Financial Crime and Fraud: Regulatory Updates

November 2020

Contents

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Financial Crime and Fraud

Overview of key regulatory updates relevant to financial services across Europe.

Introduction

Financial crime and fraud have long been at the top of regulators' agendas and are a particular focus in Europe in the context of COVID-19. Both have also been the subject of increasing numbers of civil and criminal court cases over recent years.

Whilst certain obligations on firms have been relaxed to take into account the pressures on firms dealing with the pandemic, regulators have repeatedly reinforced that firms' obligations in relation to the prevention and detection of financial crime remain.

There is an understanding that the 'new normal' may have afforded criminals new opportunities to perpetrate scams and launder money; it was reported in August that the Financial Conduct Authority (FCA) in the UK was already investigating 165 suspected COVID-19 related scams.

This newsletter contains updates on recent court judgments and activity by financial services regulators, and prosecutors, to tackle financial crime and fraud in three key jurisdictions: the UK, Germany and Spain.

UK

Updates

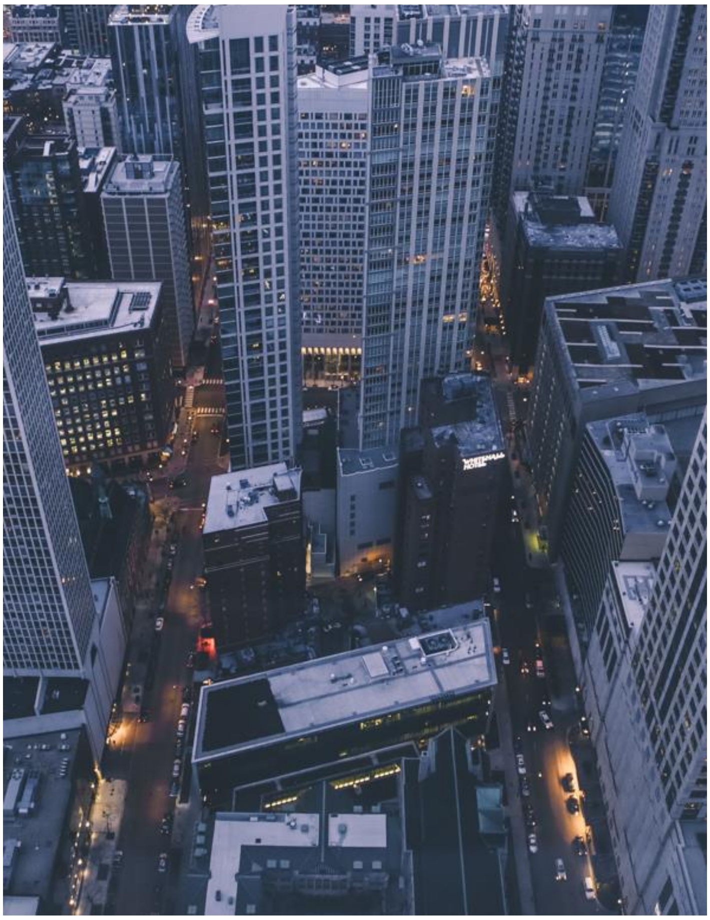
The FCA

There might have been a changing of the guard at the FCA, but one of the new CEO's first tasks in post was to reinforce a message that is some years old; "*financial crime is a high priority for the FCA",* stated Rathi in his response to the Treasury Select Committee's letter to the FCA regarding the 'FinCen' papers, *"combatting money laundering requires a multi-agency approach and we ensure our work contributes to the UK's overall effort to counter economic crime"*. Rathi also made clear that the FCA is using the full range of its supervisory and enforcement tools in order to tackle financial crime: 16 skilled person reports on firms' financial crime systems and controls were required in 2019/2020. Rathi emphasised that the regulator has the power to put in place business restrictions until it is satisfied that a firm is managing its financial crime risks effectively. This includes that significant financial penalties have been imposed on firms for failings in their systems and controls, the most recent of which occurred in June 2020 and is covered below.

The FCA's Annual Report for 2019/2020 further demonstrates the regulator's focus on financial crime over the last year: insider dealing and financial crime represented the third and fourth highest number of open enforcement investigations as at 31 March 2020, and the single largest fine during 2019/2020 (GBP 102.2m) was for anti-money laundering (AML) breaches.

Rathi's comments in his letter to the Treasury Select Committee reinforce the sentiments published in the FCA's Business Plan for 2020/2021 which made it clear that the prevention and detection of fraud and financial crime are top of the regulator's agenda and we have seen this borne out over the last few months. The FCA stated that it would make greater use of data to identify firms or areas that are potentially vulnerable to financial crime, and the regulator is currently consulting on extending the Financial Crime Data Return (REP-CRIM) reporting obligation to more firms, the details of which are covered below.

In light of the regulator's focus and the potential opportunities for fraud and financial crime more generally arising out of COVID-19, it is now more important than ever that firms are alive to emerging risks and that these are incorporated into their anti-financial crime systems and controls.



Final Notices

The 1Malaysia Development Berhad (1MDB) scandal

The 1MDB scandal has sparked multiple investigations by regulators and prosecutors across the globe. In October, the FCA published a Final Notice fining Goldman Sachs for its part in the scandal.

To summarise the facts, 1MDB was a Malaysian state investment vehicle created in 2009. In 2015, documents leaked to journalists evidenced widespread corruption and the embezzlement, on an unprecedented scale, of Malaysian state funds via 1MDB. Billions of dollars were transferred to bank accounts in Switzerland, Singapore, and the US and used to buy luxury property, jewellery and art works. Following the subsequent law enforcement and regulatory investigations, it became clear that a number of banks and financial institutions across the globe had been utilised by the protagonists in the scandal and were, therefore, involved in numerous regulatory and criminal breaches that occurred via 1MDB. The FCA's Final Notice highlighted material failures to:

- Assess and sufficiently manage financial crime risks;
- Ensure that appropriate information regarding financial crime risks was escalated to the relevant committees approving the 1MDB transactions;
- Manage allegations of bribery and misconduct regarding individuals involved in, or associated with, the 1MDB transactions; and
- Keep sufficient records to illustrate how the relevant committees had assessed the risks arising out of the 1MDB transactions or the reasons for approving them.

These failures resulted in breaches of Principles 2 and 3 of the FCA's Principles for Businesses (which impose requirements on firms to conduct business with due skill, care and diligence and take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems) and a fine of approximately GBP 48 million.

Key takeaways:

- Firms that lack sufficiently detailed risk appetite and risk management frameworks inhibit the ability of senior management to take informed decisions on risk. Senior management at financial institutions should be able to evidence that they have considered higher risk situations (e.g. higher risk clients or particularly complex transactions) against their firm's risk appetite statement and have taken decisions accordingly. This is particularly the case in light of the obligations imposed under the Senior Managers and Certification Regime (SMCR).
- The FCA highlighted in its 1MDB findings that key information and red flags were not included in management information (MI) provided to the relevant decision-making committees, such that they were not able to assess fully the risks involved in the transactions. It is, therefore, imperative that firms implement clear guidelines on the detail required in the MI provided to decision makers, and that the details included accurately represent the risks.
- Allegations surrounding bribery in relation to some of the 1MDB transactions surfaced in 2013. However, the FCA found that these concerns were not escalated in accordance with the firm's policies and procedures. It is, therefore, essential for firms to ensure that their staff are aware of, and trained on, the relevant escalation policies and procedures, particularly where financial crime risks are concerned. Implementing periodic refresher training should assist in mitigating the risk of policies and procedures not being followed.
- The FCA was notified of an employee's non-1MBD related misconduct, but the allegations of potential misconduct surrounding 1MDB (which had arisen some months previously) were not notified at the same time. In light of the obligations imposed on firms under the SMCR, it is now particularly important that firms:
  - Accurately record and deal with allegations of misconduct; and
  - Consider information that needs to be included in any notifications to the FCA, including any past allegations which have not previously been notified.
- Accurate record-keeping has long been the FCA's mantra, and in its findings relating to 1MDB, the regulator stated that the minutes of the committees which assessed and ultimately approved the 1MDB transactions did not contain enough details around the committee's consideration of risks, the rationale for the action points identified and the decision to approve the transactions. Firms should not, therefore, underestimate the importance of accurate and detailed record-keeping. This is especially the case in light of the obligations imposed on Senior Managers under the SMCR, as a result of which they will need to be able to evidence the steps taken in the areas of the business for which they are responsible.

Commerzbank

In an unfortunate turn of events this year, Commerz Bank hit the headlines following the FCA's substantial fine in June. Commerzbank AG (London Branch) was fined GBP 37,805,400 for *"failing to put adequate AML systems and controls in place between October 2012 and September 2017"*.

The bank was, to a large extent caught by a number of changing tides in respect of regulatory thinking and updates to the Money Laundering Regulations (MLRs) across the five year period to which the fine relates, in particular, we saw the launch of the Market Abuse Directive, the Fourth Money Laundering Directive and The Criminal Finances Act 2017 during this period.

Many institutions could perhaps have found themselves in the same positon where they did not adapt quickly enough to evolving regulations and regulatory standards, or heed regulatory publications at the time. As is well known in the present day, as part of regulatory intelligence, firms are expected to be up to date with all FCA publications and Final Notices. The FCA felt that the London Branch did not assimilate or act upon what the FCA described as being "clear warnings", during the period.

As a result, the bank was subject to a financial penalty, because it was felt by the regulator that the weaknesses in the bank's controls created a *"significant risk that financial and other crimes might be undetected"*. This represents a continuation of the strong regulatory intervention that we have seen over the past 3 years in relation to UK branches of 'overseas' banks in the areas of financial crime prevention, risk management and governance. The fine was levied under Principle 3 of the FCA's Principles for Businesses, which requires firms to have adequate risk management systems in place.

The dates of the purported failings are relevant here and it should be duly noted that the London Branch has undertaken a look-back exercise and a programme of enhancements, which have been independently verified by a Skilled Person's review. This type of proactive approach is always well received by the FCA and so while the weaknesses are historic for the London Branch, the lessons should not be ignored by other organisations today.

Key learnings:

Due diligence and the timeliness of on boarding checks:

- Firstly, firms need to ensure that clients cannot commence or continue to undertake any activity through any institution while due diligence checks remain incomplete, or outstanding. As per Article 30 of the MLRs which addresses timing of verification, it must take place *"before the establishment of a business relationship or the carrying out of the transaction"*.

Transaction monitoring:

- Processes and controls need to be treated as being organic and evolving. They cannot simply be left, unchecked, or static for any period of time. It is important to ensure that high-risk countries are continually updated as part of the parameters applied to Transaction Monitoring and that all clients are subject to the monitoring of their activity and the conduct of the relationship.

Lastly, given the early stage resolution of the matter and the London Branch voluntarily implementing a range of business restrictions while addressing its controls, the bank qualified for a 30% discount to the original fine.

For further details, see the Final Notice.

Decision Notices

In July, the FCA published a Decision Notice against Mr Conor Foley, the former WorldSpreads Limited (WSL) CEO, proposing to fine him GBP 658,900 for market abuse and also to ban him from performing any function in relation to any regulated activity. Mr Foley held the CF1 (Director) and CF3 (CEO) functions at WSL.

WSL was a financial spread-betting company whose holding company was WorldSpread Group Plc (WSG). Mr Foley, the majority shareholder in WSG, was involved with drafting and approving the documentation when WSG floated in August 2007.

According to the FCA, the documentation was materially misleading and failed to include key information that potential and current investors would require to make an informed decision about investing in WSG, such as the following (which the FCA argues Mr Foley was aware of):

- It failed to disclose that some WSG executives had made significant loans to WSG and its subsidiaries (the Internal Loans); and
- It failed to set out that some of WSG's subsidiaries hedged trading exposures internally (the Internal Hedging). The FCA noted that the hedging Mr Foley oversaw involved the use of fake client trading accounts, and the un-authorised use of trading accounts.

The FCA contends that Mr Foley knew of the failure to declare the Internal Loans and the Internal Hedging which took place at the time and that it gave, or was likely to give, a false or misleading impression to the market. On this basis, the regulator considers that Mr Foley committed market abuse contrary to section 118(7) of the Financial Services and Markets Act 2000 (the Act) and deliberately misled the market.

Moreover, the FCA also considers that between January 2010 and March 2012, spread bets were placed on the shares of WSG on the trading accounts of five WSL clients. The FCA considers that the spread bets on two of the five trading accounts were placed by Mr Foley without the knowledge of the clients. As such:

- In respect of the spread-bets on those two trading accounts, Mr Foley made transactions which gave a false or misleading indication to the market as to the demand for WSG shares contrary to section 118(5)(a) of the Act, and deceived the market contrary to section 118(6) of the Act; and
- The transactions placed on all five of the client trading accounts rendered statements as to WSG's credit policy contained in its annual accounts false and misleading. In light of this, the FCA considers Mr Foley contravened section 118(7) of the Act.

The FCA considers that Mr Foley lacks fitness and propriety to perform any function in relation to any regulated activity because of these reasons and also, that Mr Foley:

- managed Internal Hedging which involved the use of fake client trading accounts or real client trading accounts without their knowledge;
- dishonestly engaged in market abuse despite having been an approved person; and
- was subject to an adverse court finding in October 2014 in which he was ordered to pay WSL GBP 309,321 as a result of un-authorised loans that he procured from WSL.

Mr Foley has referred the case to the Upper Tribunal.

Indeed, earlier this year Mark Steward told Financial News that *"the regulator was bracing for an uptick in market abuses cases in the coming months"* and despite suspicious trading being harder to spot due to volatile markets caused by COVID-19, the FCA clearly has the appetite to pursue those cases which it considers threaten market integrity.

This enforcement action should be a warning to firms; it is vital that listed firms ensure that they include the necessary information in disclosures to the market and that appropriate checks and balances are in place.

The FCA's expectations are clear; all firms must remain committed, and be able to demonstrate their commitment, to observing proper standards of market conduct and detecting instances where conduct falls short of those standards.

Consultation on extending the REP-CRIM

The consultation paper (CP20-17) sets out that the FCA hopes to achieve the following outcomes:

- the additional information will allow its supervisory approach to be more data led; and
- broaden its understanding of firms.

So what does CP20-17 propose?

Under the new proposals, the FCA are seeking to extend the REP-CRIM obligation to firms that perform regulated activities which they consider potentially pose a higher risk of money laundering activity.

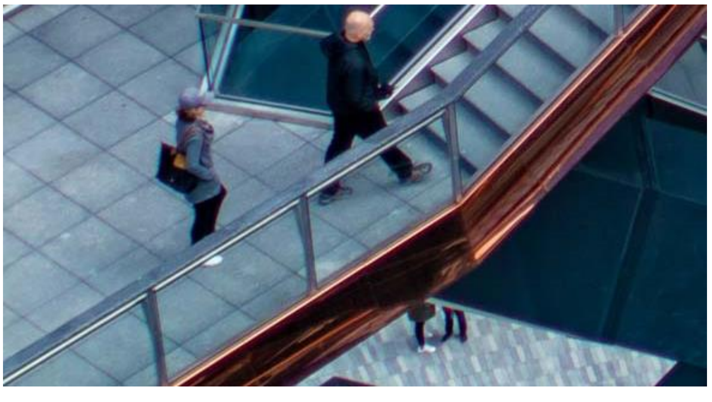
This broadly includes; those firms with permission to deal or manage investments, client money or assets firms, firms with specific permissions in respect of UCITS and AIFs, some insurance related activities, firms with 'establishing, operating or winding-up' permissions, OTFs, MTFs, Crypto exchanges, E-money firms, most Payment Institutions and lastly those firms that perform safeguarding and administering of investments.

The FCA estimate that the proposed extension would result in more than doubling the current number of firms subject to REP-CRIM, with approximately 4500 additional firms reporting annually.

What will firms need to report?

The FCA have not proposed any changes to the data collected in the REP-CRIM, so, firms newly caught by the REP-CRIM will need to provide information on:

- the number of relationships with PEPs, non-EEA correspondent banks and other relationships rated high risk;
- a breakdown of the number of customer relationships by geographical areas;
- customers refused or exited for financial crime reasons;
- Suspicious Activity Reports (SARS);
- appointed representatives exited;
- sanctions controls;
- staff with financial crime roles; and
- fraud typology (non-mandatory).



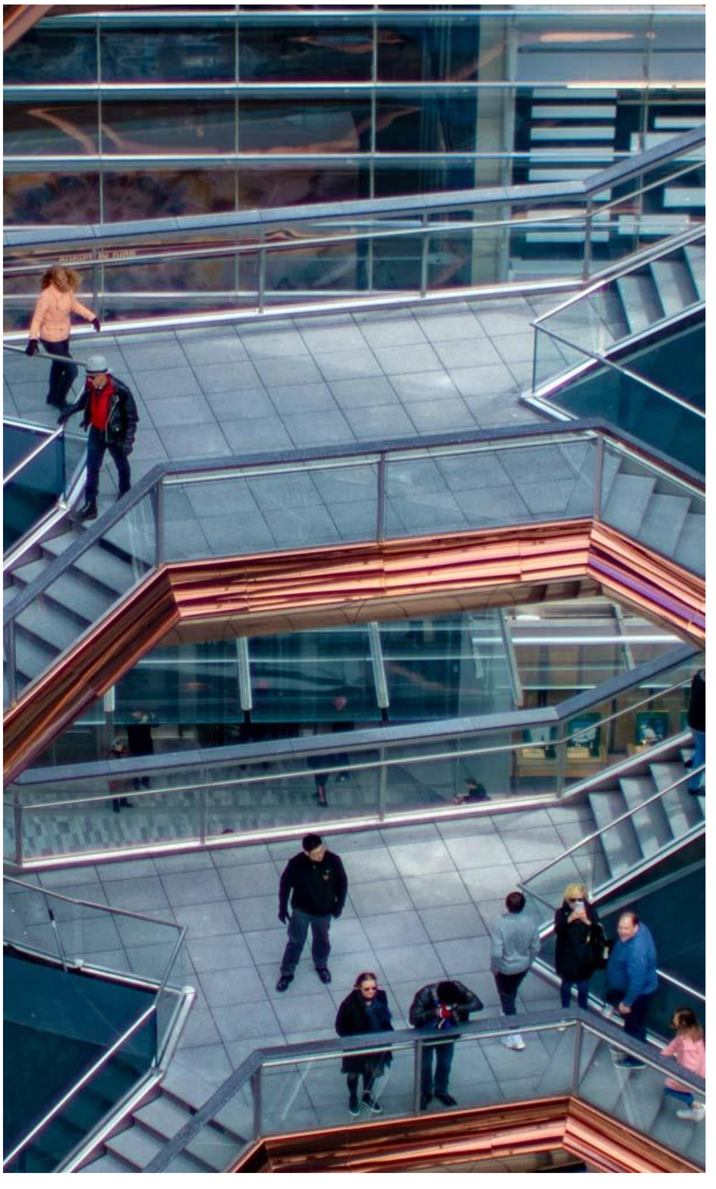
Considerations for firms

The FCA propose that the obligations will apply to all firms in scope, except for crypto asset firms, from their next accounting reference date, 12 months after any FCA rules are made, which is expected to be in Q1 2021.

For most firms, the majority of the data requirements should be well known and form part of the MLRO report.

From our experience, one of the biggest challenges for firms is producing data on customers refused for financial crime reasons. Most firms don't retain this type of data, accordingly, we would encourage regulated firms subject to the MLRs to make this a core part of their record keeping.

It is also essential that firms challenge what their data says about them and how they manage their risk.



The Serious Fraud Office (SFO)

During speeches in September and October 2020, the Director of the SFO, Lisa Osofsky, acknowledged that Brexit and COVID-19 are likely to provide those involved in economic crime with increasing opportunities. In light of this, one of the four key priorities for the SFO is to enhance cooperation *"with UK and international partners, so that criminals cannot exploit our difference or derail our global efforts to work together to tackle crime"*, a sentiment which was previously also set out in the SFO's 2019 – 2020 Annual Report.

According to the Annual Report, the prosecutor had 65 open cases at the end of March, which pales in comparison to the enforcement caseload of the FCA (which stood at around 650 at the same time). The SFO opened only five cases last year, closed five without charge and charged nine defendants, it also suffered some high profile acquittals at the beginning of 2020.

Whilst the lack of progress in cases may well be due to the length of time it takes to investigate allegations of serious fraud, bribery and corruption, there is no doubt that the SFO is facing criticism for its lack of successful convictions.

That said, in January this year the SFO secured the world's largest ever global resolution of bribery and corruption charges in a Deferred Prosecution Agreement (DPA), which saw an international aviation company pay a fine and costs amounting to EUR 991 million in the UK and EUR 3.6 billion in total. There also appears to have been a recent uptick in the prosecutor's activity: in the last three months alone, the SFO has entered into a DPA worth just under GBP 3 million and charged 11 individuals. We have set out below some key examples of the SFO's activities over the last few months.

R (on the application of KBR, Inc) (Appellant) v Director of the Serious Fraud Office (Respondent) UKSC 2018/0215

On 13 October, the matter of R (on the application of KBR, Inc) (Appellant) v Director of the Serious Fraud Office (Respondent) UKSC 2018/0215 was heard in the UK Supreme Court. The Supreme Court has yet to publish its judgment, but when it does it will be significant for all international firms (and groups).

This is because it is the first time the Supreme Court will have had to determine the extra-territorial application of any compulsory document production powers by a criminal law enforcement agency in the UK. The key issue in the case is whether the SFO can issue a notice to produce documents or information under section 2(3) of the Criminal Justice Act 1987 (CJA) requiring a foreigner to produce material held overseas.

In 2018, the Administrative Court ruled that although the SFO could only give a section 2 CJA notice to someone who was, at that time, within the jurisdiction, such a notice could operate to require the production of documents or information held by a foreigner overseas.

There appears to be an ever-increasing tendency of regulators and prosecutors globally to extend their powers to have extraterritorial effect. Should the Supreme Court adopt the approach of the Admin Court, the judgment will have far reaching implications, particularly on group companies based abroad, but whose subsidiaries, for example, are based within the UK.

Axiom Legal Financing Fund

Following allegations of fraud in October 2012, the Cayman Islands based fund, Axiom Legal Financing Fund, closed and subsequently went into receivership thus sparking an SFO investigation which opened in July 2014. Six years later, in August 2020, three individuals were charged with carrying out fraudulent scheme to divert money from the Fund:

- a former solicitor (who was struck off in 2014), was charged with three counts of fraudulent trading, contrary to Section 993(1) of the Companies Act 2006, one count of fraud, contrary to Section 1 of the Fraud Act 2006, and one count of transferring criminal property, contrary to Section 327(1)(d) of the Proceeds of Crime Act 2002;
- a former independent financial adviser, was charged with one count of fraudulent trading, contrary to Section 993(1) of the Companies Act 2006; and
- a former solicitor (who was struck off in 2018), was charged with one count of fraudulent trading, contrary to Section 993(1) of the Companies Act 2006, and one count of being concerned in an arrangement which facilitates the acquisition, retention, use or control of criminal property by another, contrary to Section 328(1) of the Proceeds of Crime Act 2002.

The first appearance at Westminster Magistrates' Court occurred on Wednesday, 30 September 2020. The trial is due to commence in March 2022.

Whilst the full details of the Axiom Legal Financing Fund case are not yet clear, the case demonstrates the length of time it takes (and the corresponding resources required) from allegations of fraud emerging, to charge (some 8 years).

The evidential burden on the SFO to prosecute such cases is high. In reality, it is unsurprising that charges are only brought in a small number of cases each year and that fewer still result in convictions. The SFO has recently concluded several DPAs and has published updated guidance on their use; given the practical difficulties and costs associated with prosecuting cases, it is likely that we will see an increased use of DPAs in future.

Civil litigation

Banks are regularly caught up in the middle of fraud given they provide a means for the proceeds of fraud to be distributed amongst fraudsters and laundered. The Proceeds of Crime Act 2002 (POCA) and MLRs are clear as to the criminal liability they face if in breach, but civil liability in private law remains an evolving legal environment.

AML and fraudulent activity go hand in hand and banks are common defendants to claims from victims who seek a solvent defendant long after the fraudsters themselves have disappeared.

We draw together below some key recent case law.

— Banks have a contractual obligation to execute the authorised instructions of their customers. However, it is an implied term of a contract between a bank and its customer, that the bank must refrain from executing an instruction if it is put on enquiry (if it has reasonable grounds for believing that the instruction is an attempt to misappropriate the customer's funds, i.e it is dishonest) (Barclays Bank Plc v Quincecare [1988] 2 WLUK 252). This is commonly referred to as the Quincecare duty.

— In November 2019, Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd [2019] UKSC 50, an investment bank, Diawa, was held liable to its customer for breach of the Quincecare duty. When considering the application of the Quincecare duty, the Supreme Court drew a distinction between a company and the individuals that owned or ran that company. Its view was that the answer to any question whether to attribute the knowledge of a fraudulent director to a company is always to be found in consideration of the context and the purpose for which the attribution is relevant. The Court was clear in identifying that the bank knew *"the account needed close monitoring"* and that the bank *"should have realised that something suspicious was going on and suspended the payment until it had made reasonable enquiries to satisfy itself that the payments were properly made".*

— Hamblin and another v World First Ltd and another [2020] EWHC 2383 (Comm) is a very recent case in which the Court considered whether the Quincecare duty might apply to a Payment Service Provider (PSP) (not a bank) in respect of a customer company controlled by fraudsters. In dismissing a summary judgment application by the PSP it considered the decision in Singularis capable of sustaining a claim of breach of mandate as a distinction could be drawn between the company and a fraudster controlling it. Plainly the courts will entertain the Quincecare duty applying to non-banks in the FS sector.

There are a number of other Quincecare cases running through the courts at present and it may only be a matter of time before the judgment in Singularis is contributed to, hopefully further clarifying the AML obligations of those in the financial sector and also helping to identify the scope of liability where customer companies are under the control of fraudsters.

Notably in Federal Republic of Nigeria v JP Morgan EWCA Civ 1641, the bank sought to exclude the Quincecare duty in contract and was held not to have done so through insufficiently clear and wide exclusion clauses.

The law will continue to evolve given the number of cases on Quincecare issues which continue to be brought, but the key practical guidance that has emerged is:

— whilst a bank is not obliged to treat every customer as suspicious, transactions must be properly monitored with suitable policies and processes in place, designed to detect suspicious activity;

— where there are suspicions of fraud/dishonesty, a bank should not execute a transaction until it has made reasonable enquiries to satisfy itself that the payment instruction is properly made;

— a bank can contract out of Quincecare obligations but terms must be very clear; and

— care should be taken when executing payment orders from individual company officers, particularly where the business has financial pressures and active creditors.

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Germany

Updates

Germany has been one of the most important jurisdictions in financial services for some years. The banking sector is split into three pillars in Germany (private banks, public saving banks and cooperative banking institutions), which historically provided some protection from turbulent capital markets, meaning most banks were conservative in the risks they took.

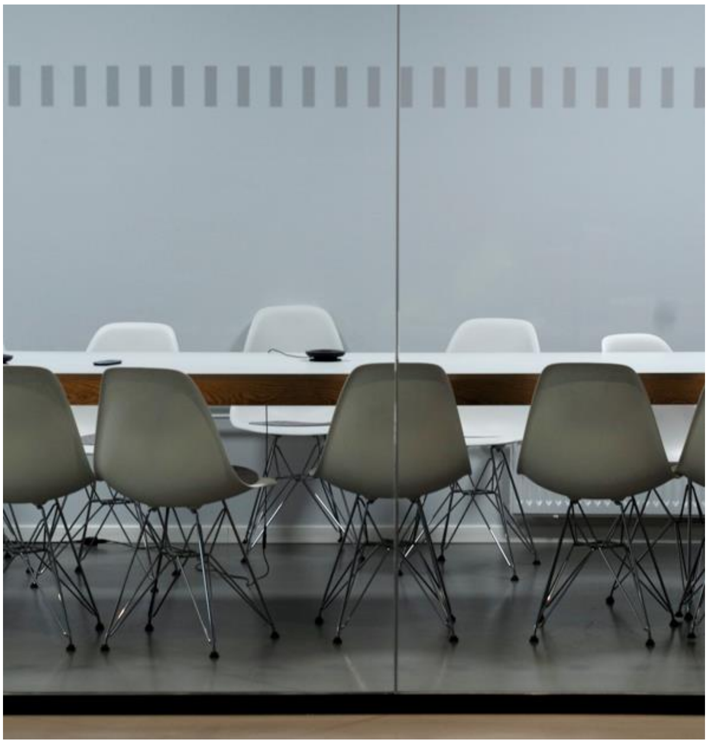
However, in recent years private institutions, and subsequently public banks, have changed their risk profiles considerably. Eventually, this has led to a number of scandals, of which the Wirecard scandal is the most recent.

The fight against financial crime, financial reporting failures and money laundering has certainly become a higher priority in Germany over recent years. However, the question remains as to whether Germany's competent enforcement institutions are able to fight financial crime effectively and efficiently.

Two of the major issues for German authorities in tackling financial crime are:

— the variety of agencies responsible for enforcing the rules, and the degree of overlap between the jurisdictions of multiple agencies; and
— the federal system that allocates general law enforcement between central agencies and the individual German states.

These structural issues have been highlighted in the wake of the Wirecard collapse.



Wirecard was a payment services provider and became one of the largest German financial services providers in recent years. In spite of the limited scope of services provided by Wirecard, its market capitalisation rose to EUR 25 billion in September 2018, which was two times larger than that of Deutsche Bank at the time.

The 'rising star' reputation of Wirecard with investors persisted despite warning signs that the company's balance sheet was overstated, and that fraudulent operations had occurred at the company for some time.

Wirecard spun the allegations in a way that triggered the German financial supervisory authority, BaFin, to issue a two month short-selling ban in February 2019, an unprecedented action at the time.

The BaFin claimed that such action was necessary to protect Wirecard from malicious hedge funds. In fact, before the publication of warnings by The Financial Times, larger short sales by certain market participants gave credence to the BaFin's concerns. In June 2020, Wirecard conceded that assets on its balance sheet in the amount of EUR 1.9 billion could not be verified after its accountant, Ernst & Young, had refused to certify the 2019 accounts (it had certified the preceding years' accounts).

It appeared that the large amounts of cash required to run Wirecard's business did not exist, though they had appeared on the balance sheet previously. The CEO Markus Braun retired, the CFO Jan Marsalek fled Germany and is currently reported to be resident in Belarus. Numerous other fraudulent actions or otherwise criminal behaviour is still being investigated.

The question of how Wirecard could have concealed its criminal activities for such a lengthy period, whilst under the supervision of the BaFin, its auditors and investors, is now being scrutinised. The findings of the investigation into Wirecard will likely have far-reaching consequences both in Germany and abroad.

A first of its kind fast track peer review by the European Securities and Markets Authority (ESMA), published on 3 November 2020, indicated that the following failings in the functioning of the BaFin and the private German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung (DPR)) contributed to the supervision failures:

— The BaFin is not sufficiently independent from the German Ministry of Finance. The number and granularity of reports required by the BaFin created exposure to political influence. Although ESMA did not see any concrete evidence of this in the Wirecard scandal, it appears to take the number and granularity of the reports as an opportunity for the Ministry of Finance to *"micro-manage"* BaFin's actitivies.
— The BaFin was not aware of dealings in Wirecard shares by BaFin employees, which raises concerns about the BaFin's internal controls.

- The DPR did not take fraud reports published regularly by The Financial Times and others seriously enough.
- The exchange of information between the various German agencies on financial reporting is inefficient. The BaFin and DPR are not aligned in their perceptions of each other's role and limitations in the context of the two-tier system.
- The BaFin did not have the requisite information to address the DPR's examinations of Wirecard thoroughly. This would have enabled the BaFin to determine whether it should take over the examinations of Wirecard from the DPR.

Even before the publication of the ESMA report, the German government had resolved to reform the BaFin. Two consultancy groups have been instructed to propose changes in the cooperation and risk management structure of the regulator.

The German Bundestag has also initiated an official investigation into the political involvement in the Wirecard scandal. Various investigations by public prosecutors have also been initiated.

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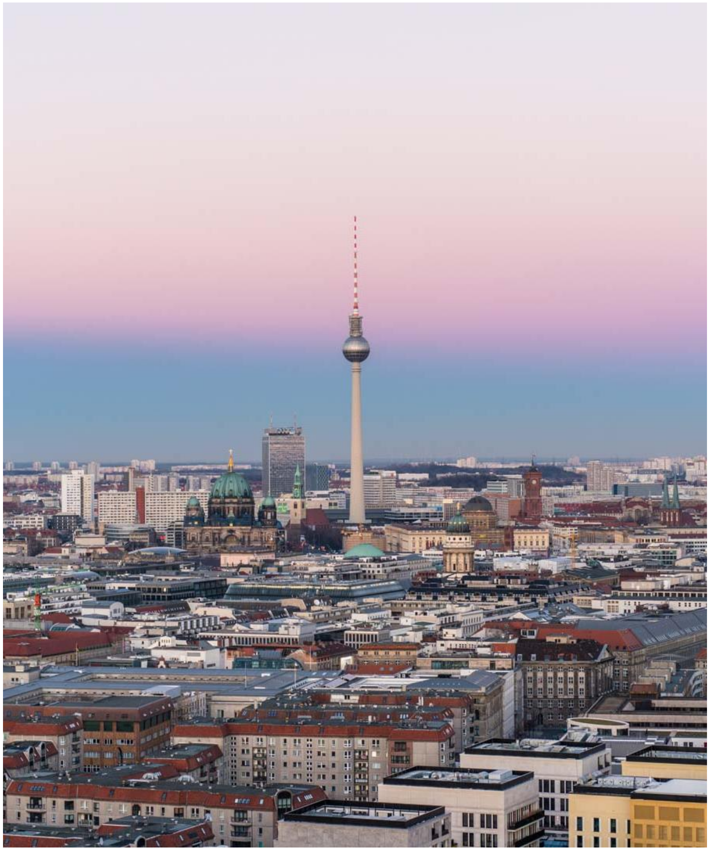


Spain

Updates

In Spain, as in other European jurisdictions, the sanctions and regulatory powers relating to the prevention of financial crime are found in legislation (both criminal and administrative), regulations and instructions or orders from different regulatory bodies (such as the Spanish Securities Market Commission (CNMV) and the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC).

The prevention and detection of financial crime remains a priority for regulators and prosecuting authorities in Spain. We have summarised below the key recent developments in this area and highlighted a landmark judgment handed down by the Spanish High Court in which multiple entities and individuals were convicted for their involvement in the falsification of annual accounts and associated fraud.

AML Legislation

Draft legislation is currently being considered by parliament which transposes the Fifth Anti-Money Laundering Directive (MLD V) into national law and which will modify Law 10/2010, 28 April, the main national law on the topic.

MLD V aims to strengthen the measures taken by firms and Member States to prevent financial crime by the following, amongst others:

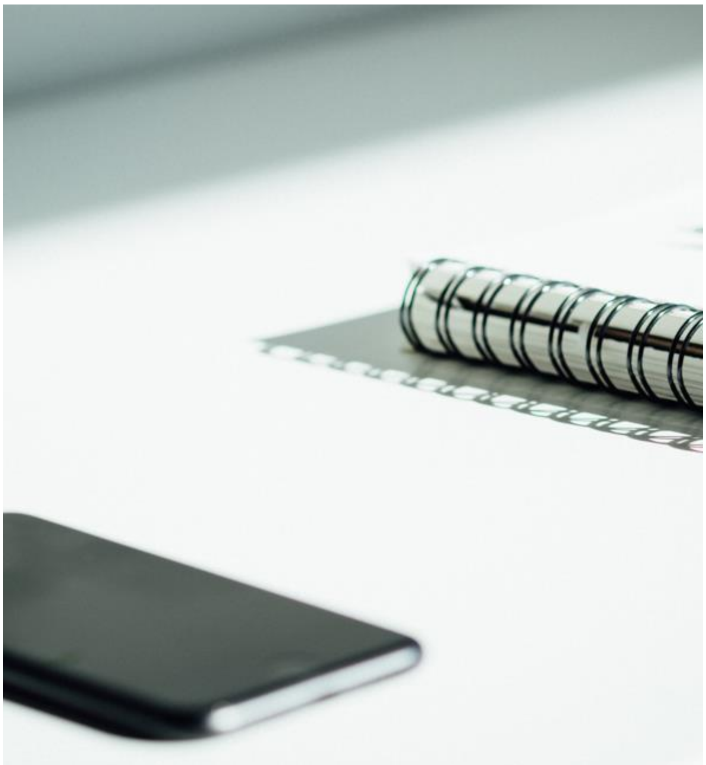
- including new businesses within its scope (such as some crypto asset service providers);
- imposing additional obligations on firms to identify the beneficial owners of legal entities;
- imposing obligations to include additional information in the Financial Ownership File for legal entities (in use in Spain since 2016);
- amending the procedures for the application of sanctions and international financial countermeasures on citizens and entities (United Nations Security Council);
- amending the responsibilities of the external expert (in terms of Art. 28 Law 10/2010 y Art. 38 RD 304/2014) who are responsible for preparing mandatory annual reports regarding firms' compliance with AML requirements. As a result of these amendments, third party advisers will have direct responsibility for the content of their reports; and
- introducing additional measures around the movement, and use, of cash as a means of payment.

ISO Standards

Several notable ISO standards focused on the prevention of financial crime have recently been approved or are due to be approved in the coming months. ISO is an independent, non-governmental international organisation with a membership of 165 national standards bodies and, through its members, it brings together experts to share knowledge and develop voluntary, consensus based, market relevant international standards that support innovation and provide solutions to global challenges.

The Compliance ISO Standards of notable reference are:

— **ISO 31022 regulation about Legal Risk Management**: Published in May 2020, which complements ISO 31000 on risk management. Among other points, it defines or helps to establish the internal and external context of legal risks such as financial crime and fraud.
— **ISO 37301 standard about Compliance Management Systems**: Due to be published in 2020. This regulation, that will replace ISO 19600, establishes the standards that a Compliance Management System must be accomplished in order to be certifiable. The goal of this Compliance Management System is to prevent risks and the commission of offences, such as financial crime and fraud, among others, inside the organisation.
— **ISO 37002 standard about Whistleblowing Management Systems (guidelines)**: Due to be published at the end of 2021. This ISO will be aimed at all types of organisations and will establish a series of guidelines for the implementation and management of channels for reporting irregularities through the reporting channel based on the principles of trust, impartiality and protection. Through this channel the employees must communicate any irregular behaviour detected inside the firm, related to financial crime, fraud, or any other offence.



SAN 2351/2020, October 6 - (the "Pescanova case")

One of the most high profile court cases of the year in Spain, the Pescanova case, relates to financial crime. Pescanova (currently named Nueva Pescanova), founded in 1960, is an international Spanish fishing company based in Galicia.

The National High Court has recently convicted the former president of Pescanova, Manuel Fernández de Sousa-Faro, and eleven of the company's senior management, for irregular practices in order to obtain bank financing for Pescanova and misstating the company's financial position (through manipulating the accounts) in order to attract investors.

In its judgment, the court highlighted the international trade operations with overseas subsidiaries that allowed Pescanova to obtain bank financing through millions of fictitious "documentary credits" owed by the subsidiaries to Pescanova, but which were not recorded in Pescanova's accounts. In addition, the defendants created a series of fictitious companies, the so-called 'instrumental companies', and simulated fish trading operations that allowed them to secure financing.

Once the requisite finance was obtained, the financial position of Pescanova was misstated in the annual accounts and other official documents. The strong financial position of the company, as falsely represented in the accounts, induced new investors and did not accurately reflect the bank financing and the high interest rates on which it had been obtained.

The court found that aggravated fraud and crimes relating to the falsification of annual accounts and economic and financial information had been committed. The former president of Pescanova was sentenced to eight years in prison, whilst the other eleven senior managers received penalties ranging from six months to three and a half years in prison.

For the first time in Spain, the company's auditors, a global accounting firm, were also convicted of falsifying economic and financial information and of falsifying the annual accounts, alongside the former president and senior managers. The individual auditor has been sentenced to three years, six months and one day in prison and large financial penalties (EUR 30 per day during 2 years) have been imposed on Pescanova and the accounting firm. In total, the fines imposed exceed EUR 51 million.

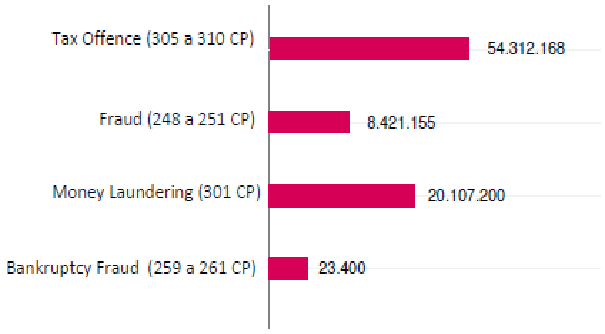
For further details please click here.

Trends in convictions for financial crime

There was a significant increase in the number of fraud convictions in 2019. Given the opportunities for fraud arising out of COVID-19, the number of fraud investigations is likely to increase, however, whether this translates into an increase in fraud convictions remains to be seen.

Interestingly, convictions for money laundering have not increased in the same way, rather they have remained relatively constant throughout the last five years.

The graph[1] below demonstrates that the total amount of fines (EUR) imposed during the period 2015 to 2020 for money laundering offences in Spain is considerably more than those imposed for fraud:



For further details please click here.

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[1] Graph taken from Laley Digital here

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