
FIRST SUPERVISORY NOTICE

To: **LQD Markets (UK) Limited**

Firm Reference
Number: **603186**

Dated: **28 January 2015**

ACTION

1. For the reasons listed below and pursuant to sections 55L(2)(c) and 55L(3) of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012, the Authority has decided to vary the permission granted to LQD Markets (UK) Limited ("LQD") pursuant to Part 4A of the Act ("LQD's Part 4A permission"), by imposing the following further requirements namely that immediately upon service of this notice on LQD (whether in electronic or hard copy form):
 - a) LQD must not in any way deal with or release any client money save as provided in paragraph (b) below;
 - b) LQD is not prohibited from:
 - (i) returning client money to any client for whom it is held, in compliance with Chapters 7 and 7A of the Client Assets chapter of the Handbook ("CASS");
 - (ii) receiving client money into its client bank accounts, in compliance with Chapters 7 and 7A of CASS; or
 - (iii) otherwise dealing with or releasing client money with the FCA's prior written consent.
 - c) For the avoidance of doubt the coming into force of this requirement constitutes a primary pooling event for the purposes of CASS 7A.2.2R(3).

d) In this requirement:

- (i) "client money" has the meaning specified in the glossary of the Handbook;
- (ii) "client bank account" has the meaning specified in the glossary of the Handbook; and
- (iii) "the Handbook" means the FCA's Handbook of rules and guidance.

REASONS FOR ACTION

Summary

2. On the basis of the facts and matters described below, the Authority considers that the variation of LQD's Part 4A permission is necessary in order to advance the Authority's consumer protection objective.
3. The Authority has identified numerous CASS rule breaches at LQD regarding its treatment of client money. In particular, LQD has failed to carry out internal client money reconciliations to identify an excess or shortfall in the client money account. Having carried out such a reconciliation following an FCA request on 23 January 2015, the firm identified a shortfall of at least \$1 million in the client money account. The firm transferred \$363,000 from the office account on 23 January 2015 in order to reduce the shortfall, leaving a shortfall of \$737,000.
4. On the information available at the date of this notice, the Authority has identified a further potential shortfall of approximately \$800,000 in relation to LQD's intermediate broker account. Whether or not this constitutes a client money shortfall will depend on the legal status of the funds in LQD's prime broker account.
5. Additionally, following IT systems and controls failings at the firm on 25 January 2015, LQD has incurred losses of a further \$500,000, resulting in a shortfall of client money of up to \$2.03 million.
6. LQD cannot meet these liabilities.
7. As a result, LQD's customers are at risk of not being able to recover the full value of the sums invested with LQD. This risk exists notwithstanding that LQD has stated that it is not giving effect to client requests to withdraw client money, and that LQD is making preparations to enter into formal insolvency proceedings. LQD estimates that there are approximately 1613 open accounts and/or client money balances with LQD. The customers who hold these positions are exposed to substantial loss in the event of default by LQD. There is also a risk that those customers who ask for their money back from LQD first will be paid out in full, leaving those customers who obtain the return of their funds last recovering only a fraction of their investment. It is in the interests of LQD's customers that the client funds held by LQD be paid out to its customers in an orderly basis.

DEFINITIONS

8. The definitions below are also used in this First Supervisory Notice:

"CASS" means the client asset rules as set out in the Authority's Handbook

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

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

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber);

“the Handbook” means the Authority’s Handbook of rules and guidance.

“LQD” means LQD Markets (UK) Limited

FACTS AND MATTERS RELIED ON

Background

9. LQD has been authorised and regulated by the Authority since 22 May 2014. It has permission to carry on the following regulated activities:
 - (a) Agreeing to carry on a regulated activity;
 - (b) Arranging (bringing about) deals in investments;
 - (c) Arranging safeguarding and administration of assets;
 - (d) Dealing in investments as agent;
 - (e) Dealing in investments as principal; and
 - (f) Making arrangements with a view to transactions in investments.
10. LQD is a firm that trades Contracts for Differences. LQD currently has approximately 1613 clients and places approximately 2,200 trades per day, primarily via the internet.

LQD Notification to the Authority

11. On 19 January 2015, the CEO of LQD sent an email to inform the FCA that it had been adversely affected by the currency movements following the decision made by the Swiss National Bank to unpeg the Swiss Franc from the Euro and was quantifying the impact.
12. On the evening of 20 January 2015, the CEO of LQD emailed the CASS Team of the FCA stating that the currency movement and lack of liquidity had resulted in a net negative position for the firm. The email provided a brief calculation showing the firm to have a gross liquidity shortfall (made up of both firm and client funds) of about \$742,995.
13. On the morning of 21 January 2015, the CASS Team telephoned LQD. LQD’s CEO informed the CASS Team that he was attempting to raise capital to rectify the firm’s current negative position, but stated that the firm may be insolvent. The Authority advised LQD to seek advice.
14. On 22 January 2015, LQD explained that it was seeking a capital injection of \$1,200,000 to fill any potential shortfall. LQD committed to giving an advanced confirmation of these funds on Monday 26 January 2015, which would clear by Wednesday 28 January 2015.
15. LQD explained to the Authority that LQD was still trading and had 460 of its 1,613 clients that were active.

CASS Visit Findings

16. On 23 January 2015, the Authority's CASS Team visited LOD's UK office. The offices are rented from Regus and LOD's staff had to travel from Switzerland to attend the visit. LOD's telephone number also diverts to Switzerland.
17. During the visit, the CASS Team found that LOD was performing a daily liquidity calculation for the firm and its clients' transactions which indicated a liquidity shortfall in the firm's account of \$742,995. The CASS Team also found that LOD was not performing an Internal Client Money Reconciliation on a daily basis. The Authority explained to the firm that performing a global liquidity calculation was not adequate as it can and did mask a client money shortfall.
18. During the visit, the CASS Team performed an Internal Client Money Reconciliation from the most current available data. This indicated a shortfall of in the client money account of at least \$1,100,000. However, this deficit may increase additionally by \$800,000 depending on the legal status of the funds in LOD's intermediate broker account.
19. LOD did not realise that a client money shortfall existed.
20. At the time, LOD had \$363,000 in the firm bank account. It was not aware of the regulatory requirements to pay the firm's money into the client bank account to make good the shortfall. Upon being requested to do so by the Authority, LOD transferred the full \$363,000 to the client bank account to reduce the overall shortfall on 23 January 2015.
21. LOD indicated to the Authority that it would generate a client and broker position report over the weekend of 24 and 25 January 2015, and provide this to the Authority on 26 January 2015. This report was not provided.

Monday 26 January 2015 – Tuesday 27 January 2015

22. On Monday 26 January 2015, LOD notified the CASS Team that a technical error with the firm's IT system during the Sunday night market opening had resulted in a large number of trades being executed which, by the time the technical error had been solved, had resulted in a loss of approximately \$500,000 incurred by the firm. This is a loss suffered by LOD. However, because the intermediate broker account is funded by the client money bank account, depending on the legal status of the funds in LOD's prime broker account, this may increase the client money shortfall.
23. Following this error, LOD has stopped all trading of new open positions and has only allowed clients to close out their existing positions. LOD has also confirmed that the proposed capital injection of \$1,200,000 will not be made.
24. On Tuesday 27 January, LOD applied to the FCA voluntarily (under section 55L(5) of the Act) to impose requirements that include the mandatory immediate termination of all remaining derivative contracts to which it is a party. The Authority has accepted that application having regard to the circumstances of the firm and the client money shortfall.
25. LOD is in the process of notifying its clients of the effect of those requirements. It is expected that many clients will react by seeking to withdraw

client money, and such withdrawals (if permitted by the firm) may take place in a disorderly fashion.

Potential for loss to be suffered by clients

26. The Authority is imposing the requirement detailed in this Notice to protect the clients of LQD suffering further losses as a consequence of the firm's client money shortfall of up to \$2.03 million and to ensure an orderly return of funds to customers.
27. The requirement set out in this Notice is required despite the voluntary requirements agreed to by LQD to date which are limited to ensuring that LQD incurs no further trading losses. The purpose of this further requirement is to ensure the preservation of client funds and to enable an orderly distribution of those funds in accordance with the CASS rules.

FAILINGS

28. The regulatory provisions relevant to this First Supervisory Notice are set out in the Annex.
29. From the facts and matters described above the Authority, having regard to its regulatory objectives, has reached the following conclusions:
 - (a) LQD appears to have contravened numerous CASS rules. These include;
 - i. failing to be able to distinguish client money held for one client from client money held for any other client, and from its own money in breach of CASS 7.6.1 R;
 - ii. failing to maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients in breach of CASS 7.6.2R
 - iii. failing to perform a daily internal client money reconciliation as set out in the guidance under CASS 7.6.6G;
 - iv. failing to perform external client money reconciliations in breach of CASS 7.6.9R;
 - v. where client money shortfall/excess has been identified, failing to top up/withdraw client money in line with CASS 7.6.13R.
 - (b) it is apparent that the firm does not have adequate systems and controls to comply with the FCA's client money rules;
 - (c) there is a high risk that LQD is unable to repay the client money shortfall of up to \$2.03 million in the short to medium term, if at all;
 - (d) LQD is therefore posing a risk to the Authority's operational consumer protection objective, and it is desirable to exercise the Authority's own initiative power to add the requirement specified at paragraph 1 of this First Supervisory Notice with immediate effect.
 - (e) The Authority believes that the proposed requirement is an appropriate and

proportionate means to protect the risks posed to LQD customers.

PROCEDURAL MATTERS

Decision Maker

30. This decision was taken by Tracey McDermott, Director of Supervision and Authorisations, in accordance with DEPP 4.2.1G(4).
31. This First Supervisory Notice is given to LQD under section 55Y(4) and in accordance with section 55Y(5) of the Act. The following statutory rights are important.

The Tribunal

32. LQD has the right to refer the matter to which this First Supervisory Notice relates to the Tribunal. The Tax and Chancery Chamber is the part of the Tribunal which, amongst other things, hears references arising from decisions of the Authority. Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, LQD has 28 days from the date on which this First Supervisory Notice is given to it to refer the matter to the Tribunal.
33. A reference to the Tribunal can be made by way of a reference notice (Form FTC3) signed by LQD and filed with a copy of this First Supervisory Notice. The Tribunal's contact details are: The Upper Tribunal, Tax and Chancery Chamber, Tax and Chancery Chamber, Rolls Building, Fetter Lane, London, EC4A 1NL (telephone: 020 7612 9730; email: fs@hmcts.gsi.gov.uk).
34. Further details are contained in "Making a Reference to the UPPER TRIBUNAL (Tax and Chancery Chamber)" which is available from the Tribunal website:
<http://www.tribunals.gov.uk/financeandtax/FormsGuidance.htm>
35. LQD should note that a copy of the reference notice (Form FTC3) must also be sent to the Authority at the same time as filing a reference with the Tribunal. A copy of the reference notice should be sent to Beatrice Schady at the Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Representations

36. LQD has the right to make written and oral representations to the Authority (whether or not LQD refers this matter to the Tribunal). If LQD wishes to make written representations it must do so by 11 February 2015, or such later date as may be permitted by the Authority. Written representations should be sent to:

Andrea Ferguson
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

37. The Authority must be informed in writing by 4 February 2015 if LQD wishes to make oral representations. If the Authority is not notified by 4 February 2015, LQD will not, other than in exceptional circumstances, be able to make oral representations.

Publicity

38. LQD should note that section 391 of the Act requires the Authority when the First Supervisory Notice takes effect (and this First Supervisory Notice takes immediate effect upon service on LQD), to publish such information about the matter as it considers appropriate.

Contacts

39. For more information concerning this matter generally, LQD should contact Andrea Ferguson at the Authority (direct line: 020 7066 7704).

Tracey McDermott
Director of Supervision and Authorisations

ANNEX TO THE FIRST SUPERVISORY NOTICE ISSUED BY THE FINANCIAL CONDUCT AUTHORITY TO LOD MARKETS (UK) LIMITED ON 28 JANUARY 2015

RELEVANT STATUTORY PROVISIONS

1. The Authority's operational objectives established in section 1(B) of the Act include securing an appropriate degree of consumer protection.
2. The Authority is authorised by section 55L of the Act to impose on that person such requirements as the authority considers appropriate where it is desirable to do so in order to advance one or more of the Authority's operational objectives.
3. Section 55N(1) of the Act states that a requirement may be imposed to require the person concerned to take, or refrain from taking, specified action.
4. Section 55(N)(2) of the Act states that a requirement may extend to activities which are not regulated activities.
5. Section 55Y of the Act allows such a variation to take effect on such date as is specified in the notice, or immediately if the Authority reasonably considers that it is necessary for the variation or the imposition of the requirement to take effect immediately.

RELEVANT HANDBOOK PROVISIONS

6. In exercising its power to impose a requirement, the Authority must have regard to guidance published in the Authority's Handbook. The relevant main considerations in relation to the action specified above are set out below.

Relevant Rules

7. CASS 7.6.1R provides that a firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client and from its own money.
8. CASS 7.6.2R provides that a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients.
9. CASS 7.6.6G provides that;
 - (1) carrying out internal reconciliations of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds in client bank accounts and client transaction accounts should be one of the steps a firm takes to satisfy its obligations under CASS 7.6.2 R, and where relevant SYSC 4.1.1 R and SYSC 6.1.1 R.

(2) A firm should perform such internal reconciliations:

(a) as often as is necessary; and

(b) as soon as reasonably practicable after the date to which the reconciliation relates;

to ensure the accuracy of the firm's records and accounts.

(3) The standard method of internal client money reconciliation sets out a method of reconciliation of client money balances that the FCA believes should be one of the steps that a firm takes when carrying out internal reconciliations of client money.

10. CASS 7.6.9R provides that a firm must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom client money is held;

11. CASS 7.6.13R When any discrepancy arises as a result of a firm's internal reconciliations, the firm must identify the reason for the discrepancy and ensure that:

(1) any shortfall is paid into a client bank account by the close of business on the day that the reconciliation is performed; or

(2) any excess is withdrawn within the same time period (but see CASS 7.4.20 G and CASS 7.4.21 R).

OTHER RELEVANT REGULATORY PROVISIONS

15. The Authority's policy in relation to the allocation of decision making powers is set out in the Decision Procedure and Penalties Manual (DEPP), certain provisions of which are summarised below.

16. DEPP 2.5.7G provides that the RDC will take the decision to give a supervisory notice exercising the FCA's own initiative powers (by removing a regulated activity, by imposing a limitation or requirement or by specifying a narrower description of a regulated activity) if the action involves a fundamental variation or requirement. Otherwise, the decision to give the supervisory notice will be taken by FCA staff under executive procedures.

17. DEPP 2.5.8G states that a fundamental variation or requirement means:

"(1) removing a type of activity or *investment* from the *firm's permission*;
or

(2) refusing an application to include a type of activity or *investment*; or

(3) [deleted]

(4) imposing or varying an assets requirement (as defined in section 55P of the *Act* (Prohibitions and restrictions)), or refusing an application to vary or cancel such a requirement.

19. DEPP 4.2.1 provides that if FCA staff recommend that action be taken and they consider that the decision falls within the responsibility of a senior staff committee:

(1) in general the FCA staff's recommendation will go before the senior staff committee;

(2) in urgent statutory notice cases for which a senior staff committee is responsible, the decision to give the statutory notice may be taken by the chairman or, if they are unavailable, a deputy chairman of the senior staff committee, and, if it is practicable, one or more other members of the committee;

(3) the chairman or deputy chairman of the senior staff committee will take such a decision only if satisfied that the action proposed should occur before it is practicable to convene a meeting of the senior staff committee;

(4) in an exceptionally urgent statutory notice case, if in the FCA staff's opinion;

(a) the action should be taken before a recommendation to the chairman or a deputy chairman of the senior staff committee could be made; and

(b) an urgent decision on the proposed action is necessary to protect the interests of consumers;

The decision may be taken by a member of the FCA's executive of at least director of division level (which may include an acting director) or, in the case of a senior staff committee which reports directly to the FCA's senior executive committee, by a member of that committee.

20. The Authority's policy in relation to its enforcement powers is set out in the Enforcement Guide (EG), certain provisions of which are summarised below.
21. EG 8.1(3) reflects section 55 of the Act under which the Authority may use its own-initiative power to vary or cancel the permission of an authorised firm where it is desirable to exercise the power where the person is failing or likely to fail the threshold conditions or in order to advance one or more of its operational objectives.

Imposing requirements on the Authority's own initiative

22. EG 8.1B provides that the Authority will have regard to its statutory objectives and the range of regulatory tools that are available to it, when it considers how it should deal with a concern about a firm.
23. EG 8.3 provides that the Authority will exercise its formal powers under sections 55L of the Act, where the Authority considers it is appropriate to ensure a firm meets its regulatory requirements. EG 8.3(1) specifies that the Authority may consider it appropriate to exercise its powers where it has serious concerns about a firm or the way its business is being or has been conducted.

Use of the own-initiative power in urgent cases

24. EG 8.6 states that the Authority may impose a variation of permission so that it takes effect immediately (or on a specified date) if it reasonably considers it necessary for the variation to take effect immediately, having regard to the ground on which it is exercising its own-initiative power.
25. EG 8.7 provides the circumstances in which the Authority will consider exercising its own initiative power as a matter of urgency, including where circumstances indicate that it is appropriate to use statutory powers immediately to require

and/or prohibit certain actions by the firm in order to ensure the firm addresses these concerns (EG 8.7(2)).

26. EG 8.8 provides a list of situations which will give rise to such serious concerns. Specifically, EG 8.8(1) includes where information indicates a risk of loss or other adverse effects for consumers, where action is necessary to protect their interests.
27. EG 8.9 sets out the factors the Authority may consider in addition to the full circumstances of each case when it decides whether an urgent variation of Part 4A permission is appropriate. In particular, EG 8.9(1) states a factor is the extent of any loss, or risk of loss, or other adverse effect on consumers, and EG 8.9(9) states that the Authority may take into account the (sometimes significant) impact that a variation of permission may have on a firm's business and on its customers' interests, including the effect of variation on the firm's reputation and on market confidence.
28. EG 8.10 provides that when varying a Part 4A permission at its own-initiative, the Authority may include in the Part 4A permission as varied any limitation or restriction which it could have imposed if a fresh permission were being given in response to an application under section 55A of the Act.
29. EG 8.11 states that examples of the limitations that the Authority may impose when exercising its own-initiative power in support of its enforcement function include limitations on the category of customers that a firm can deal with.