25 The North Colonnade
Canary Wharf
London
E14 5HS

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

FINAL NOTICE

To: **Paul Axel Walter**

Individual Reference Number: **PAW01128**

Date of Birth: **2 March 1970**

Date: **22 November 2017**

1. ACTION

1.1. For the reasons given in this Final Notice, the Authority hereby imposes on Mr Paul Walter a financial penalty of £60,090 pursuant to section 123(1) of the Act for engaging in market abuse in contravention of section 118(5) of the Act.

2. SUMMARY OF REASONS

2.1. In July and early August 2014, Mr Walter, an experienced bond trader employed by Bank of America Merrill Lynch International Limited (BAML), in the course of his employment carried out a strategy of entering quotes on the BrokerTec inter-dealer trading platform in relation to six Dutch State Loans (DSLs) that were designed to induce, and had the effect of inducing, other market participants who were tracking quotes to raise or lower their quotes so that he could benefit from those price movements.

2.2. He represented to the market an intention to buy when his true intention was to sell and represented an intention to sell when his true intention was to buy. When his intention was to sell, his misleading quotes, skewed to Best Bid, induced other market participants to raise their bids. When he wanted to buy, his misleading low offers induced others to lower their offers. Mr Walter then aggressed (traded by selling bonds into an existing bid or by buying from an existing offer) these bids or offers, thereby trading at a more advantageous price than he would have achieved at that time, but for his having misled other market participants.

2.3. Specifically, on 11 instances during the Relevant Period, Mr Walter entered a series of quotes i.e. a bid and an offer quote, with high bid quotes that became Best Bid on the BrokerTec trading platform for the specific DSL he was bidding for, and worst offer. After some other market participants who were tracking his quotes had raised their own bids in response to his Best Bid, Mr Walter sold into the bids of other market participants and then cancelled his own quote. In doing so, on each instance he sold the DSL, he sold at a higher price than he would have secured at that time, had he not posted a series of misleading Best Bid quotes and then sold through his own bid.

2.4. On one other instance during the Relevant Period, Mr Walter entered a series of quotes with low offer quotes that became Best Offer on the BrokerTec platform for the specific DSL he was offering to sell. When other market participants had lowered their offers in response to his offer, Mr Walter purchased the DSL from the market participants who had recently lowered their offer price and then cancelled his own quote. In doing so, he was able to purchase at that time the DSL he was offering to other market participants at a lower price than he would have secured had he not posted a series of Best Offer quotes and then purchased through his own offer.

2.5. Mr Walter was able to manipulate the market in this way because he knew that certain market participants used automated systems (algorithms) to follow the Best Bid and Best Offer. Mr Walter took advantage of this to attract these algorithms to follow his quotes and so sell or buy the DSLs at higher or lower prices.

2.6. These market participants were affected by Mr Walter's trading in the Relevant Period because his trading strategy manipulated their prices and led to them buying DSLs at a higher price than they would otherwise have done and on one occasion selling at a lower price than they would otherwise have done. Three such instances on 18 July led to a complaint being made by a market participant to BrokerTec.

2.7. Mr Walter's abusive trading in the 12 instances during the Relevant Period resulted in a profit of €22,000 to his book.

2.8. Mr Walter's behaviour constituted market abuse within the meaning of section 118(5) of the Act in that it gave a false and misleading impression as to the price and supply or demand of the DSLs and it also secured the price at an artificial level.

2.9. The Authority regards this as a serious example of market abuse, notwithstanding that it was committed negligently rather than deliberately, in particular because of the following factors:

(1) Mr Walter was an approved person and an experienced trader of government bonds with 20 years of experience;

(2) Although the Authority has concluded that Mr Walter did not intend to commit market abuse, he should have realised that his behaviour constituted market abuse. His behaviour constituted a serious failure to act in accordance with the standards reasonably expected of market participants and did not cease even after he was put on notice of concerns about his behaviour (which BrokerTec had raised in a telephone call with him); and

(3) Through his repeated trading strategy Mr Walter sought to influence the prices of the government bonds to his advantage and the detriment of certain other market participants. Such behaviour undermines confidence in the UK markets.

2.10. The Authority has therefore imposed a financial penalty on Mr Walter in the amount of £60,090, pursuant to section 123(1) of the Act, for engaging in market abuse. This action supports the Authority's statutory objective of protecting and enhancing the integrity of the UK financial system.

3. DEFINITIONS

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

"the Act" means the Financial Services and Markets Act 2000, as in force at the relevant time;

"the Authority" means the Financial Conduct Authority;

"BAML" means Bank of America Merrill Lynch International Limited;

"Best Bid" means the highest bid from a market participant to buy in the BrokerTec order book for a specific bond;

"Best Offer" means the lowest offer from a market participant to sell in the BrokerTec order book for a specific bond;

"BrokerTec" means the multilateral trading facility operated by BrokerTec Europe Limited as an electronic inter-dealer trading platform for fixed income business (further described at paragraph 4.9);

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

"DSL" means a Dutch State Loan, a fixed income bond issued by the Dutch State Treasury Agency (as described in paragraph 4.4);

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

"MAR" means the Code of Market Conduct in the Handbook, as in force during the Relevant Period;

"Market-maker" means a firm (or trader within the firm) that quotes bid and offer prices in a range of instruments and can act as principal in supplying liquidity by buying or selling from their own inventory;

"Primary Dealer" means a firm appointed for the trading, promotion and distribution of government bonds whose status carries with it a number of rights and obligations;

"Relevant Period" means the period 2 July 2014 to 8 August 2014; and

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

4. FACTS AND MATTERS

4.1. During the Relevant Period, Mr Walter was a Director and senior trader within the Global Rates, EMEA (Europe, Middle East and Africa) Linear Rates European Government Bond Trading Desk at BAML. He had significant market experience having started trading government bonds in 1995. During the Relevant Period, Mr Walter had responsibility for approximately 80 bonds including Dutch, Finnish and German bonds.

4.2. As a Market-maker, Mr Walter's role at BAML included providing liquidity to BAML's clients who wanted to buy or sell bonds, managing the corresponding risk for BAML from its long or short positions in these bonds and generating a return for BAML from the buying and selling of these bonds.

4.3. Mr Walter was an approved person and held the CF30 (customer) controlled function until 11 August 2014 when he was suspended by BAML. He had held a controlled function for 12 years.

The Eurozone Government Bond market and Dutch State Loans

4.4. The global fixed income market is one of the most actively traded in the world and the government bond market constitutes one of the most important parts of the fixed income market. Fixed income securities are used by governments to finance their activities and deliver services to their populations. This market is often a benchmark for other asset classes and is invested in and traded by a wide selection of consumers, from individuals to corporate and government pension funds. Within the Eurozone government bond market, fixed income bonds issued by the Dutch State Treasury Agency are known as DSLs.

Primary Dealers for DSLs

4.5. Every year the Dutch State Treasury Agency appoints a number of Primary Dealers for the trading, promotion and distribution of DSLs. Firms appointed as Primary Dealers for DSLs have a number of rights and obligations to maintain their status, primarily participating in the primary issuance of DSLs and an obligation to support a liquid secondary market.

4.6. To support a liquid secondary market, Primary Dealers need to meet certain requirements on a designated trading system such as ICAP's BrokerTec platform. In accordance with those requirements, if a Primary Dealer does not provide a sufficient quantity of a bond, for a sufficient number of hours, within a certain spread, they will not meet their Primary Dealer obligations.

The DSLs

4.7. Mr Walter's misconduct during the Relevant Period relates to his trading, in the course of his employment, in the following DSLs:

(1) ISIN NL0006007239 DSL 4.5 07/15/17 ("the July 2017 Bond") – a DSL maturing in July 2017 (a 3-year maturity in the Relevant Period) paying a coupon of 4.5%. It was, during the Relevant Period, usually quoted on the interbank markets in sizes of 10 million.

(2) ISIN NL0010514246 DSL 1.25 01/15/19 ("the January 2019 Bond") – a DSL maturing in January 2019 (a 4½-year maturity in the Relevant Period) paying a coupon of 1.25%. It was usually quoted on the interbank markets in sizes of 10 million.

(3) ISIN NL0009086115 DSL 4.0 07/15/19 ("the July 2019 Bond") – a DSL maturing in July 2019 (a 5-year maturity in the Relevant Period) paying a coupon of 4%. It was usually quoted on the interbank markets in sizes of 10 million.

(4) ISIN NL0010418810 DSL 1.75 07/15/23 ("the July 2023 Bond") – a DSL maturing in July 2023 (a 9-year maturity in the Relevant Period) paying a coupon of 1.75%. It was usually quoted on the interbank markets in sizes of 10 million.

(5) ISIN NL0000102317 DSL 5.5 01/15/28 ("the January 2028 Bond") – a DSL maturing in January 2028 (a 13½-year maturity in the Relevant Period) paying a coupon of 5.5%. It was usually quoted on the interbank markets in sizes of 2 to 5 million.

(6) ISIN NL0010071189 DSL 2.5 01/15/33 ("the January 2033 Bond") – a DSL maturing in January 2033 (an 18½-year maturity in the Relevant Period) paying a coupon of 2.5%. It was usually quoted on the interbank markets in sizes of 2 to 5 million.

The BrokerTec platform

4.8. BrokerTec is an electronic inter-dealer trading platform for fixed income business, including European government bonds. BrokerTec enables market participants to buy and sell European government bonds by posting two–way quotes or by aggressing (trading by selling bonds into an existing bid or by buying from an existing offer) the bid or offer quote of another market participant. BrokerTec facilitates both manual and automated trading (such as through algorithms). The minimum size for market participants to post quotes on BrokerTec for the six relevant DSLs is 2 million. Trading on BrokerTec is carried out anonymously.

4.9. On 1 July 2014, BrokerTec became a designated trading system for the purposes of DSL Primary Dealers' quoting obligations, enabling DSL Primary Dealers to meet their quoting obligations by quoting on BrokerTec. BAML was not a DSL Primary Dealer, but the market participants who were directly affected by Mr Walter's trading ("Firm A", "Firm B" and "Firm C") were DSL Primary Dealers.

4.10. Mr Walter used BrokerTec as the principal platform on which he would trade DSLs in the inter-dealer market to reduce the long or short positions he acquired when providing liquidity to BAML's customers.

4.11. Mr Walter's trading strategies on BrokerTec fell into two categories: legitimate trading activity and abusive trading activity.

Mr Walter's legitimate trading activity on BrokerTec

4.12. When Mr Walter engaged in legitimate trading activity on BrokerTec:

(1) he posted quotes on BrokerTec with either a high bid or low offer price, depending on whether he was looking to buy or sell, and waited for another market participant to aggress his high bid or low offer; or

(2) he aggressed the bid or offer of another market participant who was providing quotes.

Mr Walter's abusive trading activity on BrokerTec

4.13. The above trading activity was distinct from Mr Walter's abusive trading activity that gave a false and misleading impression as to the price and supply or demand of the

DSLs and secured the price at an artificial level. His abusive trading activity in the Relevant Period consisted of a number of steps which resulted in him selling a DSL despite appearing to be a buyer of the DSL (or which resulted in him buying the DSL despite appearing to be a seller of it).

4.14. First, Mr Walter would enter a quote on BrokerTec with a high bid and high (i.e. weak) offer quote (or a low offer quote and low (i.e. weak) bid). Through these quotes he represented to the market an intention to buy (or sell); however, this was in fact the opposite of his true intention. These quotes represented the Best Bid (or Best Offer) on BrokerTec at the time. They did not, and were not intended to, attract more liquidity to the market by attracting new participants. Rather, the quotes were intended to influence the price of other existing market participants who were tracking quotes. The opposite sides of the quotes were entered at levels that meant it was unlikely they would have been aggressed by other market participants (thus if he was Best Bid he would also be worst offer and if he was Best Offer he would also be worst bid).

4.15. To mitigate the impact if his Best Bid (or Best Offer) were to be aggressed by other market participants before he had executed his abusive trading strategy, he quoted in the smallest size permissible on the platform (2 million) as this meant that if his bid (or offer) was hit (or lifted), his exposure was limited to the smallest sized trade possible.

4.16. Mr Walter would then wait for other market participants to adjust their quotes, raising their bids as a result of his Best Bid (or lowering their offers as a result of his Best Offer) knowing that other market participants often used automated systems, including algorithms, to update their quotes by 'tracking' the Best Bid and Best Offer on BrokerTec for each bond.

4.17. Mr Walter would then adjust his quote, raising his bid (or lowering his offer) incrementally once he could see one or more market participants tracking his quote. Once Mr Walter could see that those tracking him had adjusted their quotes and raised their bid (or lowered their offer) to a price Mr Walter was willing to sell (or buy) at, he would execute an order to sell (or buy) from one or more of the market participants that were tracking his bid (or offer). These sell or buy orders were always, with the exception of one instance, of a greater size than that of his current quote, but occurred within the prevailing bid/offer spread.

4.18. Having executed his trade, Mr Walter would then cancel his own quote to avoid being aggressed by other market participants. The market would then revert to a level at which the prices were no longer manipulated by Mr Walter's quote. This trading strategy meant that Mr Walter took a risk that his Best Bid (or Best Offer) quote would be hit (lifted). This happened on two instances.

4.19. Mr Walter was able successfully to carry out his trading strategy because he deleted his quote after his trade had been executed. Had he deleted his quote before selling to or buying from other market participants, the bids that were tracking his Best Bid would also have dropped when he deleted his Best Bid (or risen in relation to the deletion of his Best Offer post-trading).

4.20. It would have been particularly difficult for market participants to identify a participant engaging in this pattern of trading on BrokerTec because the identity of a participant was protected both pre-trade and post-trade.

4.21. Therefore, Mr Walter represented to the market an intention to buy when his true intention was to sell and represented an intention to sell when his true intention was to buy. When his intention was to sell, his misleading Best Bids induced other market participants to raise their bids. When he wanted to buy, his misleading Best Offers induced others to lower their offers. Mr Walter then aggressed these bids (or offers), thereby trading at a more advantageous price than he would have achieved at that time, but for his having misled other market participants.

Trading on 3 July 2014

4.22. An illustration of Mr Walter's abusive trading is his activity on 3 July 2014 relating to the January 2028 Bond (see paragraph 4.7(5) above). Mr Walter's trading on that day involved a number of other participants who were also quoting on BrokerTec including Firm A and Firm B.

4.23. To use BAML's trading system, Mr Walter had to enter a quote and these prices would be automatically adjusted as the markets moved. However Mr Walter controlled the extent to which his quotes moved in line with the market as he could manually adjust these quotes.

First trade on 3 July 2014

4.24. At 09:04 on 3 July 2014, Mr Walter purchased 30 million Euro nominal of the January 2028 Bond from one of BAML's clients at a price of €143.370. This purchase moved Mr Walter's book position to being long 29,809,877.

4.25. At 09:32:56, Mr Walter entered a quote in size 5 million on BrokerTec, with a bid at €143.046 and an offer at €143.247. Mr Walter's offer became Best Offer on BrokerTec. At 09:32:59, Mr Walter adjusted his quote, improving the offer further by reducing his sell price to €143.245. At 09:33:01, Mr Walter improved the offer further by reducing his offer quote to €143.228. This would have suggested that Mr Walter's intention was to sell the January 2028 Bond. At 09:33:03, not having had his offer lifted by other market participants, he deleted his quote and exited the BrokerTec platform. These initial quotes were legitimate activity on BrokerTec with the objective of selling 5 million of the January 2028 Bond. However, the remainder of the activity described below comprised abusive trading activity.

4.26. Between 09:49:54 and 09:51:58 on 3 July 2014, Mr Walter returned to BrokerTec and entered and exited the BrokerTec market on four separate instances. However, on these instances Mr Walter entered a quote in a size of 2 million which led to him becoming Best Bid and worst offer on the order book, which was the opposite position to his earlier quote that morning. He initially entered a bid 0.016 above the existing Best Bid on BrokerTec and then raised this incrementally. This would have suggested that Mr Walter wanted to buy the January 2028 Bond.

4.27. At 09:52:09, Mr Walter entered a quote on the BrokerTec platform with a bid for 2 million at €143.202 which became Best Bid on the order book and worst offer for 2 million at €143.403. Prior to Mr Walter entering his orders the Best Bid was €143.170 in 2 million.

4.28. The consequence of Mr Walter's quotes was that each of the other market participants' bids moved down one place in the order book. At 09.52.10, milliseconds after Mr Walter entered his bid, Firm B increased its bid by 0.032 from €143.167 to €143.199.

4.29. At 09:52:11, less than two seconds after entering his Best Bid quote and one second after Firm B raised its bid, Mr Walter entered an order to sell up to 15 million at a price of €143.193 or better. This resulted in a trade in which Mr Walter sold 5 million to Firm

B at a price of €143.199. The trade occurred as the bid entered by Firm B was above the minimum price limit set by Mr Walter and the BrokerTec system prevents market participants from aggressing their own orders, allowing Mr Walter to bypass his own bid.

4.30. Mr Walter then cancelled his quote less than two seconds later. Mr Walter's trading strategy in this instance resulted in a profit of €1,540, this being the difference in sale price of 5 million between the Best Bid available before Mr Walter commenced the specific pattern of trading and the price at which Mr Walter sold the DSL.

Second trade on 3 July 2014

4.31. Following the first sell trade at 09:52:11, Mr Walter entered and exited the BrokerTec platform on 12 instances between 09:53:40 and 09:57:33. Each time he entered the BrokerTec platform on those instances he provided a quote with a Best Bid price and in a size of 2 million.

4.32. At 09:57:57 Mr Walter entered a quote into the market with a bid for 2 million at €143.247 which became Best Bid. This would have suggested that Mr Walter intended to buy the January 2028 Bond. Immediately prior to Mr Walter entering his quote, the Best Bid was at €143.209 in 2 million, followed by Firm A at €143.193 in a size of 3 million.

4.33. Firm A then reacted to these adjustments by improving its bid by 0.042 from €143.193 to €143.235 for 3 million. As a consequence, Firm A maintained its second position in the order book.

4.34. At 09:58:00, while Mr Walter's bid remained in first position on the order book, he entered an order to sell up to 15 million at a price of €143.229 or better, resulting in a trade whereby Mr Walter sold 3 million to Firm A at €143.235.

4.35. Less than 1½ seconds after the trade was executed, Mr Walter cancelled his quote. Mr Walter's trading strategy in this instance resulted in a profit of €940, this being the difference in sale price of 3 million between the Best Bid available before Mr Walter commenced the specific pattern of trading and the price at which Mr Walter sold the DSL.

Third trade on 3 July 2014

4.36. At 10:20:32 Mr Walter returned to quoting on BrokerTec with a quote (his bid becoming Best Bid for 2 million at €143.254, 0.034 above the existing Best Bid). He then removed his orders and exited the market approximately 3 seconds later.

4.37. Approximately 30 seconds after exiting BrokerTec, Mr Walter re-entered BrokerTec with a quote. His bid of 2 million at €143.265 became Best Bid, 0.035 above the existing Best Bid. This would have suggested that he intended to buy the January 2028 Bond. Between 10:20:55 and 10:21:57 he made a series of changes to his prices.

4.38. At 10:21:59, Mr Walter manually increased his bid to €143.323. Almost immediately afterwards, Firm A increased its bid price from €143.303 to €143.313 in 3 million, maintaining its position of second Best Bid on the order book. Then at 10:22:00, Firm B also increased its bid price from €143.301 to €143.318 with the result that it was the second highest bid (immediately below Mr Walter) on the order book.

4.39. At 10:22:02, while remaining Best Bid on the order book, Mr Walter entered an order to sell up to 10 million at a price of €143.299 or better. This action resulted in two trades being executed. Mr Walter sold 5 million to Firm B at €143.318 and 3 million to Firm A at €143.313.

4.40. Less than two seconds after these trades were executed, Mr Walter cancelled his own quote.

4.41. Mr Walter's trading strategy in this instance resulted in a profit of €7,080 from these sales to Firm B and Firm A, this being the difference in sale price of 8 million between the Best Bid available before Mr Walter commenced the specific pattern of trading and the price at which Mr Walter sold the DSL to Firm B and Firm A.

Fourth trade on 3 July 2014

4.42. At 10:31:09 Mr Walter entered a quote on BrokerTec with a bid for 2 million at €143.305, 0.035 above the existing Best Bid. Approximately 110 milliseconds later, Firm B increased its bid price by 0.035 to €143.295. Mr Walter then increased his bid from €143.305 to €143.318 and Firm B increased its bid to €143.308.

4.43. At 10:31:23, Mr Walter (who was still at Best Bid on the order book) further increased his bid to €143.328 and this was followed almost immediately, by Firm B improving its price by 0.010 to €143.318.

4.44. At 10:31:25, two seconds later, Mr Walter entered an order to sell up to 10 million at a price of €143.307 or better. This resulted in a trade whereby Mr Walter sold 5 million to Firm B at €143.318 and he then, after about two seconds, cancelled his quote.

4.45. Mr Walter's trading strategy in this instance resulted in a profit of €2,600, this being the difference in sale price of 5 million between the Best Bid available before Mr Walter commenced the specific pattern of trading and the price at which Mr Walter sold the January 2028 Bond to Firm B.

Summary of trading on 3 July 2014

4.46. As a result of the trades on BrokerTec between 09:52 and 10:31 on 3 July 2014 (described above), Mr Walter reduced the size of his long position by approximately 20 million from nearly 29 million to 8,809,877.

4.47. Mr Walter carried out his abusive trading strategy on four separate instances on 3 July 2014. On each occasion Mr Walter entered quotes that led to him being Best Bid on the order book, thereby giving the impression that he intended to buy the January 2028 Bond. He then increased his bid a number of times and after Firm A and/or Firm B had increased their bids in response to Mr Walter's bid, he reversed his trading strategy by selling into those bids. Mr Walter was not a genuine buyer on each of these instances: rather, he intended to sell the January 2028 Bond and induced other market participants to raise their bids so that he could benefit from the price adjustments.

4.48. Although Mr Walter was seeking to sell up to 5 million when he entered the initial Best Offer quote, he then entered quotes to become Best Bid with a size of 2 million. This was the minimum size required to quote on BrokerTec and meant that if his Best Bid was hit, he would have limited exposure.

Other abusive trading in the Relevant Period

4.49. Mr Walter carried out his abusive trading strategy both before and after 3 July 2014 on a further eight separate instances, which are set out in summary form below. In these further eight instances of abusive trading, the methodology used by Mr Walter was similar to that detailed above in relation to the January 2028 Bond on 3 July 2014.

Abusive trading in the July 2019 Bond on 2 July 2014

4.50. From 13:11:28, Mr Walter entered quotes on BrokerTec, becoming Best Bid in 2 million at €117.447 which he then further increased to €117.452. Firm A also improved its bid from €117.445 to €117.450. At 13:11:38, Mr Walter entered an order to sell which resulted in a trade whereby Mr Walter sold 5 million to Firm A at €117.450. He then cancelled his quote.

4.51. As a result of the above trade, Mr Walter reduced his long position in the July 2019 Bond from approximately 11.5 million to 6.5 million. He then went on to sell another 6 million that day so that his closing position was approximately 0.5 million long. The Authority therefore believes that between 13:11:28, when Mr Walter began entering increasing Best Bids, and 13:11:38 he was misleading the market as his true intention was to sell. The abusive trading on this occasion resulted in a profit of €400.

Abusive trading in the January 2033 Bond on 15 July 2014

4.52. At 08:53.54, Mr Walter entered a quote which resulted in him becoming Best Bid in 2 million. He then increased his bid a number of times to €107.068 whilst Firm A improved its bid from €107.051 to €107.061. Mr Walter then entered an order to sell that resulted in him selling 2 million to Firm A at its bid price of €107.061 and then cancelled his quote.

4.53. As a result of the above trade, Mr Walter reduced his position from being long approximately 1.7 million to being short 0.3 million. The Authority therefore believes that between 08:53:54 when Mr Walter began entering increasing Best Bids, and 08:54:48, he was misleading the market as his true intention was to sell. The abusive trading on this occasion resulted in a profit of €1,900.

Abusive trading in the July 2017 Bond and January 2019 Bond on 18 July 2014

4.54. On 18 July 2014, at 08:31:54, Mr Walter entered the BrokerTec platform in relation to the July 2017 Bond with a quote that resulted in him becoming Best Bid in 2 million. This was 0.015 higher than the Best Bid at the time Mr Walter first entered a quote on BrokerTec that morning. Less than one second later, Firm A and Firm B both raised their bids by 0.015. At 08:31:56, Mr Walter sold 10 million to Firm A at €112.983 and 10 million to Firm B at €112.982 before cancelling his quote.

4.55. Approximately two minutes later, Mr Walter re-entered BrokerTec and placed a further quote, resulting in him becoming Best Bid in 2 million, 0.009 above the existing Best Bid in the market. After Firm A had increased its bid price by 0.009, Mr Walter sold 10 million to Firm A at €112.980 and then cancelled his quote.

4.56. As a result of the above trades Mr Walter reduced his long position in the July 2017 Bond from 39.5 million to 9.5 million. Mr Walter then went on to sell another 8 million later that day so that his closing position was approximately 1.5 million long.

4.57. The Authority therefore believes that between 08:31:54 when Mr Walter entered a Best Bid, and 08:31:56, and between 08:34:16, when Mr Walter entered a Best Bid, and 08:34:18, he was misleading the market as his true intention was to sell. The abusive trading on these two instances resulted in a profit of €2,800 and €1,100 respectively.

4.58. At 11:25:32 Mr Walter re-entered the BrokerTec platform, this time for the January 2019 Bond, with a quote resulting in him becoming Best Bid in 2 million, 0.019 above the preceding Best Bid in the market. Within seconds, Firm A raised its bid by 0.018 and then Mr Walter sold 5 million to Firm A at a price of €104.007 before cancelling his quote.

4.59. Mr Walter also reduced his long position in the January 2019 Bond from being long approximately 6.5 million to being long 1.5 million. The Authority therefore believes that between 11:25:32, when Mr Walter entered a Best Bid, and 11:25:34, he was misleading the market as his true intention was to sell. The profit from this abusive trading was €800.

Abusive trading in the January 2019 Bond on 21 July 2014

4.60. On 21 July 2014, from 12:43:09, Mr Walter entered quotes for the January 2019 Bond which resulted in him being Best Bid in 2 million, which he then increased further. Firm A also improved its bid and at 12:43:59, Mr Walter sold 2 million to Firm A at €103.979 and then cancelled his quote.

4.61. Mr Walter was long 1.5 million and thereby reduced his position with the above trade to being short 0.5 million. The Authority therefore believes that between 12:43:09, when

Mr Walter began entering increasing Best Bids, and 12:43:59, he was misleading the market as his true intention was to sell. The profit from this abusive trading was €220.

Abusive trading in the July 2023 Bond on 22 July 2014

4.62. On 22 July 2014, at 09:09:53 Mr Walter entered a quote for the July 2023 Bond in size 2 million with a bid which was 0.012 above the Best Bid prior to his entry. Immediately after Firm A had increased its bid price by 0.012 to €104.676, Mr Walter sold 5 million to Firm A and cancelled his quote.

4.63. As a result of the above trade Mr Walter reduced his long position in the July 2023 Bond from being long approximately 6.9 million to being long 1.9 million. The Authority therefore believes that between 09:09:53, when Mr Walter entered a Best Bid, and 09:09:55, he was misleading the market as his true intention was to sell. The profit from this abusive trading was €500.

Abusive trading in the January 2033 Bond on 8 August 2014

4.64. Mr Walter's abusive trading on 8 August 2014 relates to the January 2033 Bond. On this occasion, Mr Walter's abusive trading took place on the offer side of the order book. At 12:35:06 Mr Walter entered a quote which resulted in him being Best Offer in 2 million and continued to lower his offer in incremental steps to €110.737. Firm A and Firm C also lowered their offers and at 12:36:03 Mr Walter purchased 3 million from Firm A at €110.744 and 5 million from Firm C at €110.747 before cancelling his quote.

4.65. As a result of the above trades Mr Walter reduced his position from being short approximately 14.5 million to being short 6.5 million. Mr Walter then went on to purchase another 7 million of the bond so that his closing position for the day was long 0.5 million. The Authority therefore believes that between 12:35:56, when Mr Walter began entering lower offers, and 12:36:03, he was misleading the market as his true intention was to buy. The profit from this abusive trading was €2,120.

Totality of Mr Walter's BrokerTec trades in the Relevant Period

4.66. Therefore, in the Relevant Period, Mr Walter carried out his abusive trading strategy on 11 instances on the bid side of the order book and once on the offer side of the order book. On each occasion Mr Walter entered a quote in a size of 2 million – the minimum size required to quote in the DSLs on BrokerTec. An analysis of Mr Walter's trades on

BrokerTec in the Relevant Period revealed that these 12 instances of abusive trading amount to over half of his trades by number, for the six relevant DSLs on BrokerTec.

4.67. The first instance of Mr Walter's abusive trading occurred on 2 July 2014. This was one day after the introduction of the Primary Dealer programme on BrokerTec on 1 July 2014. This introduction on BrokerTec led to increased liquidity in trading DSLs on BrokerTec as Primary Dealers were required to quote for certain periods and in minimum sizes, and certain of them used algorithms to follow Best Bids or follow other quotes in order to fulfil this obligation. Mr Walter was able to take advantage of this tracking activity to carry out successfully his manipulative trading strategy, quoting in small sizes, executing trades in larger sums once his Best Bid or Best Offer had been followed by others and then deleting his own quote.

4.68. BrokerTec allowed market participants to quote bid and offer prices in relatively small sizes of 2 million for each DSL. Mr Walter abused this feature by posting his manipulative quotes in small sizes of 2 million while others posted their bids and offers in sizes of 2, 3, 5 or 10 million depending on the liquidity of the specific DSL. Mr Walter did this so that if his high bid or low offer were to be aggressed by another market participant, Mr Walter would only have to buy or sell 2 million DSL at the high bid or low offer price, while he retained the ability to sell or purchase significantly more from the other market participants when they raised their bid prices or lowered their offers in response to his quote.

4.69. Mr Walter's abusive trading in the 12 instances during the Relevant Period resulted in a profit of €22,000, this being the difference in sale or purchase price between the Best Bid or Best Offer available immediately before Mr Walter commenced the specific pattern of abusive trading and the price at which Mr Walter sold or purchased the DSLs.

Mr Walter's telephone call with BrokerTec

4.70. On 22 July 2014, Mr Walter received a telephone call from BrokerTec. The purpose of the telephone call was to discuss a complaint that had been made to BrokerTec in relation to Mr Walter's trading on 18 July 2014 and BrokerTec's concerns that Mr Walter had on several instances, on several different dates, "*bid the price up with a size of two*" and then once others had increased their price, traded with them for the full size they were offering. In the course of the telephone call Mr Walter refused to answer any questions. Mr Walter's explanation for his response is that he did not believe the call was genuine and he followed BAML protocol by giving a “no comment” response. The call did, however, identify the trading that had occurred on the relevant instances and would therefore have given Mr Walter notice of the concerns about that trading. Despite being on notice of the concerns regarding his trading, Mr Walter carried out the same trading strategy on 8 August 2014.

Mr Walter’s explanations for trading

4.71. When BAML first asked Mr Walter about the trading, he stated it might have been the result of making errors in entering his quotes onto the system. When questioned by BAML on a second occasion, he stated that he may have been seeking to buy bonds in sizes of 2 million to round up or down his book positions. He later accepted that neither of these explanations was adequate.

4.72. In interviews with the Authority, Mr Walter stated that he was a buyer of DSLs when he quoted Best Bid prices on BrokerTec, although he could not recall the specific reason for being a buyer. According to Mr Walter, it was possible he was looking to buy a large order (in excess of 50 million) and was potentially progressing that order in sizes of 2 million to get a better price and be less disruptive to the market. Mr Walter stated that he could not recall why he sold but that he might have sold to those tracking his prices because they were “spoiling” his market by making his bid look less competitive and therefore less attractive in the market and that he wanted to discourage the other market participants from following him.

4.73. Analysis of Mr Walter’s trading and book positions does not support his claim that he was a genuine buyer or that he was building a large order.

4.74. His trading and positions in the six DSLs at the time evidence a trading pattern in which Mr Walter did not incrementally build large long or short positions. In those instances in which he did acquire a large position from a BAML client, he wound that position down. The instances in which he sold into bids by those tracking him coincide with when he was long on the relevant DSL and thus reducing his position by selling the DSL was consistent with his broader trading pattern. He also set the size limits for his sell orders, executed against those who were tracking him, by reference to his long position in that specific bond.

4.75. In addition, on 2, 3, 15 and 21 July Mr Walter began his trading on BrokerTec by entering genuine Best Offer quotes and then switched to Best Bid quotes (without having traded in the meantime) when his Best Offer quotes had not been aggressed by other market participants.

5. FAILINGS

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

Market abuse

5.2. In trading the DSLs on BrokerTec Mr Walter was engaging in behaviour in relation to a qualifying investment admitted to trading on a prescribed market within the meaning of section 118(1)(a) of the Act and the market abuse provisions in Part VIII of the Act apply to his trading.

5.3. Mr Walter's trading in the DSLs was contrary to section 118(5) of the Act. Mr Walter's behaviour gave a false and misleading impression as to the price and the supply or demand of the DSLs. This is because on the 11 instances described in paragraphs 4.22-4.63 above, Mr Walter had no intention of buying and on the one occasion described in paragraphs 4.64-4.65 above, he had no intention of selling. His behaviour gave a false and misleading impression and indicated that he was a genuine buyer/seller at a particular price and in a particular volume when, in fact, he undertook the trading strategy so as to benefit from the price movement when he did trade in the opposite direction and in accordance with his true intention.

5.4. By carrying out the trading strategy described above, Mr Walter secured the price of the DSLs at an artificial level and was able to sell or buy the DSLs at a more advantageous price than he would otherwise have been able to do at that time, albeit the price he obtained was within the prevailing bid/offer spread.

5.5. The Authority has had regard to the descriptions of behaviour that amount to market abuse and the factors to be taken into account when determining whether conduct amounts to market abuse, which are set out in MAR. In particular, the Authority has taken into account MAR 1.6.4E (manipulating transactions: price positioning), MAR 1.6.5E (not legitimate reasons), MAR 1.6.9E (false or misleading impression) and MAR 1.6.10E (abnormal or artificial price levels).

5.6. Mr Walter's trading on the 12 instances identified in this Notice constituted market abuse in that it was behaviour consisting of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which gave a false or misleading impression as to the price of the DSLs and secured the price of the DSLs at artificial levels (section 118(5)(a) and (b) of the Act).

6. SANCTION

Financial penalty

6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. The Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5C sets out the details of the five-step framework that applies in respect of financial penalties imposed on individuals in market abuse cases.

Step 1: disgorgement

6.2. Pursuant to DEPP 6.5C.1G, at Step 1 the Authority seeks to deprive an individual of the financial benefit derived directly from the market abuse where it is practicable to quantify this.

6.3. The Authority has not identified any financial benefit that Mr Walter personally derived directly from the market abuse.

6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.5. Pursuant to DEPP 6.5C.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the market abuse. That figure is dependent on whether or not the market abuse was referable to the individual's employment. The market abuse committed by Mr Walter was referable to his employment. In cases where the market abuse was referable to the individual's employment, the Step 2 figure will be the greater of:

(a) a figure based on the percentage of the individual's "relevant income";

(b) a multiple of the profit made or loss avoided by the individual for their own benefit, or for the benefit of other individuals where the individual has been instrumental in achieving that benefit, as a direct result of the market abuse (the "profit multiple"); and

(c) for market abuse cases which the Authority assesses to be seriousness level 4 or 5, £100,000.

6.6. The Authority has not identified any profit made or loss avoided for Mr Walter's own financial benefit from the market abuse.

6.7. An individual's relevant income is the gross amount of all benefits they received from the employment in connection with which the market abuse occurred for the period of the market abuse.

6.8. The period of the market abuse committed by Mr Walter was from 2 July 2014 to 8 August 2014. Pursuant to DEPP 6.5C.2(5), where the market abuse lasted less than 12 months, the relevant income will be that earned by the individual in the 12 months preceding the final market abuse. Therefore, the relevant period for calculating Mr Walter's relevant income is the 12 month period ending on 8 August 2014. Mr Walter's relevant income in the 12 month period ending 8 August 2014 was £300,452.

6.9. In cases where the market abuse was referable to the individual's employment:

(1) the Authority determines the percentage of relevant income which applies by considering the seriousness of the market abuse and choosing a percentage between 0% and 40%; and

(2) The percentage range and profit multiple range are divided into five fixed levels which reflect, on a sliding scale, the seriousness of the market abuse; the more serious the market abuse, the higher the level. For penalties imposed on individuals for market abuse there are the following five levels:

Level 1 – 0%;

Level 2 – 10%;

Level 3 – 20%;

Level 4 – 30%;

Level 5 – 40%;

6.10. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the market abuse, and whether it was committed deliberately or recklessly.

6.11. DEPP 6.5C.2G(15) lists factors likely to be considered level 4 or 5 factors. Of these, the Authority considers it to be a relevant factor that his conduct was repeated, occurring on 12 separate instances between 2 July and 8 August 2014, and did not cease despite his being put on notice of concerns about his behaviour (which BrokerTec had raised in a telephone call with him) (DEPP 6.5C.2G (15)(c)).

6.12. DEPP 6.5C.2G(16) lists factors likely to be considered level 1, 2 or 3 factors. Of these, the Authority considers the following factors to be relevant:

(1) Mr Walter made no direct profits as a result of the market abuse (DEPP 6.5C.2G(16)(a);

(2) Mr Walter's conduct had no actual effect on the orderliness of the market (DEPP 6.5C.2G(16)(b)); and

(3) the market abuse was committed negligently (DEPP 6.5C.2G(16)(c)).

6.13. The Authority has also taken into account that:

(1) The benefit to Mr Walter's trading book from the abusive trading was limited but could have increased significantly over the medium and long term had he not been suspended from BAML on 11 August 2014, and his behaviour only ceased when he was suspended by BAML;

(2) Mr Walter influenced the prices of the government bonds to his advantage and the detriment of other market participants. Whilst there was no actual adverse effect on the orderliness of the market, such behaviour undermines the confidence in UK markets and gives a false and misleading impression as to demand, supply and price;

(3) Mr Walter was an approved person and an experienced trader of government bonds with 20 years of experience; and

(4) Mr Walter did not intend to commit market abuse, as he did not intend or foresee that the likely or actual consequences of his actions would result in

market abuse. However, the Authority considers that Mr Walter should have realised that his behaviour constituted market abuse, and that his behaviour constituted a serious failure to act in accordance with the standards reasonably expected of market participants. This behaviour did not cease even after Mr Walter was put on notice of concerns about his conduct (which BrokerTec had raised in a telephone call with him).

(5) Mr Walter took advantage of the anonymity provided by BrokerTec, knowing that he could not easily be identified and therefore it would be more difficult for other market participants to attribute the trades in question to him.

6.14. Taking all of these factors into account, the Authority considers the seriousness of the market abuse to be level 3. This means the Step 2 figure is: 20% of £300,452 = £60,090.

Step 3: mitigating and aggravating factors

6.15. Pursuant to DEPP 6.5C.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2 to take into account factors which aggravate or mitigate the market abuse. Having considered each of the factors listed in DEPP 6.5C.3G, the Authority has concluded that there are no aggravating or mitigating factors such as to justify an adjustment to the Step 2 figure.

6.16. Step 3 is therefore £60,090.

Step 4: adjustment for deterrence

6.17. Pursuant to DEPP 6.5C.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the market abuse, or others, from committing further or similar market abuse, then the Authority may increase the penalty.

6.18. The Authority considers that the Step 3 figure of £60,090 represents a sufficient deterrent to Mr Walter and others, and so has not increased the penalty at Step 4.

6.19. Step 4 is therefore £60,090.

Step 5: settlement discount

6.20. Pursuant to DEPP 6.5C.5G, if the Authority and the individual 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 individual reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.21. No settlement discount applies.

6.22. Step 5 is therefore £60,090.

6.23. The Authority has therefore imposed a total financial penalty of **£60,090** on Mr Walter for market abuse.

7. REPRESENTATIONS

7.1. Annex B contains a brief summary of the key representations made by Mr Walter, and how they have been dealt with. In making the decision which gave rise to the obligation to give this Final Notice, the Authority has taken into account all of the representations made by Mr Walter, whether or not set out in Annex B.

8. PROCEDURAL MATTERS

Decision maker

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

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

Manner of and time for Payment

8.3. The financial penalty of £60,090 must be paid in full by Mr Walter to the Authority by no later than 6 December 2017, 14 days from the Final Notice.

If the financial penalty is not paid

8.4. If all or any of the financial penalty is outstanding after its due date for payment, the Authority may recover the outstanding amount as a debt owed by Mr Walter and due to the Authority.

Publicity

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

8.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contact

8.7. For more information concerning this matter generally, contact Stephen Robinson (direct line: 020 7066 1338) or Lehong Mac (direct line: 020 7066 5742) of the Enforcement and Market Oversight Division of the Authority.

Mario Theodosiou
Head of Department, Enforcement and Market Oversight Division
Financial Conduct Authority

ANNEX A

LEGAL AND REGULATORY PROVISIONS

Section 118 of the Act

118 Market abuse

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

(a) occurs in relation to –

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

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

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

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

[…]

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

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

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

Section 123 of the Act

123 Power to impose penalties in cases of market abuse

(1) If the [Authority] is satisfied that a person ("A") -

(a) is or has engaged in market abuse, or

(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse,

it may impose on him a penalty of such amount as it considers appropriate.

(2) But the [Authority] may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that –

(a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or

(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.

Section 119 of the Act

119 The Code

(1) The [Authority] must prepare and issue a code containing such provisions as the [Authority] considers will give appropriate guidance to those determining whether or not behaviour amounts to market abuse.

(2) The code may among other things specify -

(a) descriptions of behaviour that, in the opinion of the [Authority] amount to market abuse;

(b) descriptions of behaviour that, in the opinion of the [Authority], do not amount to market abuse;

(c) factors that, in the opinion of the [Authority], are to be taken into account in determining whether or not behaviour amounts to market abuse;

(d) descriptions of behaviour that accepted market practices in relation to one or more specified markets;

(e) descriptions of behaviour that are not accepted market practices in relation to one or more specified markets.

(2A) In determining, for the purposes of subsections (2)(d) and (2)(e) or otherwise, what are and what are not accepted market practices, the [Authority] must have regard to the factors and procedures laid down in Articles 2 and 3 respectively of the Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council.

(3) The code may make different provision in relation to persons, cases or circumstances of different descriptions.

(4) The [Authority] may at any time alter or replace the code.

MAR

MAR applies to all persons seeking guidance on the market abuse regime (MAR 1.1.1G).

It provides assistance in determining whether behaviour amounts to market abuse but does not exhaustively describe all types of behaviour that may or may not amount to market abuse.

MAR 1.6.2 E

Descriptions of behaviour that amount to market abuse (manipulating transactions): false or misleading impressions

The following behaviours are, in the opinion of the [Authority], market abuse (manipulating transactions) of a type involving false or misleading impressions:

[…]

(4) entering orders into an electronic trading system, at prices which are higher than the previous bid or lower than the previous offer, and withdrawing them before they are executed, in order to give a misleading impression that there is demand for or supply of the qualifying investment at that price…

MAR 1.6.4 E

Descriptions of behaviour that amount to market abuse (manipulating transactions): price positioning.

The following behaviours are, in the opinion of the [Authority], market abuse (manipulating transactions) involving securing the price of a qualifying investment:

[…]

(3) entering small orders into an electronic trading system, at prices which are higher than the previous bid or lower than the previous offer, in order to move the price of the qualifying investment, other than for legitimate reasons;

MAR 1.6.5 E

Factors to be taken into account: "legitimate reasons"

In the opinion of the [Authority] the following factors are to be taken into account when considering whether behaviour is for "legitimate reasons" and are indications that it is not:

(1) if the person has an actuating purpose behind the transaction to induce others to trade in, or to position or move the price of, a qualifying investment;

(2) if the person has another, illegitimate, reason behind the transaction or orders to trade;

(3) if the transaction was executed in a particular way with the purpose of creating a false or misleading impression.

<u>MAR 1.6.9 E</u>

Factors to be taken into account: behaviour giving a false or misleading impression

In the opinion of the [Authority], the following factors are to be taken into account in determining whether or not a person's behaviour amounts to market abuse (manipulating transactions):

[…]

(5) the extent to which orders to trade given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed;

(6) the extent to which orders to trade given change the representation of the Best Bid or offer prices in a financial instrument admitted to trading on a regulated market, or more generally the representation of the order book available to market participants, and are removed before they are executed;

[…]

<u>MAR 1.6.10 E</u>

Factors to be taken into account: behaviour securing an abnormal or artificial price level

In the opinion of the [Authority], the following factors are to be taken into account in determining whether or not a person's behaviour amounts to market abuse (manipulating transactions):

(1) the extent to which the person had a direct or indirect interest in the price or value of the qualifying investment or related investment;

(2) the extent to which price, rate or option volatility movements, and the volatility of these factors for the investment in question, are outside their normal intra-day, daily, weekly or monthly range; and

(3) whether a person has successively and consistently increased or decreased his bid, offer or the price he has paid for a qualifying investment or related investment…

[…]

ANNEX B

REPRESENTATIONS

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

<u>Applying the standard of proof</u>

2. *As a matter of law, the more serious an allegation, the less likely it is that the alleged event occurred and, hence, the stronger the evidence must be before one can conclude that the allegation is established on the balance of probabilities. In this case, the evidence against Mr Walter does not stand up to scrutiny at all. Mr Walter (while not recalling the specific trading incidents in question) has provided a possible explanation for the trading pattern, and the Authority has not produced any evidence capable of rebutting that explanation.*

3. The Authority takes the same approach as the Upper Tribunal (to which Mr Walter may refer this matter following the issue of this Notice, should he wish to do so) in cases brought by the Authority under Part VIII of the Act. Accordingly, it applies the ordinary civil standard whereby allegations must be proved on the balance of probabilities (that is, whether it is more likely than not that the misconduct occurred). However, the Authority does not agree with Mr Walter's representation as to how that standard is to be applied. The more inherently unlikely an event, the stronger the evidence that will be required to prove it. However (as stated by the Upper Tribunal in *Hannam v FCA* [2014] UKUT 233: see in particular paragraph 155 of that decision), there is no rule of law that a more serious allegation is inherently more unlikely than a less serious one.

4. Accordingly, in considering the evidence, including the explanations provided by Mr Walter, the Authority has considered whether particular matters alleged are more likely to have occurred than not (having due regard to their inherent probability or otherwise), and its reasons for reaching its conclusions are set out in this Notice.

<u>The Authority must show an intention to mislead, which is not supported by the evidence</u>

5. *The Authority must show that Mr Walter only placed his bids or offers with the intention of misleading the market, and intending to trade in the opposite direction. The evidence in fact shows that he was a genuine buyer of DSLs in July 2014 and a genuine seller in August 2014, as evidenced by the fact that he bought more DSLs than he sold in July,*

and sold more than he bought in August.

6. The Authority notes that no mental element on the part of the person alleged to have engaged in market abuse is required to establish that a contravention of section 118(5) of the Act has occurred. However, the Authority agrees that on the facts of this particular matter its case is that Mr Walter's intention in placing the quotes was to mislead and that he intended to trade in the opposite direction.

7. The Authority does not consider that Mr Walter's intention may be demonstrated by reference to how many DSLs he bought or sold overall in any parts of the period in question. The Authority considers (as explained more fully below) that analysis of Mr Walter's trading on BrokerTec and other platforms demonstrates that his aim was to manage his overall trading book towards a flat position in DSLs (ie not long or short on any particular bond or "bucket" of bonds of similar maturities), which is inconsistent with an overall strategy to buy or sell particular bonds (or "buckets" of bonds).

<u>Mr Walter had no motive to commit market abuse</u>

8. *The Authority has failed to establish any motive on the part of Mr Walter for committing market abuse. He had little (if any) financial incentive to commit market abuse. His profit and loss figures for the year until he was suspended from trading were approximately US$4.5 million, whereas the financial gain to BAML from the trades in question was, by comparison, negligible at €22,000. He is a highly experienced trader and was an approved person with a clean disciplinary record. He had always kept himself up-to-date with compliance training and was therefore well aware of the consequences of, and penalties for, market abuse. He would not have jeopardised his career for the sum in question; nor did he have any other motivation such as a sense of control over the users of algorithms. He was a user of algorithms himself, and not hostile to them.*

9. The Authority accepts that the financial profit for BAML was insignificant, and for Mr Walter personally probably non-existent. The Authority has formed no view as to Mr Walter's particular motivation in committing market abuse; however, it considers that he did not appreciate (although he was negligent in not doing so) that his actions constituted market abuse and therefore would not have realised that he was risking his career and reputation by acting as he did.

Mr Walter's bids were genuine and high-quality

10. *Mr Walter's bids were high-quality (best bid/offer and improving the bid/offer spread) and available for multiple seconds, which is a long time in the context of the market in question. They were available for trading long enough that their validity should not be questioned and, indeed, they were highly likely to trade. There were no safeguards in place to prevent the bids from trading, and they did not have the characteristics seen in cases of "spoofing" and "layering" (such as layering quotes placed some distance from the "touch" which survive for extremely short periods before being cancelled, and a "saw-tooth" pattern).*

11. The Authority's case is not that Mr Walter was engaged in either of the types of market abuse commonly known as spoofing and layering. It agrees that Mr Walter's strategy was not without risk: it was possible that other market participants could have traded with Mr Walter on the basis of his bids, and indeed this did on occasion happen. Its view is, however, that he did not intend that it should and in that sense the quotes were not genuine. It considers that Mr Walter deliberately bid in the smallest possible size in order to minimise the disadvantage to his trading book if this should happen. The Authority considers that the gap between Mr Walter's trading through his own bids and his cancelling them was short enough on each occasion to be consistent with him cancelling them as soon as possible after trading.

The market was not affected, as conceded by Enforcement's own expert

12. *The Enforcement case team's own industry expert was of the view that Mr Walter's strategy did not change the overall available liquidity for investors or create a materially misleading overall market for the bonds in question. He considered that Mr Walter likely had no intent to move the market headline prices, or to give a false or misleading impression to other market participants as to the overall supply and demand in the marketplace. Further, in his initial report the expert had expressed the view that Mr Walter's conduct did not amount to market manipulation.*

13. It is not the Authority's case that Mr Walter's actions changed the overall available liquidity for investors, moved the headline market prices or created a false or misleading impression as to overall supply and demand in the marketplace. It considers that he created a false or misleading impression as to demand or supply by misrepresenting his own intentions as buyer/seller of the bonds and secured the price of the bonds (momentarily) at an artificial level, contrary to section 118(5) of the Act.

The views of the Enforcement team's expert are consistent with that analysis. His final report (as opposed to his initial draft) supported the view that this amounted to market abuse, but in any event that is a matter of law and, in the light of the evidence, the Authority is satisfied that Mr Walter's actions did amount to market abuse. The Authority notes that Mr Walter does not take issue with the Authority's legal analysis as to what is required to establish a contravention of section 118(5).

<u>Others were also of the view that market abuse had not been committed</u>

14. *Mr Walter was the subject of an internal inquiry by BAML after the issue was raised by Broker Tec and the inquiry cleared him of any wrongdoing. Even though BAML was aware of only three trades, it was able to consider the nature of those trades, and weight should be given to its conclusion that the behaviour did not contravene any rules or regulations.*

15. *The trader who complained to BrokerTec was interviewed by the Authority and appears to have considered the incident complained of irritating (because it forced him to re-enter his quote) rather than serious, and that it did not amount to "spoofing".*

16. As noted at paragraph 11 above, the Authority agrees that Mr Walter's conduct did not amount to "spoofing". As set out in that paragraph, the Authority has concluded that the quotes in question were not genuine in the sense that Mr Walter did not intend them to be accepted.

17. Neither the trader concerned nor BAML were aware of all the trading incidents in question. The Authority does not consider that, being aware of only a limited number of instances, they were nevertheless in possession of all the relevant facts. In any event, the views expressed by them do not alter the Authority's conclusion that, considered in the light of all the relevant facts, the trading incidents did amount to market abuse.

18. Indeed, the complaint was summarised by BrokerTec as being that someone had "*bid the price up with a size of two and then once the other customer had increased his price trading with him for the full size*". The behaviour described was market abuse under section 118(5) of the Act.

<u>Mr Walter probably sold into his quotes to stop algorithms from tracking him</u>

19. *Mr Walter is unable to remember any of the trades in question but believes the most likely explanation is that he was selling through his own quotes in order to stop algorithms from tracking him, having observed after placing his quotes that they were doing so. He would have done this because a cluster of bids/offers below/above the*

best bid/offer was disruptive to his intended activities. He would have been intending to build a long (or short) position in the bonds in question, but to do so incrementally in sizes of 2 million in order not to reveal his intention to the market. Building a position is perfectly normal behaviour for a Market-maker. He would have been prepared to sacrifice his long (or short) position in order to get rid of the tracking algorithm. Trading through one's own quote is now discouraged but it was commonly done at the time and could serve a legitimate purpose, as in the instant case. Mr Walter would then have exited the market to assess the situation and adjust his trading strategy as might be required: as he said in interview with the Authority, to "compose myself…reconfigure and then go back in".

20. The Authority finds this explanation implausible in a number of respects, and does not accept that it is correct. There is no evidence of Mr Walter actually building a large position incrementally using small trades at any point over the Relevant Period. His trading is consistent with an intention to flatten his position following client trades entered into by him in his function as Market-maker. The large size of the trades Mr Walter executed through his quotes contrasts with the small size of his quotes (which were invariably at the minimum size of 2 million) and it seems improbable he would have been prepared, or that he would have considered it necessary, to sacrifice the whole of his long (or short) position in a bond for this purpose if it were his intention to build a large position. The Authority considers that this activity was consistent with him aiming to flatten his position, and setting his size limits according to the size of his existing position, when selling through his own quotes. In this case, the Authority is concerned not with the general propriety of traders of trading through their own quotes, but with the issue of why Mr Walter did it on the twelve occasions identified. Further, after exiting the market, Mr Walter did not "go back in", having adjusted his trading strategy; rather, on each occasion his positions remained flatter than before the trading.

<u>The Authority has not established a pattern of behaviour</u>

21. *The twelve instances relied upon by the Authority are not enough to establish a pattern of behaviour on Mr Walter's part and the Authority should not draw any firm conclusions from such a small sample.*

22. These occasions of trading, though relatively few in number, follow a particular pattern that is distinct from the rest of Mr Walter's trading examined by the Authority.

Mr Walter did not know when placing his quotes that they would be tracked

23. *Mr Walter had no reason to know, before placing his quotes, that they would be tracked, and did not in fact know this. Mr Walter was unaware of the launch of the Primary Dealer programme on BrokerTec. He would not have expected tracking algorithms to track quotes as small as 2 million because such algorithms would normally be set not to track quotes under a certain size.*

24. Mr Walter confirmed in interview with the Authority that he was well aware of the practice of some dealers using tracking algorithms and that it was "obvious" that this was happening from the reaction to actions initiated by him. Indeed, his final explanation for his conduct (see paragraph 19 above) is predicated on his awareness after placing the quotes in question of being tracked at a level of 2 million, a practice which, in the context of that explanation, he has not presented as extraordinary. He clearly regarded the use of tracking algorithms by dealers as routine. Whether or not Mr Walter knew about the Primary Dealer programme, its introduction gave rise to a significant increase in the amount of market-making activity on BrokerTec. Mr Walter accepted in interview with the Authority that Primary Dealers often tracked the best bid and offer quotes using algorithms and the Authority considers it unlikely that he would not have noticed an increase in the use of algorithms following the introduction of the BrokerTec Primary Dealer programme (whether or not he knew that to be the reason). For these reasons, the Authority is satisfied that Mr Walter would have been aware that he was being tracked on the occasions in question, whether or not this was what he would ordinarily have expected algorithms to do.

The Authority has unfairly judged Mr Walter for his inconsistent explanations

25. In considering his previous explanations for his conduct, which were inconsistent with the explanation now relied upon (summarised at paragraph 19 above) the Authority should bear in mind that Mr Walter is unable to remember any of the trades in question, which were insignificant in the context of his overall trading, which would have consisted of several thousand trades and an even larger number of orders over the Relevant Period. On the first occasion, he had been presented with evidence about certain of the trades without warning at the end of a trading day, and without any context. He was trying to assist BAML in offering his previous explanations, by reconstructing what had happened, but in the circumstances it would have been odd if he had recalled the details.

26. The Authority does not place great weight on the changes in explanation provided by Mr Walter for the trading patterns in question, and makes due allowance for the circumstances in which Mr Walter was questioned by BAML. It also notes that his position is that he simply cannot recall the relevant trades, so that he has not changed his account of events as actually recollected. Nevertheless the changing explanations for the trading patterns in question do not engender confidence in the explanation ultimately adopted by him as the most likely.

Mr Walter's conduct after the call with BrokerTec

27. One of the trading instances of which the Authority complains took place after the telephone call received by Mr Walter from BrokerTec referred to at paragraph 4.70 of this Notice. The Authority has suggested it should have put Mr Walter on notice of concerns and caused him to change his behaviour. Mr Walter does not recall this call and believes he would have considered it to be a hoax at the time (hoax calls being a common occurrence in the market). If he thought it was a hoax, and as he did not believe he was doing anything wrong, he cannot be criticised for not changing his behaviour.

28. The Authority does not allege that Mr Walter committed deliberate market abuse, as he did not intend or foresee that the likely or actual consequences of his actions would result in market abuse. However, notwithstanding his position that he cannot recall it, Mr Walter does not dispute that the call took place and was from BrokerTec, and indeed this is indisputable because it was recorded and the other party has confirmed his identity. Even if Mr Walter thought it was a hoax (and the Authority accepts that he

may have done so), it did identify the trading that had occurred on the relevant instances and thereby put him on notice that there were concerns about his conduct on those instances. This should have given him pause for thought as to whether the conduct in question was acceptable. This exacerbates his negligence in relation to the final instance of market abuse.

Financial penalty

29. *The Authority is stretching the application of the market abuse regime in its eagerness to achieve an outcome in this case. In an area where there has been uncertainty on what constitutes market abuse, no financial penalty is appropriate.*

30. *The Authority should take into account that Mr Walter cooperated fully with both his employer and the Authority during their investigations.*

31. Mr Walter has not given details of how he considers the application of the market abuse regime is being stretched by the Authority, nor (other than as set out at paragraphs 14-18 above) what uncertainty he considers there to have been. In particular, Mr Walter has not taken issue with the Authority's interpretation of section 118 of the Act in this case. The Authority has set out in this Notice why it considers Mr Walter's conduct to constitute market abuse and why it considers it to be serious.

32. The Authority considers the degree of cooperation shown by Mr Walter during the investigations was unexceptional and, accordingly, it should neither increase nor decrease the financial penalty to be imposed.