

HORIZON

from
SKADI

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HIGHLIGHTS

- July's 'Spotlight' feature, Taxing Situations, looks at where authorities may turn their attention to in the hunt for tax revenues.
- A detailed look at the BoE concerns regarding the increase in UK Gilt repo settlement fails.
- Following the Barclays rescission offer, a look at Credit Risk Management controls.

CATEGORY OVERVIEW

For the third consecutive month, **Regulatory Updates** took the highest share of articles featured in The SKADI Sammendrag. Crypto regulations accounted for one sixth of these headlines, with several countries and regulators implementing and planning rules. With this sector starting to mature, we anticipate further developments in this area. A further 12% of stories related to exposure and sanctions against Russia.

AML news dropped in July below average levels, nevertheless subsequent headlines in this area are likely to increase. The Enablers Act, [passed](#) by the US House of Representatives (but not yet by the Senate), will force trust companies, lawyers, art dealers and others to investigate clients and report suspicious activity to the U.S. Department of Treasury.

Fraud articles fell substantially in June; headlines in this area related to separate events rather than from a common theme. News [reports](#) included a development in the Missing Cryptoqueen (one of SKADI's favourite podcasts of 2019). The FBI added Ruja Ignatova, to their Top Ten Most Wanted list.

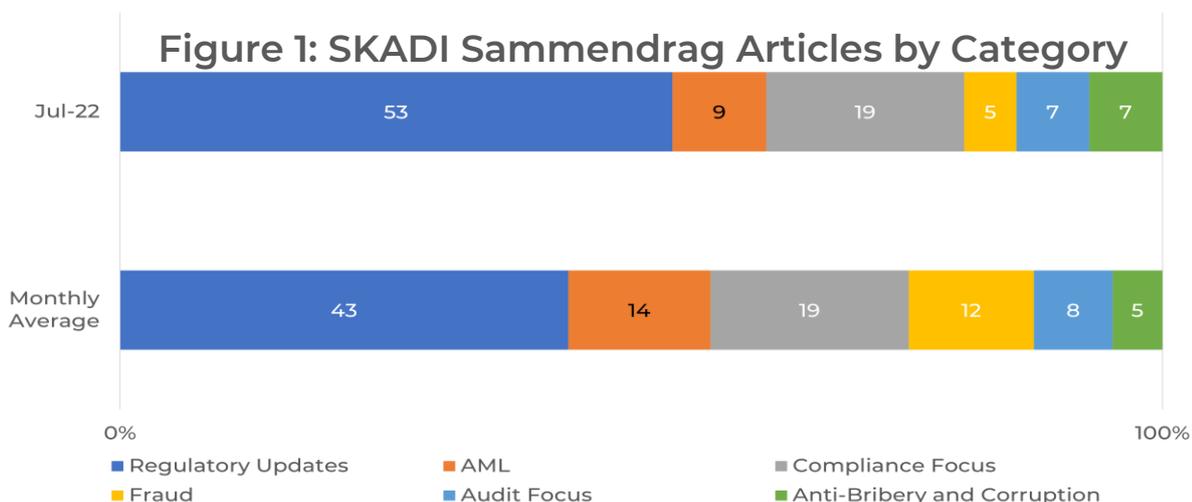
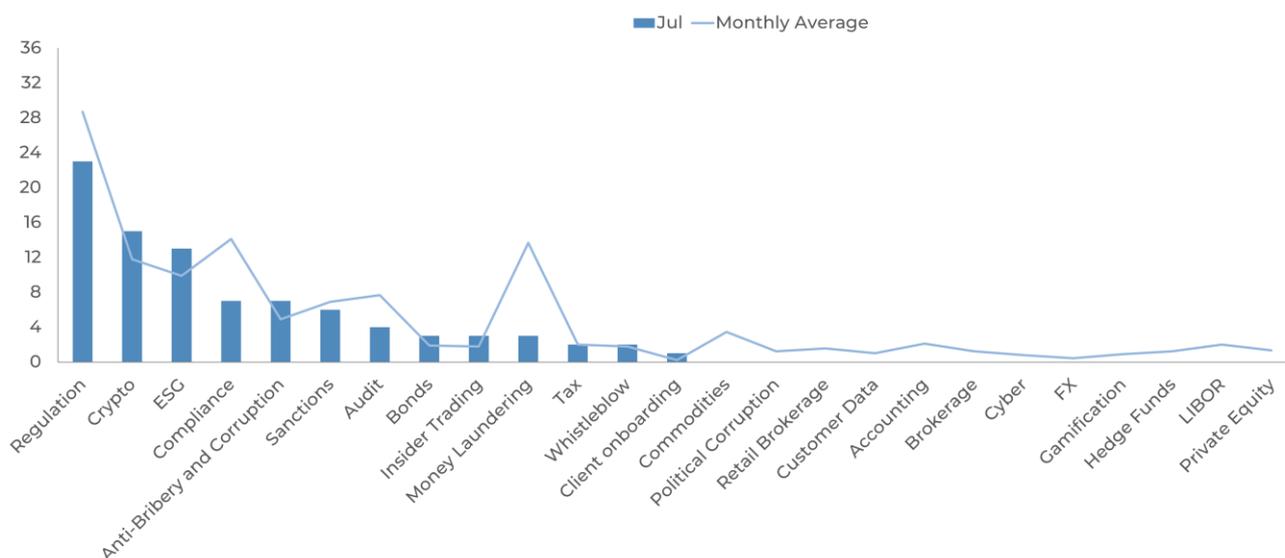


Figure 2: SKADI Sammendrag Articles by Topic



TOPIC DETAILS

Regulatory stories in July featured several headlines covering the use of personal devices, with three Investment Banks impacted. Bank of America's CFO [announced](#) approximately USD 200 mln had been earmarked for a regulatory case relating to the unauthorized use of personal mobile phones, with investigations into record keeping of employee communications. US regulators are also [probing](#) whether UBS staff communications were properly documented. These developments were closely followed by Barclays, who reached a [proposed](#) resolution of USD 200 mln with US regulators for the use of unapproved messaging channels.

SKADI first highlighted regulatory scrutiny in this area back in the December 2021 [issue](#) of Horizon, after the initial JPMorgan settlement. We foresaw that it would be an ongoing area of concern for regulators (and a key focus for control staff) and, with the most recent slew of fines, would expect headlines to decrease in this area as internal controls at most financial institutions should (hopefully!) now be up to scratch.

Other **Regulatory** stories included the Bank of England's [announcement](#) that they were "unhappy" regarding the recent rise in Gilt repo settlement fails (minutes of the May-22 UK Money Market Code Sub-Committee meeting were released 8-July). Repurchase Agreements, or repos, form an agreement between two parties whereby one side sells an asset, in exchange for cash whilst agreeing to repurchase the same asset at a slightly higher price. Whilst different maturities are available, overnight transactions are most popular, unwinding the next day.

As SKADI's Dave Bridges explains, "...anticipated settled positions in CREST can easily be produced, and the relevant repo bookings can then be made. However, several factors will influence what actually settles... counterparties may fail to deliver securities for purchases or repo returns from the previous day, and T0 trades will cause a knock-on effect to the settled inventory position."

Inexperienced staff and low liquidity were cited as potential causes of the fails from LCH and Euroclear. With the Gilt market having certain trades that simply cannot afford to



fail, unless these risks are correctly controlled a single small failure can trigger a much larger repo or trade to fail with serious consequences.

Regulatory updates included the FT [story](#) that former JPMorgan employees “scammed the market” according to prosecutors who accused three individuals with racketeering, wire fraud, spoofing and commodities fraud. The charges related to using spoof trades in silver and gold futures on the CME for over seven years. Prosecutors alleged that huge volumes of trades flooded the market which had no intention of being executed to manipulate prices.

In **Audit** headlines, the Financial Times also [reported](#) a record year in the UK for fines levied against accountancy firms. Fines from The Financial Reporting Council (FRC) totalled GBP 46.5 mln, a large rise compared to GBP 16.7 mln in the previous year. Over half of the charges were made against KPMG, with the firm receiving four fines, more than any other firm.

KPMG's charges did not include a sanction for GBP 14.4 mln made in July for providing false and misleading information throughout audits of Carillion and Regeneris. The FRC announced that missing documents had been forged and manufactured when requested. The FRC are continuing to investigate the audit of Carillion, whose collapse has raised the point of auditing standards needing improvement.

Sanctions coverage in July continued to include developments impacting Russia. Revised sanctions announced by the EU will enable funds at Russian banks to be unblocked to ease the movement of obstructed food and fertilisers. Other sanctions stories included Moscow's [announcement](#) of banks from “unfriendly countries” being granted permission to trade foreign currencies on Russian FX markets. The “unfriendly” list includes the UK, US and the entire EU and other countries. A ban on trading in Roubles remains unchanged.

SPOTLIGHT: TAXING SITUATIONS

With the UK Conservative Party leadership race descending into a fight about who can cut taxes the most, it provides an opportune moment to look at taxation, and how governments are going to deal with the stark reality of servicing increasing interest payments on all the debt that has been raised over the past years. As we publish this piece, the Bank of England has announced the biggest interest rate hike since 1995 and has issued a warning of a long recession.

Earlier this month, in a widely reported [interview](#) with the BBC, the IMF's Mark Flanagan warned the UK that “...debt-financed tax cuts at the current time would be a mistake” and he further went on to say that “...if anything, the tax ratio needs to be lifted”. If the electoral friendly promise of reducing personal taxation to help with the cost-of-living crisis (in itself a possible further inflationary push, exacerbating the problem further!) is enacted, then the question has to be asked where will the extra tax revenue take come from?

A [recent case](#) bought by the IRS against Amgen to attempt to claw back USD 10 bln in taxes due to profit being booked via a Puerto Rican subsidiary will draw attention to multinational corporation's international tax practices and, in our opinion, there will be a concerted push by tax authorities to examine in detail any “tax efficient” products structured by banks over the past few years.

HORIZON Takeaway Points for Audit and Control Teams

- With the US Dollar Index (DXY) gaining over 10% so far in 2022, we are starting to see contagion effects spilling over, especially into the Emerging Markets. Sri Lanka's foreign-debt crisis and political upheaval acts as a reminder of how sensitive markets can be, and there will be concerns that we don't see a repeat of what happened in 1997. Emerging Market exposure should therefore be a key focus.
- The [release](#) of details regarding the rescission offer announced by Barclays to buy back up to USD 17.6bn of securities sold in breach of US regulations highlights both the oversight and implementation of Risk Management Controls. SKADI continues to recommend revisiting Credit Risk Management Controls to see where they may have been deliberately or inadvertently circumvented.
- As highlighted earlier in this piece, tax issues should be front and centre of control functions priorities, and any tax efficient products that were structured in recent years should be checked to make sure that documentation is watertight.

What is it we're doing here?

Released every morning, The SKADI Sammendrag covers headlines to assist Compliance, Internal Audit and control teams. In this monthly research document, HORIZON, we collate and analyse these 100 or so articles, finding themes and areas of focus for control functions.

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