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**FINAL NOTICE**

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**To:** The Royal Bank of Scotland plc and The Royal Bank of Scotland N.V. (together "RBS")

**Firm**

**Reference Numbers:** 121882 and 124635

**Date:** 16 July 2013

**1. ACTION**

- 1.1. For the reasons given in this Notice, the Authority hereby imposes on RBS a financial penalty of £5,620,300
- 1.2. RBS has agreed to settle at an early stage of the Authority's investigation and therefore qualified for a 30% (Stage 1) reduction of the financial penalty under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a penalty of £8,029,100.

**2. SUMMARY OF REASONS**

2.1. The Authority has decided to take this action because:

(1) between 5 November 2007 and 1 February 2013 (the "Relevant Period"), RBS failed to report accurately approximately 44.8 million transactions; and

(2) between 5 November 2007 and February 2012 failed entirely to report approximately 804,000 transactions, that it executed.

This represents failures in relation to 37% of transactions reportable by RBS during the Relevant Period. RBS therefore breached rules in SUP 17 and Principle 3.

- 2.2. Accurate and complete transaction reporting is essential to enable the Authority to meet its operational objective of protecting and enhancing the integrity of the UK financial system. The primary function for which the Authority uses transaction reports is to detect and investigate suspected market abuse, insider trading and market manipulation.
- 2.3. A transaction report is a data set submitted to the Authority that relates to an individual financial market transaction which includes (but is not limited to) details of the product traded, the firm that undertook the trade, the trade counterparty and the trade characteristics such as buy/sell identifier, price and quantity.
- 2.4. The Authority considers the reporting failures by RBS during the Relevant Period as particularly serious, given that the Authority (i) has provided a significant quantity of guidance to firms on how to report, and check those reports and (ii) had during the Relevant Period, published a number of Enforcement actions taken in relation to similar failings by other firms.
- 2.5. Many of the problems at RBS detailed in this Notice arose as a result of significant systems challenges posed by the takeover by The Royal Bank of Scotland plc ("PLC") of ABN Amro Bank N.V. (now known as The Royal Bank of Scotland N.V.) ("NV") in October 2007. Given the considerable resources available to RBS, it should have been able to overcome these challenges and ensure that adequate systems and controls were in place.

### **3. DEFINITIONS**

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

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

"SUP" means the Authority's Supervision Manual; and

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

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

- 4.1. The implementation of the Markets in Financial Instruments Directive ("MiFID") across all European Economic Area (EEA) member states on 1 November 2007 (effective 5 November 2007 for transaction reporting) introduced changes to the list of products in which transactions have to be reported and standardised the list of fields which need to be included in the reports .
- 4.2. Both prior to and during the Relevant Period the Authority has provided significant guidance on transaction reporting issues. This guidance has included presentations to industry groups and trade associations, the Transaction Reporting User Pack, numerous Market Watch articles, a transaction reporting helpline and a transaction reporting library on the Authority website. The Authority has also made available to all firms a tool to enable them to regularly review their transaction data by requesting a sample of data they have submitted to the Authority. The Authority encourages firms to use this tool by raising awareness of it at our Transaction Monitoring Forums and publishing reminders in our Market Watch newsletters.
- 4.3. During the Relevant Period the Authority published Final Notices and imposed financial penalties in respect of seven firms for transaction reporting failures.
- 4.4. Firms are able to report transactions to the Authority using one or more Approved Reporting Mechanisms ("ARMs"). Following the takeover of NV RBS had 38 different transaction recording systems involved in providing data used in transaction reporting and 3 different ARMs were used to deliver transaction reports. However it was not until early 2010 that it was recognised that the overly complex and fragmented recording and reporting systems required significant work to ensure they were effective. Even at that stage RBS failed to appreciate the full scale of the reporting problem across the business, and the establishment of effective transaction reporting systems and controls was not adequately prioritised.
- 4.5. PLC and NV are both MiFID investment firms.
  - (1) Throughout the Relevant Period, RBS reported approximately 44.8 million transactions inaccurately (all of which should have been reported accurately in accordance with SUP 17.4.1EU/SUP 17 Annex 1EU); and

- (2) Between 5 November 2007 and February 2012, RBS failed entirely to report approximately 804,000 reportable transactions (all of which should have been reported in accordance with SUP 17.1.4R).
- 4.6. The bulk of the failures to report arose from the use by NV of an incorrect reference code to identify transaction counterparties. The remainder relate to other inaccuracies that emanated from both NV and PLC and included: use of incorrect timestamp; use of incorrect FRN; incorrect venue identification; incorrect prices; duplicate reporting; incorrect instrument identifier code for 'over the counter' (OTC) derivatives; and incorrect instrument description for OTC derivatives .
- 4.7. PLC transaction reporting systems and controls were defective until June 2011 because:
  - (1) From November 2007 to June 2010 it failed to establish clearly defined ownership and responsibility among senior management for transaction reporting, and it was not until June 2011 that these arrangements were fully embedded and effective;
  - (2) From November 2007 to June 2011 it failed to establish adequate oversight of transaction reporting. RBS began significant efforts to address this issue from 2010. However effective oversight was not fully established until June 2011 primarily due to the challenges arising from the disparate reporting systems and the lack of priority transaction reporting had been given prior to 2010 within the enlarged RBS. As a result:
    - (a) PLC's written procedures in relation to transaction reporting received no senior management scrutiny until November 2010 even though it was recognised that the written procedures were out of date from late 2009;
    - (b) Although PLC began improving the quality of management information from June 2010 this remained inadequate until June 2011 despite the issue being recognised in late 2009.
  - (3) Until December 2010 it failed to provide adequate training to staff on transaction reporting;

(4) Until June 2011 it failed to carry out adequate assurance testing of transaction reports with failures to report transactions continuing until February 2012.

4.8. The Authority acknowledges that PLC started to take steps to address these failings from the end of 2009, and that the drive to resolve these failings intensified from around the time of contact from the Authority in May 2010 in relation to concerns about transaction reporting at RBS. In particular, in mid-2010 RBS commenced work on a major Transaction Reporting Project in order to produce a single transaction reporting platform and compliant transaction reporting processes. The Project comprised:

- the design and implementation of a Strategic Transaction Reporting Hub, which substantially reduced the complexity and fragmentation of RBS' transaction reporting processes and systems;
- a dedicated team to identify, manage and resolve transaction reporting problems and to carry out root cause analysis of any failings; and
- "front to back" assurance testing carried out by a dedicated team.

Between 2010 and 2012 RBS spent £14.45 million on transaction reporting, including £8.3 million on the Strategic Transaction Reporting Hub on the delivery of which approximately 40 staff worked in 2011 and 2012.

## **5. FAILINGS**

5.1. Section 206 of the Act gives the Authority the power to impose a penalty on an authorised firm if he has contravened a requirement imposed on him by or under the Act or by any directly applicable Community regulation or decision made under the Markets in Financial Instruments Directive.

5.2. The Authority considers that RBS has breached SUP 17.1.4R and SUP 17.4.1EU and Principle 3. SUP 17.1.4R states:

*"A firm which executes a transaction:*

*(1) in any financial instrument admitted to trading on a regulated market or a prescribed market (whether or not the transaction was carried out on such a market); or*

*(2) in any OTC derivative the value of which is derived from, or which is otherwise dependent upon, an equity or debt-related financial instrument which is admitted to trading on a regulated market or on a prescribed market;*

*must report the details of the transaction to the Authority.*

5.3. By failing entirely to report 804,000 transactions, RBS breached its obligations under SUP 17.1.4R.

5.4. SUP 17.4.1EU states:

*'Reports of transactions made in accordance with Article 25(3) and (5) of MiFID shall contain information in SUP 17 Annex 1 EU which is relevant to the type of financial instrument in question and which the FSA declares is not already in its possession or is not available to it by other means.'*

SUP 17 Annex 1 EU sets out the minimum content of a transaction report in a table including Field Identifiers and Descriptions.

5.5. 44.8 million of the transactions that RBS executed in the Relevant Period were reported incorrectly in breach of its obligations under SUP 17.4.1EU as the data they contained was not in the format required by SUP 17 Annex 1 EU.

5.6. Principle 3 of the Principles states that:

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

5.7. NV is an incoming EEA branch passporting into the UK under Article 32 of the MiFID Directive. NV is authorised by the Autoriteit Financiële Markten (the AFM), the Dutch regulator. The Authority is taking action against NV in accordance with the jurisdictional powers assigned to it in Article 32(7) of the MiFID Level 1 Directive. Most, but not all, issues relating to systems and controls are reserved by EU instrument to home state regulators. In this case the Authority takes no action in respect of NV's systems and controls.

5.8. Between November 2007 and June 2011 PLC breached Principle 3 by failing to (i) clearly apportion responsibilities (ii) ensure effective oversight (iii) ensure written

reporting procedures were adequately updated (iv) ensure availability of adequate management information (v) ensure adequate training of staff and (vi) carry out adequate assurance testing on transaction reports.

## **6. SANCTION**

### **Financial penalty**

- 6.1. The conduct at issue took place both before and after 6 March 2010. As set out at paragraph 2.7 of the FSA Policy Statement 10/4, when calculating a financial penalty where the conduct straddles penalty regimes, the Authority must have regard to both the penalty regime which was effective before 6 March 2010 (the 'old penalty regime') and the penalty regime which was effective after 6 March 2010 (the 'new penalty regime').
- 6.2. The Authority has adopted the following approach in this case:
- (1) calculated the financial penalty for RBS's misconduct from 5 November until 6 March 2010 by applying the old penalty regime to that misconduct;
  - (2) calculated the financial penalty for RBS's misconduct from 6 March 2010 by applying the new regime to that misconduct; and
  - (3) added the penalties calculated under (1) and (2) to produce the total penalty.
- 6.3. For the purposes of establishing penalty figures applicable to the misconduct falling within the old and new regimes the Authority has determined the number of transactions under reported or inaccurately reported both before and after 6 March 2010 using approximate monthly figures as set out below.
- (1) Between November 2008 and June 2011 RBS submitted 42,963,411 transaction reports with unique internal identifiers when BIC and FRN codes were available. The Authority has determined this equates to 1,342,607 such reports per month and that RBS therefore submitted approximately 21,481,712 such reports in both the 16 months from November 2008 to 6 March 2010 and the 16 months from 6 March 2010 to June 2011.
  - (2) Between November 2007 and February 2013 RBS submitted 1,827,667 reports containing other inaccuracies. The Authority has determined this

equates to 29,011 such reports per month. RBS therefore submitted or failed to submit approximately 812,308 such reports in the 28 months from November 2007 to 6 March 2010 and 1,015,385 such reports in the 35 months between March 2010 and February 2013.

(3) Between November 2007 and February 2012 RBS failed to report 804,058 transactions. The Authority has determined this equates to 15,766 such reports per month. RBS therefore failed to submit approximately 441,448 such reports in the 28 months from November 2007 to 6 March 2010 and 362,618 such reports in the 23 months between March 2010 and February 2012.

6.4. The Authority has calculated the penalty on the basis that the total number of transactions failings falling with the period November 2007 to March 2010 was approximately 22,735,468 and the total falling with the period March 2010 to February 2013 was approximately 22,859,715.

#### **Financial Penalty under the old regime**

6.5. The Authority's policy on the imposition of financial penalties relevant to the misconduct prior to 6 March 2010 is set out in the version of Chapter 6 of DEPP that was in force prior to 6 March 2010.

For the purpose of calculating the penalty under the old regime in respect of the reporting and systems and controls failings at RBS between November 2007 and March 2010 the Authority has considered the factors set out below.

#### *Deterrence (DEPP 6.5.2G (1))*

6.6. The principal purpose of imposing a sanction is to promote high standards of regulatory and market conduct. We consider that a penalty of the amount proposed below, when considered in conjunction with the costs already incurred by RBS, will deter them and other similar firms from committing breaches.

6.7. We consider that the penalty will demonstrate generally to other large firms the importance and benefits of ensuring compliant business following significant takeovers, and reinforce the importance of accurate transaction reporting to the orderly conduct of markets in the UK and wider Europe.

#### *Seriousness and impact (DEPP 6.5.2G (2))*

- 6.8. The transaction reporting and systems failures in respect of RBS were pervasive and continued over an extended period.
- 6.9. RBS's failure to submit accurate transaction reports had the potential to hinder the Authority's ability to detect and investigate suspected market abuse, insider trading and market manipulation.
- 6.10. Given RBS's size and the high volume of transactions that it either failed to accurately report or failed to report at all, the impact of the failures in this case was significant.

*Deliberate or reckless (DEPP 6.5.2G (3))*

- 6.11. We do not consider that RBS's conduct was deliberate or reckless.

*Financial Resources (DEPP 6.5.2G (5))*

- 6.12. Given RBS's size the Authority considers that it has sufficient financial resources available to pay a penalty of the level proposed. The proposed fine is in line with past cases involving similar sized firms with similar resources, and is in the Authority's view sufficient to achieve credible deterrence and is consistent with the Authority's objective of protecting and enhancing the integrity of the UK financial system.

*Benefit gained/loss avoided (DEPP 6.5.2.G(6))*

- 6.13. RBS did not profit from the breaches and its failure to implement adequate reporting systems was a failure to get to grips with the significant organisational and systems challenges presented by the takeover of ABN Amro N.V. rather than a calculated policy.

*Conduct following the breach (DEPP 6.5.2.G(8))*

- 6.14. RBS has provided full cooperation in the course of the Authority investigation.
- 6.15. RBS committed significant resources to a number of reviews by both an independent compliance firm and a law firm which identified the extent of the breaches of SUP 17. The independent compliance firm provided further advice on improved systems to ensure compliant transaction reporting. RBS also carried out the work on the Transaction Reporting Project and made the investments referred to at paragraph 4.8 above.

*Disciplinary Record (DEPP 6.5.2.G(9))*

- 6.16. RBS has not previously been subject to disciplinary action by the Authority in respect of transaction reporting.

*Past action by the Authority (DEPP 6.5.2.G(10))*

- 6.17. During the period from November 2007 to March 2010 the Authority published 7 Final Notices that set out action taken against firms for breaches of SUP 17 and PRIN 3.

*Authority Guidance (DEPP 6.5.2.G(12))*

- 6.18. Prior to and during the period from November 2007 to March 2010 the Authority published guidance on transaction reporting in the 17 September 2006 edition of Market Watch at page 3, the 19 March 2007 edition at page 5; and in 28 June 2008 edition at page 10.

*Old Regime Penalty*

- 6.19. Applying these factors the appropriate level of penalty to be imposed under the old regime would be £3 million. Following the application of discount for Stage 1 Settlement in this case the penalty to be imposed is £2.1 million.

**Financial penalty under the new penalty regime**

- 6.20. Under the new regime 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.

The Authority has determined that the total number of transactions failings falling with the new regime period is 22,859,715.

**Steps 1-3**

- 6.21. RBS did not financially benefit from their breaches (for the purpose of Step 1, DEPP 6.5A.1). For the purpose of Step 2, DEPP 6.5A.2, the Authority considers that the number of misreported and under reported transactions executed by RBS during the Relevant Period is an appropriate indicator of the harm or potential harm caused. As set out at paragraph 6.4 above, the Authority has established the appropriate basis figure at Step 2 to be £22,859,715 by attributing a value of

£1 to each reportable transaction executed by RBS in breach of SUP17 during the Relevant Period post 6 March 2010. The Authority has determined the seriousness of RBS's breaches to be Level 3 for the purposes of Step 2 having taken into account:

(a) DEPP 6.5A.2 (6-9) which lists factors the Authority will generally take into account in deciding which level of penalty best indicates the seriousness of the breach.

(b) DEPP 6.5A.2G(11) which lists factors likely to be considered 'level 4 or 5 factors'.

(c) DEPP 6.5A.2G(12) which lists factors likely to be considered 'level 1, 2 or 3 factors'.

6.22. Of these, the Authority considers the following factors to be relevant:

(i) The breach revealed weaknesses in RBS's procedures, management systems and internal controls relating to transaction reporting;

(ii) RBS did not make any profit or avoid any loss as a result of the breach:

(iii) There was no loss to consumers, investors or other market users;

(iv) There was a potentially significant effect on market confidence; and

(v) There is evidence that the breach was committed negligently or inadvertently.

6.23. For the purposes of this case the Authority has applied the following percentages to the seriousness factors considered at DEPP 6.5A.2 (3):

(a) level 1 - 0%

(b) level 2 - 10%

(c) level 3 – 20%

(d) level 4 – 30%

(e) level 5 – 40%

6.24. The Authority, having taken into account all the factors above, has determined a level 3 seriousness factor is appropriate in this case. The penalty calculation is therefore 20% of £22,859,715. The figure after Step 2 is therefore £4,571,943.

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

6.25. At Step 3 the Authority may increase or decrease the amount of financial penalty arrived at after Step 2 to take account of any mitigating or aggravating factors. In accordance with DEPP 6.5A.3(1) any adjustment must be made by way of a percentage of the Step 2 figure. The Authority acknowledges that the RBS did take steps to mitigate the situation, notably acting wholly in co-operation with the Authority from the initial discovery of the breaches (prior to any enforcement action having been discussed) admitting culpability and taking positive independent steps to rectify the breaches (including commissioning two independent reports into the matter). However as stated at paragraph 2.4 above, the Authority considers the reporting failures by RBS to be aggravated by the fact the Authority (i) has provided a significant quantity of guidance to firms on how to report, and check those reports and (ii) had during the Relevant Period, publicised a number of Enforcement actions taken in similar failings by other firms. The Authority therefore considers that the aggravation justifies an increase of 10% to the Step 2 figure. The figure after Step 3 is therefore £5,029,137.

### **Step 4: Adjustment for deterrence**

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

6.27. The Authority considers that the figure at Step 3 is sufficient to achieve deterrence. The penalty figure after Step 4 is therefore £5,029,137.

### **Step 5: Settlement discount**

6.28. Pursuant to DEPP 6.5A.5, 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 individual reached agreement.

6.29. The Authority and RBS reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.30. The penalty figure after Step 5 is therefore £3,520,300 million.

## **7. PENALTY**

7.1. The Authority considers that combining the two separate penalties calculated under the old and new penalties regimes produces a figure which is proportionate and consistent with the Authority's statements that the new penalty regime may lead to increased penalty levels. The Authority therefore imposes on RBS a financial penalty of £5,620,300 (after Stage 1 Settlement Discount) for breaching SUP 17.4.1EU and 17.1.4.R and PRIN 3.

## **8. PROCEDURAL MATTERS**

### **Decision maker**

8.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

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

## **9. MANNER OF AND TIME FOR PAYMENT**

9.1. The financial penalty must be paid in full by RBS to the Authority by no later than 26 July 2013, 14 days from the date of this Final Notice.

## **10. IF THE FINANCIAL PENALTY IS NOT PAID**

10.1. If all or any of the financial penalty is outstanding on 27 July 2013, the Authority may recover the outstanding amount as a debt owed by the Firm and due to the Authority.

## **11. PUBLICITY**

11.1. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the 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 a 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 RBS or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

## **12. Authority contacts**

12.1. For more information concerning this matter generally, contact Neil Gamble or Ken O'Donnell at the Authority (direct lines respectively: 020 7066 1884 and 0207 066 1374).

Matthew Nunan

Head of Department

FCA Enforcement and Financial Crime Division