

# Cum-Ex: What is it and how will my firm be impacted?

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10 June 2021



# Presenters



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# Agenda

**1** | Introduction

**2** | Cum-Ex Trading Schemes

**3** | Impact on UK Regulated Entities

**4** | Q&A Session

# Cum-Ex Trading Schemes

**David Stern**

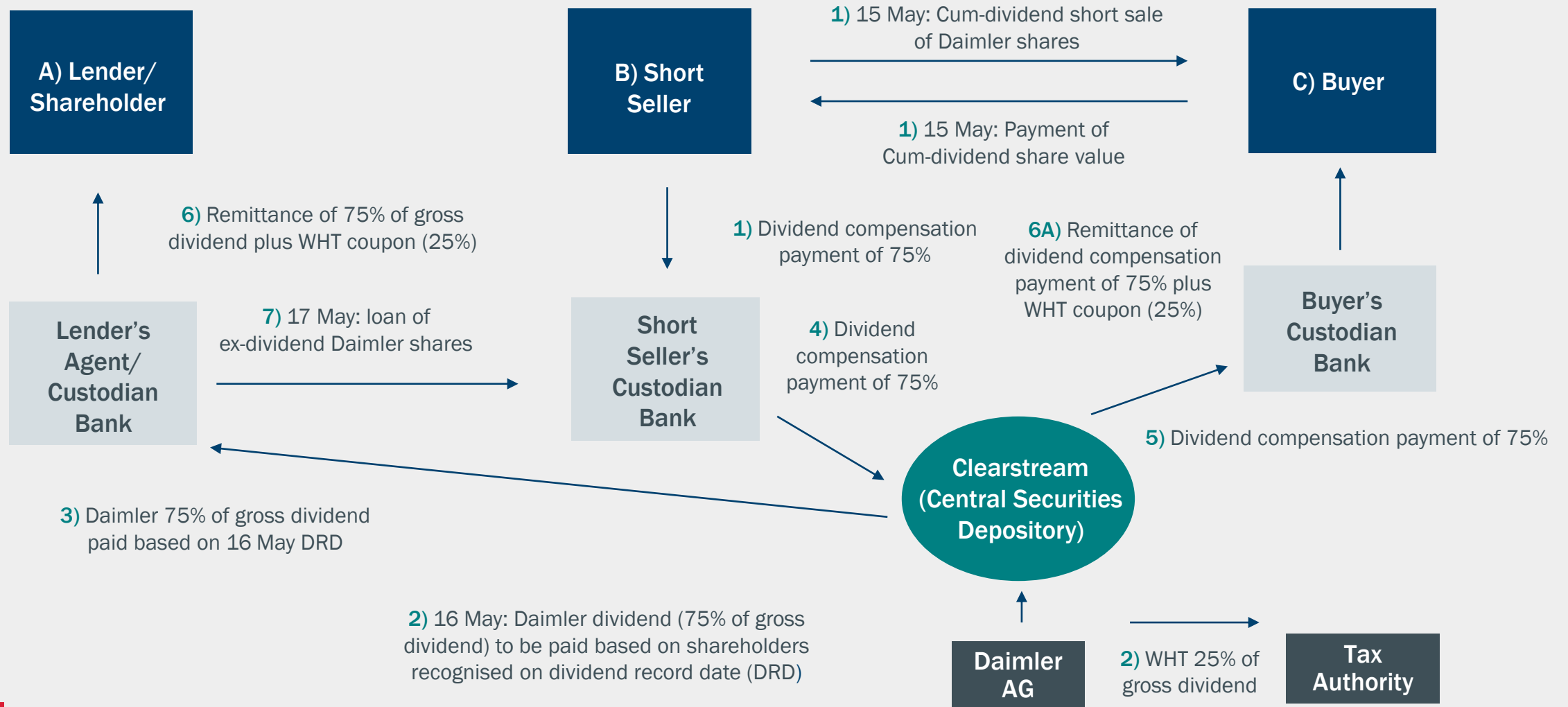
# Context & Explanation

A dividend arbitrage trading practice focused on multiple tax rebate claims from EU state treasuries worth an estimated €55bn.

- FCA and HMRC are engaged—the SFO is keeping watch
- Criminal, regulatory investigations and civil recovery actions with significant ramifications in the UK for:
  - Banks
  - Investment fund clients
  - Inter-dealer brokers (IDBs)



# German Cum-Ex Trade Illustration: T+2



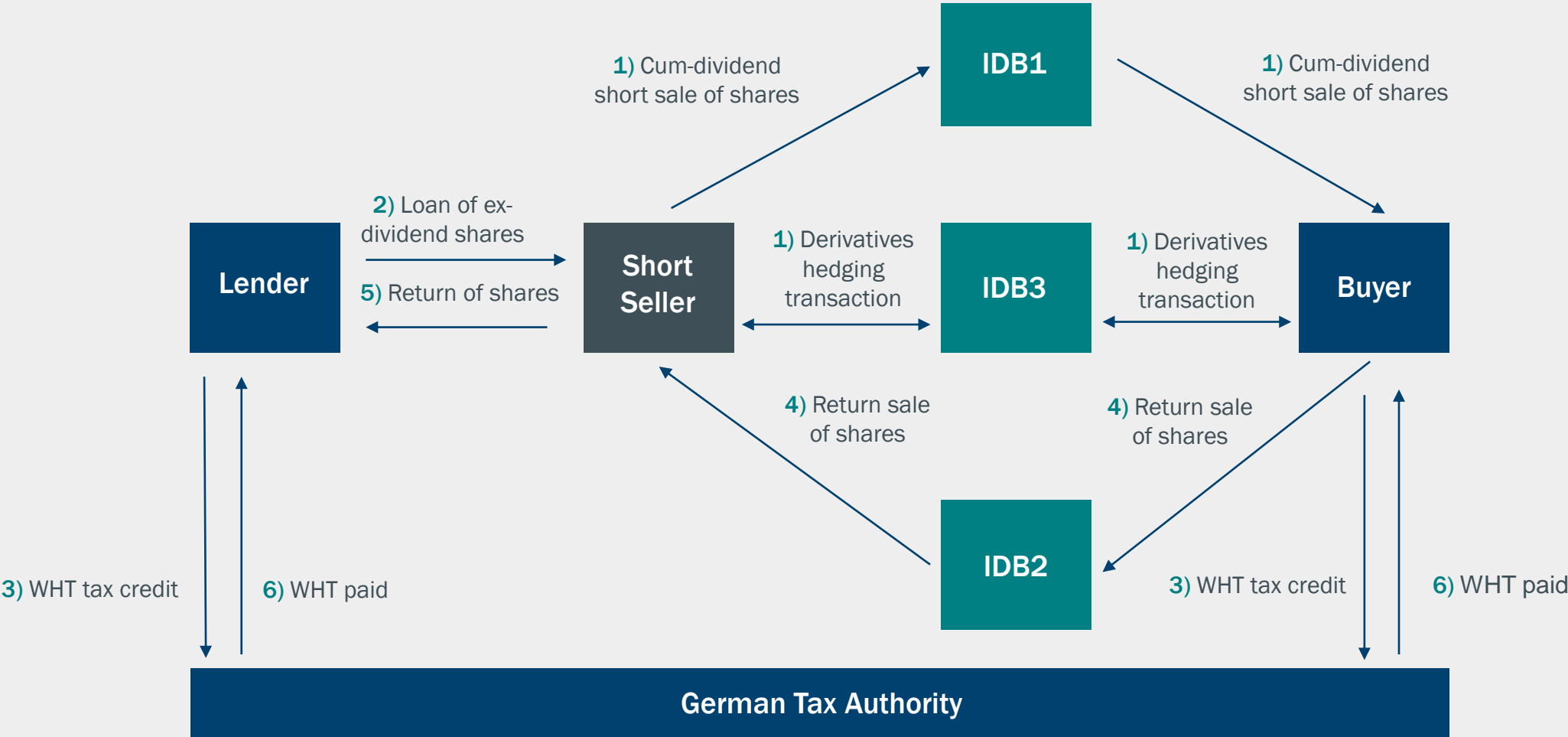
# The Wider Marketplace

CumEx trading is a highly complex network of parties, providing liquidity and services essential to its operation.

- Transactions commonly involved five trade legs:
  - Sale of the shorted stocks
  - Purchase of the stocks
  - Collateralized stock loan agreements to facilitate the short sale
  - OTC forward agreements/derivative hedging
  - Return of the borrowed stock



# Use of Inter-Dealer Brokers (IDBs)





# **Impact for UK Regulated Entities - The Sapien Capital Ltd Case**

**Alexandra Will**

# The Sapien Case



The screenshot shows the FCA website's news page. At the top left is the FCA logo (Financial Conduct Authority). To the right is a search bar. Below the logo is a navigation menu with buttons for 'About us', 'Firms', 'Markets', 'Consumers', 'News' (highlighted in red), and 'Publications'. A breadcrumb trail reads 'Home / News / FCA fines Sapien Capital Ltd for serious financial crime control failings in relation to cum/ex trading'. The main headline is 'FCA fines Sapien Capital Ltd for serious financial crime control failings in relation to cum/ex trading'. Below the headline are icons for 'Print Page' and social media sharing (LinkedIn, Twitter, Email). A sub-header indicates 'Press Releases | First published: 06/05/2021 | Last updated: 06/05/2021'. The main text states: 'The FCA has fined [Sapien Capital Ltd](#) £178,000 for failings which led to the risk of facilitating fraudulent trading and money laundering. The fine was reduced due to serious financial hardship.'

Source: <https://www.fca.org.uk/news/press-releases/fca-fines-sapien-capital-ltd-serious-financial-crime-control-failings-relation-cum-ex-trading>

# The Sapien Case – Summary of FCA Findings

- ✓ Sapien Capital Limited is a **UK-based corporate finance advisory and brokerage firm** that offered diverse capital services to global clients.
- ✓ Between 10 February and 10 November 2015, Sapien Capital Limited executed purported OTC equity trades to the value of **approximately £2.5 billion in Danish equities and £3.8 billion in Belgian equities.**
- ✓ The **OTC trades were linked to Cum-Ex** – they had a circular pattern of extremely high value trades that seemed to be undertaken to avoid the normal need for payments and delivery of securities in the settlement process. In addition, the transaction patterns showed no changed of ownership of traded shares.
- ✓ FCA fined Sapien Capital Limited an original amount of £236,740 for **systems and controls failings** that led to the risk of facilitating fraudulent trading and money laundering.
- ✓ The original fine was **reduced to £178,000** due to Sapien's cooperation in the investigation and it being able to demonstrate financial hardship suffered without reduction in the fine.

# The Sapien Case – Why is the case significant?

- ✓ With the Sapien case the FCA has **imposed its first fine in relation to failings in the context of cum-ex trading**, dividend arbitrage and withholding tax reclaim schemes.
- ✓ While the **underlying transactions** relate to cum-ex trading schemes, the FCA did not touch upon the question of legality of cum-ex in the case.
- ✓ The FCA's focussed on the **significant gaps and weaknesses** in Sapien's financial crime systems and controls in its Final Notice . In addition to this, the FCA considered that individuals deliberately circumvented the already inadequate controls for the time period under consideration.
- ✓ The **UK High Court of Justice** in April 2021 **dismissed a case by the Danish tax agency** (Skattestyrelsen, SKAT) against Sanjay Shah / Solo Capital Partners claiming that Shah had defrauded the tax authority of EUR1.9 billion EUR through cum-ex trading schemes on the basis that the Danish state was not entitled to enforce its own laws in an English court.
- ✓ UK regulatory / supervisory bodies **increasingly focus on control weaknesses and control failures** in the regulated sector (e.g. recent Natwest proceedings, Commerzbank (FCA), MT Global Limited (HMRC)).

# The Sapiens Case - FCA investigation and findings

- The FCA found that Sapien Capital Limited was in breach of the following principles (FCA Handbook PRIN 2.1):

- Principle 2 - A firm must conduct its business with due skill, care and diligence.
- Principle 3 - A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

- FCA says it is continuing further investigations into UK brokers' involvement in cum/ex dividend arbitrage schemes.
- Mark Steward, director of enforcement and market oversight at the FCA, said: "These transactions ran money laundering and other financial crime risks which **Sapien incompetently failed to see.**"

# The Sapiens Case - FCA investigation and findings

Principle 2 - A *firm* must conduct its business with due skill, care and diligence.

Sapien Capital Limited failed to:

CDD /  
EDD

- properly conduct CDD
- gather information to enable them to understand their customer's business
- undertake and document a risk assessment for each Solo Client
- complete EDD for any Solo Client despite non being physically present for IDV amongst risk factors
- assess Solo Clients against categorisation criteria set out in COBS 3.5.2R

Ongoing  
Monitoring

- Sapiens failed to conduct transaction monitoring of Solo Clients' purported trades
- Sapiens failed to recognise numerous red flags

SAR Filing

- Sapiens failed to report payments to the FCA

# The Sapiens Case - FCA investigation and findings

**Principle 3 - A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.**

## Risk Management

Sapien Capital Limited failed to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems

## Policies and Procedures

Sapien Capital Limited's policies and procedures were inadequate for identifying, assessing, and mitigating the risk of financial crimes posed by Solo Group as they failed to:

- Give adequate guidance on how to conduct risk assessments and what factors to consider;
- Set out adequate processes and procedures for EDD;
- Set out adequate processes and procedures for transaction monitoring, including how transactions are monitored and with what frequency; and
- Set out adequate procedures for how to identify suspicious transactions.

# Considerations for UK firms....what to do next

What was your organisations role or involvement in Cum-Ex?

(Potential) active involvement in cum-ex as broker, investor, lender or trader

(Potential) involvement in cum-ex as custodian / depository bank (which issued tax certificates), as financial, legal or tax advisor.

Your organization had no direct/indirect involvement in cum-ex, but some of your clients are implicated.

New requirements / obligations for all financial institutions.

Does your organisation have adequate and up to date AML systems and controls in place?

Enterprise wide risk assessments

Product risk assessment / Product lifecycle

Robust approach to KYC / CDD / EDD

Policies and Procedures

Ongoing Monitoring including robust approach to TM



# Q&A

# Thank You

# Contact

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