.

6.21. The figure at Step 3 is therefore £40,806,716.

Step 4: adjustment for deterrence

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

6.23. The Authority considers that the Step 3 figure of £40,806,716 represents a sufficient deterrent to BCMUK, and so has not increased the penalty at Step 4.

6.24. The figure at Step 4 is therefore £40,806,716.

Step 5: settlement discount

6.25. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement.

6.26. The Authority and BCMUK did not reach agreement and so no discount applies to the Step 4 figure. The Step 5 figure (after rounding down to the nearest £100) is therefore £40,806,700.

Penalty

6.27. The Authority has therefore decided to impose a total financial penalty of £40,806,700 on BCMUK for breaching Principle 8.

REPRESENTATIONS AND EXPEDITED REFERENCE

7.1 Through the Warning Notice, the Authority gave notice that it proposed to take the action described above and BlueCrest was given the opportunity to make representations to the Authority about that proposed action.

7.2 However, following receipt of the Warning Notice, and pursuant to DEPP 5.1.8I G (1), BlueCrest notified the Authority that, in relation to the substance of the Warning Notice, it wished to use the expedited reference procedure; this procedure enables a person subject to enforcement action to challenge the action proposed in a warning notice before the Tribunal without engaging with the Authority's internal decision-making process. In accordance with DEPP 5.1.8G G (2), BlueCrest confirmed that it waived and would not exercise any rights under section 387(2) of the Act in respect of the Warning Notice.

7.3 The Authority has therefore decided to take the action set out above.

PROCEDURAL MATTERS

- 8.1. This Decision Notice is given to BCMUK under section 206 and in accordance with section 388 of the Act. The following paragraphs are important.

Decision maker

- 8.2. The decision which gave rise to the obligation to give this Decision Notice was made by the RDC. The RDC is a committee of the Authority which takes certain decisions on behalf of the Authority. The members of the RDC are separate from the Authority staff involved in conducting investigations and recommending action against firms and individuals. Further information about the RDC can be found on the Authority's website:

<https://www.fca.org.uk/about/committees/regulatorydecisions-committee-rdc>.

The Tribunal

- 8.3. BlueCrest has the right to refer the matter to which this Notice relates to the Tribunal. Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, BlueCrest has 28 days from the date on which this Notice is given to it to refer the matter to the Tribunal. 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 EC4A 1NL (tel: 020 7612 9730; email fs@hmcts.gsi.gov.uk). Further information on the Tribunal, including guidance and the relevant forms to complete, can be found on the HM Courts and Tribunal Service website:

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

- 8.4. A copy of the reference notice (Form FTC3) must also be sent to the Authority at the same time as filing a reference with the Tribunal. A copy of the reference notice should be sent to Ross Murdoch at the Financial Conduct Authority, 12 Endeavour Square, London E20 1JN.
- 8.5. Once any such referral is determined by the Tribunal and subject to that determination, or if the matter has not been referred to the Tribunal, the Authority will issue a Final Notice about the implementation of the decision set out in this Notice.

Access to evidence

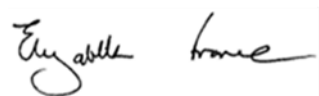
- 8.6. Section 394 of the Act applies to this Decision Notice.
- 8.7. The person to whom this Decision Notice is given has the right to access:
- a) the material upon which the Authority has relied in deciding to give this Decision Notice; and
 - b) the secondary material which, in the opinion of the Authority, might undermine that decision.

Confidentiality and publicity

- 8.8. This Decision Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). Section 391 of the Act provides that 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. BlueCrest should be aware, therefore, that the facts and matters contained in this Notice may be made public.

Contact

- 8.10. For more information concerning this matter generally, contact Ross Murdoch at the Authority (direct line: 020 7066 3999; email Ross.Murdoch@fca.org.uk).



Elizabeth France
Deputy Chair, Regulatory Decisions Committee

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

RELEVANT STATUTORY PROVISIONS

7.1 The Authority's statutory objectives, set out in section 1B(3) of the Act, include the consumer protection objective.

Section 206(1) of the Act provides:

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

RELEVANT REGULATORY PROVISIONS

The Principles for Businesses

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

Principle 8 provides:

"A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client."

Senior Management Arrangements, Systems and Controls ("SYSC")

SYSC sets out rules and guidance for firms in relation to systems and controls.

During the Relevant Period, SYSC 10.1.3R provided:

"A firm must take all reasonable steps to identify conflicts of interest between:

(1) the firm... and a client of the firm; or

(2) one client of the firm and another client;

that arise or may arise in the course of the firm providing any service referred to in SYSC 10.1.1 R."

SYSC 10.1.7R provided:

"A firm must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest as defined in SYSC 10.1.3 R from constituting or giving rise to a material risk of damage to the interests of its clients."

SYSC 10.1.8R provided:

"(1) If arrangements made by a firm under SYSC 10.1.7 R to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented, the firm must clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business for the client.

(2) The disclosure must:

(a) be made in a durable medium; and

(b) include sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the service in the context of which the conflict of interest arises.

..."

DEPP

Chapter 6 of DEPP, which forms part of the Authority's Handbook, sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act.

The Enforcement Guide

The Enforcement Guide sets out the Authority's approach to exercising its main enforcement powers under the Act.

Chapter 7 of the Enforcement Guide sets out the Authority's approach to exercising its power to impose a financial penalty.