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Overseas Banks Legal and Compliance Forum

Introducers/Finders Agreements:

Associated litigation, financial crime and regulatory risks in investment banking, private banking and wealth management markets

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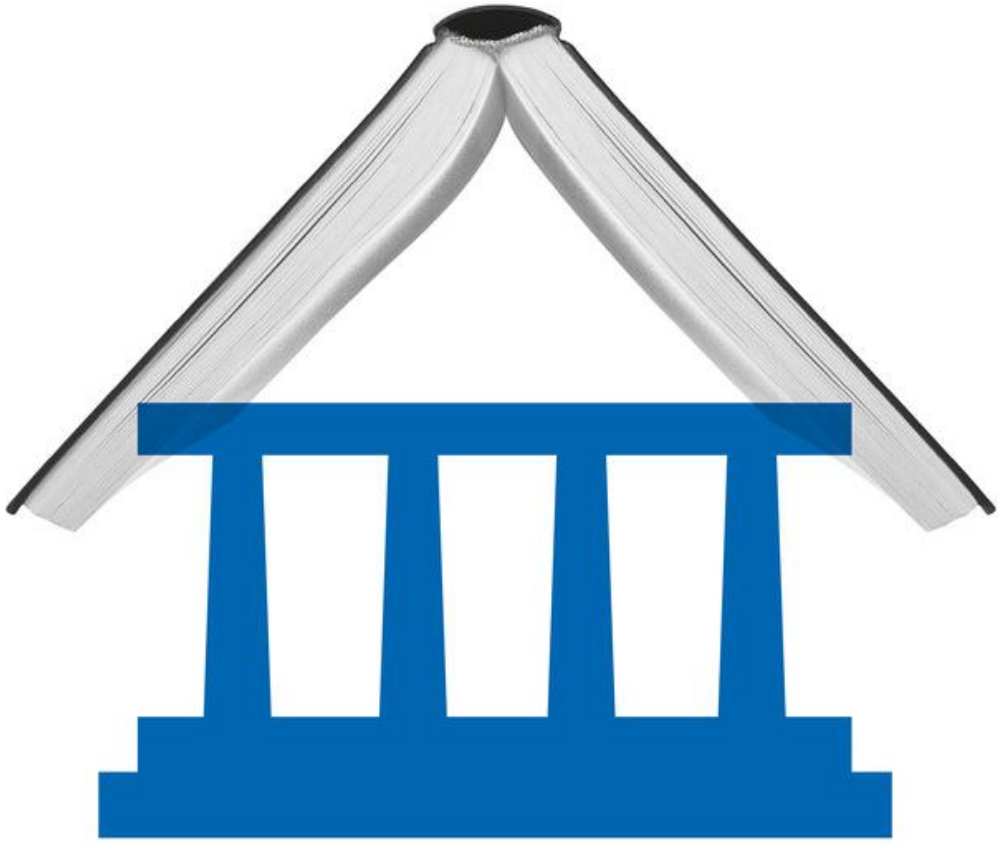

Agenda

Introducers/Finders Agreements

- Introduction
- Regulatory risk – Practical guidance around compliance risks (**Noreen Husain**)
- Corruption risk and criminal liability (**Neill Blundell**)
- Litigation risk (**David Flack**)
- FCA Enforcement risk (**Greg Brandman**)
- Q&A

Introduction – Introducers/Finders Agreements

- Common form of agreement in all areas of financial services
- Variety of forms:
  - Fixed Fee basis
  - Commission basis
  - On-going business relationship
  - Referral Fee arrangements
- Attitude of the regulators
  - Understanding and effectively mitigating the risks

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Regulatory risk – Practical guidance around compliance risks – Noreen Husain

Introducers/Finders Agreements

Regulatory risk

What do we mean by "Finder" or "Introducer" ?

- A person or body corporate who introduces clients to a firm normally in return for commercial benefit e.g. remuneration (monetary or non monetary)

- Exclusion from FCA or PRA authorisation **IF** merely introducing and not undertaking regulated activities which require regulatory authorisation (as per the Regulated Activities Order)

Introducers/Finders Agreement

Regulatory Risk

Common Pitfalls

- Introducer is party to the advice and transaction by virtue of the relationship with the client and/or attendance at meetings
- Introducers not subject to full AML checks
- Process of introduction not verified as part of the due diligence process (Conflicts of interest considered?)
- Ongoing monitoring of introducer activities and monies paid not undertaken
  - How best to achieve this: e.g. requiring the introducer to have a bank account with you
- T&Cs not explicit in terms of scope of introducer activity
- Customers not made aware of the introducer fee/remuneration
- Customers unduly influenced by the introducer

Introducers: Key Points

- Ensure robust initial due diligence is undertaken.
- Consider if the introducer is a PEP Ensure KYC/AML checks are appropriate and undertaken for every new finder (Inc. periodic checks)
- Review the process for monitoring payments made to introducer by booking centres (nb risks of overseas booking centres)
- Ensure booking centres do not accept introducers without approval from the UK regulated business (nb alignment of requirements re confidentiality and disclosure)
- Review the T&Cs for introducers – are they robust and clearly define remuneration structure and conditions/scope of introductions

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Corruption risk and criminal liability – Neill Blundell

Introducers / Finders Agreements

Corruption risk and criminal liability

Why worry ?

- Introducers, like other third parties, can create many risks
- Some of these risks may give rise to criminal liability:
  - Bribery Act 2010 (section 7)
  - Money laundering offences
  - Fraud

Introducers / Finders Agreements

Criminal Liability

Bribery Act 2010: Section 7 (corporate liability)

- A commercial organisation is guilty of an offence if a **person associated with** the organisation bribes another person intending to
  - obtain or retain business for that organisation, or
  - obtain or retain an advantage in the conduct of business for that organisation
- It does not matter whether the act or omission takes place in the UK or elsewhere
- Knowledge of the bribe is irrelevant (strict liability)
- The company can be liable even if it does nothing improper
- Definition of an associated person clearly covers "introducers"

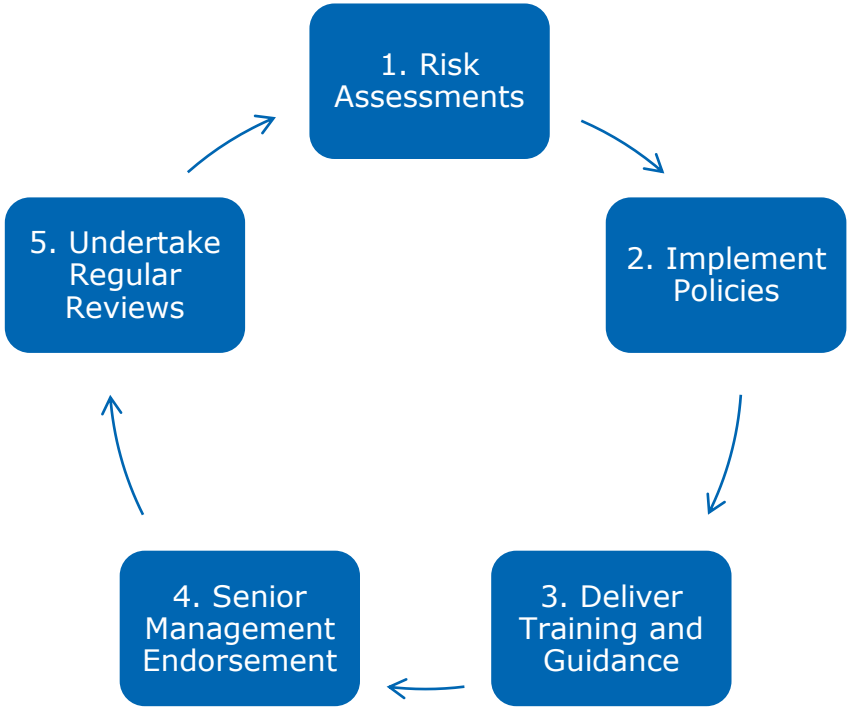
Penalties

- Unlimited fine
- Being disbarred from public procurement in the UK if the organisation or its directors commit an individual offence under UKBA

Bribery Act 2010

The defence

- The only defence available is that the organisation had **adequate procedures** in place to prevent the bribery from occurring
- The burden of proof is on the organisation to prove it had adequate procedures in place: the key test is whether the procedures are proportionate to the risks involved



Bribery Act 2010

Warning signs and mitigation

- UK enforcement history shows that intermediaries and other third parties are a major area of exposure
- Red flags:
  - poor documentation
  - no clear business case
  - no proper due diligence
  - lack of approvals
  - poor transparency in use of funds
  - unusual payment channels and commercial structures
  - no proof of delivery of services
- Need for risk-based due diligence checks on third parties to be engaged
- Formal contracts should require third parties to behave in an ethical way and in compliance with anti-bribery legislation
- Need for formal approval and monitoring processes to check reasonableness of payments made to third parties

Money laundering

Potential offences under POCA

- Under Proceeds of Crime Act 2002 (**POCA**), "Money Laundering":
  - Relates to "Criminal Property"
    - Conceals, disguises, converts or transfers... – s.327
    - Enters into/concerned in arrangements a party knows or suspects facilitates the acquisition, retention, use or control of... – s.328
    - Acquires, uses or has possession of... - s.329
- Disclosure defence – s.338
- Failure to disclose – ss.330-332
  - Employees to Money Laundering Reporting Officer (MLRO)
  - MLRO to National Crime Agency (NCA)
- Tipping off – s.333A
  - Contemplated/actual investigations
  - NCA disclosures
- Prejudicing an investigation – s.342
- Up to 14 years' imprisonment and unlimited fine
- Note that POCA has **extra-territorial reach**

Money laundering

POCA: investigatory/remedial powers & punishment

- Police
  - Production orders
- SFO
  - Section 2 orders
- Police/SFO
  - Account monitoring orders
  - Freezing or forfeiture
- Roles of Police/SFO/NCA
- Fine/imprisonment
- DPAs

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Litigation risk arising from Introducers/Finders agreements – David Flack

Litigation Risk – the key issues

- Oral vs Written
- Full agreement or short form side letter?
- Governing Law and Jurisdiction clause?
- Indemnities/Warranties
- Expenses/disbursements
- Conflicts of Interests/Agency
  - secret commissions and transparency
- Conflicting international regulatory regimes and laws

UBS AG v Kommunale Wasserwerke Leipzig GmbH [2014] EWHC 3615 (Comm)

Case study – the danger of relying on an introducer/finder

Brief Overview of the facts

- In 2006 and 2007, KWL, the Leipzig municipal water company, sold credit protection to UBS, and several other banks, on portfolios of investment grade bonds through a series of derivative products known as Single Tranche Collateralised Debt Obligations (STCDOs).
- KWL sold the protection to fund receiving credit protection from UBS on 4 specific US entities (to which KWL was significantly exposed due to prior deals) plus an upfront premium of c. USD 35 million.
- The effect of STCDOs was that if approx. 8 or more securities in the portfolio defaulted over a period of eight years then KWL would be liable to UBS for many hundreds of million of dollars.
- The entry into the STCDOs was brokered by a Swiss firm called Value Partners who acted as financial advisers to KWL and introduced KWL to UBS.
- Value Partners had in fact bribed the managing director of KWL to secure the deal and took a significant proportion of the upfront premium (passing a proportion back to the KWL MD personally).
- In the financial crisis of 2008-2009, a number of securities in the portfolios defaulted and UBS sought payment from KWL under the terms of the STCDOs of approximately USD 350 million.

The judge dismissed UBS' claims for payment

- KWL did not allege (and the judge did not find) that UBS knew about the bribe between Value Partners and KWL's MD.

- However, the judge granted KWL's claim for rescission of the STCDO's - allowing KWL to avoid their consequences - on the grounds that:

  - **Agency**: Although it was accepted that Value Partners were KWL's agent, Value Partners also acted as agent for UBS in paying the bribe to KWL; and

  - **Conflict of Interest**: There was a fundamental undisclosed conflict of interest in Value Partners position vis a vis UBS and KWL.

The Agency Issue

- The judge's finding that Value Partners, as well as being an agent of KWL, was also an agent of the bank was based on the facts (e.g. after considering Value Partners role in liaising with, working together to ensure the conclusion of the transaction and various other conduct which suggested that Value Partners in fact considered UBS its client).

- The judge then went on to find that the bribe was paid in the course of the agency with the bank:
  - Irrelevant that the principal did not authorise or know of the bribe;
  - Principal was **responsible in law** for agent's conduct;
  - The bribe had been paid

> "*for the very purpose for which [UBS] had engaged [the intermediary], namely to direct [the derivatives] business to UBS from its clients, regardless of whether it was in the clients' interests to enter into such transactions. It was paid from the proceeds of the transaction into which KWL had been induced to enter.*"

The Conflict of Interest Issue

- KWL was also able to rely on alternative arguments that the relevant transaction should be undone because there was a conflict of interest on the part of Value Partners flowing from its dual (and "*hopelessly conflicted*") agency and KWL had not known of or consented to the conflict.

- UBS were aware that Value Partners were acting under such an undisclosed conflict of interest in seeking to advance their relationship with UBS at KWL's expense; for example, unknown to KWL:
  - Value Partners had sought extra remuneration from UBS – even though not ultimately paid - in return for recommending that UBS's asset management arm be appointed portfolio manager; and
  - UBS and Value Partners also entered into a separate forward looking introducing brokers agreement for future deal opportunities (even though none transpired)

Was Rescission Fair?

- UBS argued that KWL should not be allowed the equitable remedy of rescission because the transaction took place against the backdrop of the corrupt relationship between a senior manager at KWL and the intermediary, such that the remedy was unfair and disproportionate, and KWL could not be considered to have 'clean hands'.

- The judge found that UBS was responsible in law for the bribe and that it had chosen to deal with KWL through an intermediary knowing that intermediary was failing in its duties as an agent.

> "A bank which enters into a corrupt arrangement with a financial intermediary who purports to be representing the other party to the transaction is not in a strong position to invoke general equitable principles as a matter of discretion and must take the consequences of its actions."

Conclusion

- In the concluding words of the judge:

> *"Neither UBS nor KWL emerges with credit from this saga.* ***For UBS it has been a case study in how not to conduct investment banking in a fair and honest way****. It is to be hoped that the events described belong to a bygone era…"*

> *"Mr Heininger's [KWL's MD] greed and dishonesty could easily have been catastrophic for KWL. They would have been if it had not been for the fact that the dishonest advisers with whom he was in bed overreached themselves by entering into a corrupt arrangement with a maverick banker at UBS who was allowed far too much autonomy, with a view to ripping off not only KWL but their other clients as well."*

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FCA Enforcement risk – Greg Brandman

FCA Enforcement Risk

Areas of concern to the regulator

- Risks arising from Introducers/Finders arrangements
  - Conflicts of interest
    - Transparency
    - Undue influence
  - Financial Crime
    - Fraud
    - Money Laundering
    - Bribery and Corruption
- Are those risks being managed effectively ?
  - identification of risk
  - onboarding and ongoing monitoring
  - appropriateness of fees
  - risk of adverse inferences around culture where controls are lax
  - training

FCA Enforcement Risk

Managing the risk arising from introducer arrangements

Areas of focus for the FCA

- On-boarding
  - introducer due diligence
  - introducer questionnaire
  - risk assessment
  - independence of the finder approval process
- Governance
  - policy and procedures for dealing with introducers
  - transparency with the underlying client
- From whom do you take your instructions ?
  - influence of the finder with the client
- Nature of the agreement and the fees payable under it
  - what is the business case / commercial rationale ?
- Compliance oversight and transaction monitoring

FCA Enforcement Risk

Risks of getting it wrong

NB: The FCA is taking enforcement action in this space

- PRIN 1
  - A firm must conduct its business with integrity
- PRIN 2
  - A firm must conduct its business with due skill, care and diligence
- PRIN 3
  - A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems
- PRIN 6
  - A firm must pay due regard to the interests of its customers and treat them fairly
- PRIN 8
  - A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client

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QUESTIONS?

About today's speakers

David Flack, Partner, Eversheds LLP

David is a partner in the Financial Services Disputes and Investigations Group specialising in all aspects of disputes and investigations.

From July 2006 to February 2014 David was in-house litigation counsel for UBS AG in London where he was responsible for managing litigation and regulatory investigations for the investment bank in Europe, the Middle East and Africa. David was engaged in many high-profile litigation and regulatory matters during his time at UBS including several high profile UK High Court trials and developed particular expertise in relation to disputes relating to complex structured products, all forms of derivatives, commercial loans and investment banking advisory mandates.

Prior to his time at UBS, David spent 9 years in private practice as a commercial disputes lawyer at Clifford Chance in London. David gained experience acting for both commercial and financial institutions across multiple jurisdictions on a broad range of areas including advising on issues of contractual construction, shareholder disputes, fraud, mis-selling of financial structured products and disputes relating to post-acquisition M&A issues.

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About today's speakers

Gregory Brandman, Partner, Eversheds LLP

- Greg is a partner in the Financial Services Disputes and Investigations team in London and the head of Eversheds LLP's contentious financial services regulatory practice. Before joining Eversheds in 2011, he was a Manager in the Wholesale Department of the Enforcement Division of the Financial Services Authority.
- Greg specialises in financial services regulatory investigations and enforcement defence work. He represents firms and individuals who are under investigation by the FCA and the PRA for misconduct, including systems and controls violations, market abuse, client money/assets breaches, mis-selling and other misconduct.
- Greg is an approved skilled person on the FCA/PRA's s166 panel. He regularly publishes articles, speaks at conferences and delivers training to clients in relation to financial services regulatory matters, including senior management accountability, conduct risk, CASS, governance and culture.

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About today's speakers

Neill Blundell, Partner, Eversheds LLP

- Neill is Head of Eversheds' Fraud & Investigations Group. He specialises in all types of fraud and financial crime issues that impact on our clients, including bribery & corruption, money laundering and sanctions.

  Neill is recommended in both Legal 500 and Chambers 2011 as a "personable and highly skilled professional".

  Neill regularly lectures on fraud related issues, is an author of the chapter on "Overseas Assets" in "Fraud: Law, Practice & Procedure" and a contributor to Mitchell Taylor & Talbots "Confiscation & the Proceeds of Crime".

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About today's speakers

Noreen Husain, Regulatory Director, Eversheds Consulting

- Noreen is a Regulatory Director within Eversheds' FS Regulatory Consulting Practice. Noreen's role is focussed on providing clients with practical compliance advice on a variety of issues which can impact our clients immediately or in the future. Noreen and the rest of the team partner with our legal teams to deliver robust, pragmatic and achievable solutions.

- Noreen is an experienced regulatory professional with over 19 years experience. She has a strong knowledge of risk frameworks and effective compliance and regulatory risk management. Noreen has particular expertise in Culture, Governance, systems & controls and Conduct. Her experience is gained from a variety of industry sectors and previous senior compliance roles within the financial services industry. Noreen has also attained an MSc in Financial Regulation and Compliance Management.

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