



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

22nd Floor
20 Queen Street West
Toronto ON M5H 3S8

22^e étage
20, rue queen ouest
Toronto ON M5H 3S8

**IN THE MATTER OF
ROYAL BANK OF CANADA**

STATEMENT OF ALLEGATIONS

(Subsection 127(1) and Section 127.1
of the *Securities Act*, RSO 1990, c. S.5)

A. OVERVIEW

1. The foreign exchange (“FX”) markets are among the largest and most liquid markets in the world.¹ Their integrity is of central importance to the broader capital markets, including the Ontario capital markets. Over a period of at least three years, from 2011 to 2013 (the “Material Time”), Royal Bank of Canada (“RBC”) failed to have sufficient supervision and controls in its FX trading business. Additionally, despite actions taken by RBC in November 2013 to impose a ban on multi-dealer chatrooms, as described below certain compliance monitoring issues continued into 2015. RBC did not sufficiently promote a culture of compliance in the FX trading business, which allowed FX traders to behave in a manner which put RBC’s economic interests ahead of the interests of its customers, other market participants and the integrity of the capital markets. Failures of this nature put customers at risk of harm and undermine market integrity. RBC’s failures in this regard were contrary to the public interest.

2. RBC’s failure to have sufficient supervision and controls in its FX trading business allowed the inappropriate sharing of confidential customer information by RBC FX traders with FX traders at other competitor firms on a regular basis. Staff (“Staff”) of the Ontario Securities Commission (the “Commission”) have identified many hundreds of prohibited disclosures

¹ The daily average volume turnover of the global FX market was over USD 5 trillion in April 2013 according to the Bank for International Settlements (BIS) Triennial Central Bank Survey 2013.

throughout 2011-2013. In many of the prohibited disclosures, confidential customer information was shared by RBC FX traders with other participants in the chatroom. In other instances, the prohibited disclosures came from a chatroom participant from another institution which allowed the RBC FX traders to gain a potential advantage in the market and over traders at other firms who did not have access to this information.² The disclosures included detailed information about the customer orders such as trade sizes, timing, price, or stop-loss levels.

3. RBC appeared to rely primarily on its front office³ FX trading supervisors and their delegates, who were responsible for the first line of defence, to identify, assess and manage risks concerning the disclosure of confidential customer information. The front office failed to adequately discharge these responsibilities with regard to obvious risks associated with confidentiality and conflicts of interest. These failings occurred in circumstances where some of those responsible for managing front office matters were aware of and/or at times involved in the inappropriate disclosures described herein. They also occurred even though a Managing Director in RBC's FX trading business, RBC Managing Director A, was aware of confidentiality risks arising from the use of electronic chatrooms as early as April 2012.

4. Staff expect firms trading in FX to identify, assess and manage appropriately the risks of non-compliance with the *Securities Act*⁴ (the "Act") and risks to the integrity of the capital markets. Staff also expect firms to promote a culture of compliance where their personnel adhere to high ethical standards and ensure their behaviour does not put customers and the integrity of the capital markets at risk. Firms must be vigilant about detecting, thwarting and addressing potential market abuse activities, including behaviours where market participants use their position to gain an inappropriate advantage over other market participants.

5. Given that the markets for FX transactions are interconnected as spot transactions are part of the basis upon which the value of FX forwards, swaps and options are determined, and given the importance of the FX markets and their impact on the broader capital markets, it is vital to

² Although Staff is not alleging specific violations as described below, or suggesting that there is evidence of such misconduct, it is helpful to describe generally the types of misconduct that gives rise to market integrity issues. For the purpose of providing guidance to market participants, types of misconduct could include front running, trading ahead, proprietary position, or triggering stops.

³ Front Office means RBC's FX Trading Desk.

⁴ RSO 1990, c S.5.

fostering confidence in the capital markets that market participants like RBC ensure honest and responsible conduct by its employees in the FX trading business.

B. FACTS

Staff of the Enforcement Branch of the Commission (“**Enforcement Staff**”) make the following allegations of fact:

(1) Background

6. RBC is a Schedule 1 Bank under the *Bank Act* (Canada).⁵ During the Material Time, and at present, RBC Capital Markets, a division of RBC, engaged in the purchase and sale of foreign currencies with customers and for itself (“FX Trading”), as defined below. RBC Capital Markets did not engage in trading on behalf of or with retail customers.

7. In the Material Time, RBC's FX business was based primarily in Toronto and London (U.K.). For some of the Material Time, RBC also had trading or sales desks in New York, Hong Kong and Sydney. In the Material Time, RBC took positions in spot transactions, forwards, swaps and over-the-counter-options.

8. During the Material Time, RBC primarily participated in the above FX transactions with customers and for RBC's own account (“proprietary trading”). Making profitable trades could be dependent on correctly assessing the direction of the market for various currency pairs.

9. The FX markets are primarily over-the-counter markets. Accordingly, a bank's profitability and ability to manage business risk in its FX Trading business was dependent on the quality of information its traders possessed. Individual traders sought to understand macroeconomic factors affecting currency rates. There was also an advantage to knowing “market flow” including which institutions were buying or selling which currencies in significant amounts and details of those trades.

10. Exchanging “market colour” including economic analysis relating to the movement of currencies was acceptable. However, during the Material Time, traders inappropriately sought

⁵ SC 1991, c. 46.

and disclosed specific transaction details, to gain an advantage in the market, which led to the chatroom misconduct described below.

11. The frequent flow of information between traders of different firms using various communication platforms increases the risk of traders sharing confidential information. It is therefore particularly important that financial institutions exercise sufficient control and monitoring of such communications.

(2) Chatroom Misconduct

12. It was common practice during most of the Material Time for FX traders at firms to use electronic messaging services, such as chatrooms on Bloomberg, to communicate with FX traders at other firms. While the use of such communication tools is not in itself inappropriate, the frequent and significant flow of information between traders at different firms increased the potential risk of traders engaging in improper activity, including, amongst other things, the sharing of confidential customer information.

13. RBC FX traders were involved in several large chatrooms involving FX traders from other international banks (“Multi-Dealer Chatrooms”) in addition to bi-lateral chats. Staff have identified many hundreds of prohibited disclosures throughout 2011-2013.

14. Membership in some of these chatrooms was on an invite only basis and based on members willingness to contribute to the chat.

15. Participation in chatrooms with traders from other firms had a profit motive. Traders sought an advantage to make more profitable trades on behalf of their bank, which in turn would benefit the trader through performance incentives. For example, in response to another trader’s comment “*mate the only reason you’re up this year is cause of my info*”, an RBC trader, RBC Trader B, stated: “*i agree ur tips hav been hot this year.*”

16. RBC had a number of policies and procedures in place during the Material Time that applied to FX Trading. The disclosure of confidential customer information to other traders and third parties was contrary to RBC’s policies and accepted industry standards.

17. During the Material Time, certain RBC FX traders regularly provided confidential information to, and received confidential information from, the traders of other financial institutions, including in respect of the existence of customer stop loss orders. This sharing of confidential information occurred in Multi-Dealer Chatrooms and in bi-lateral chats.

18. All RBC traders understood that the sharing of specific customer names was unequivocally prohibited. While traders were encouraged to seek and use “market flow” and “market colour” in the course of their trading, there was no clear indication as to what, aside from customer names, was impermissible and what was permitted. Consequently, confidential information including specific transaction details was disclosed by RBC traders to individuals at other institutions. The disclosure of such information in some instances was a breach of confidentiality and created the potential risk that this information could be used for the trader’s benefit and to the customer’s detriment.

19. The following is an RBC trader receiving information about a customer stop loss order from a trader at another firm in a Multi-Dealer Chatroom:

Bank A Trader: I have decent stop below 20 eur fyi

Bank B Trader: ta

RBC Trader B: a weak one or one that been there a while

Bank A Trader: very fresh

RBC Trader B: just sitting there ready to be popped

...

RBC Trader B: ill let my 24 bid ride a few pips then⁶

20. The sharing of confidential information was a two-way street. For example, on January 10, 2013, RBC Trader B inappropriately disclosed information about a “huge” option that was expiring the next day:

RBC Trader B: between u s

RBC Trader B: there is huge 13240 tom exp

⁶ In this chat, RBC Trader B has received confidential information about Bank A Trader’s stop and RBC Trader B appears to be using this information to inform his market strategy to make a profit. This behaviour could undermine market integrity because RBC Trader B appears to be using confidential information to gain an advantage over the rest of the market.

Bank A Salesperson: ok

Bank A Trader: ta

21. Despite the request from RBC Trader B to keep the information “between us”, the Bank A Salesperson shared the information he received about the “huge” option expiring with customers the following morning.
22. This illustrates that once information is shared, the risk created is impossible to control as it can be further disclosed to a potentially unlimited chain of recipients.
23. The exchange of information by FX traders was permitted by RBC supervisors and understood by FX traders to be part of their job. However, RBC failed to sufficiently control what information traders were exchanging.
24. RBC’s disclosures of confidential customer information put the customers at risk of economic loss. The behaviour also undermined market integrity.
25. There is no evidence or indication that RBC was involved in any plan or collusion to attempt to manipulate the WM/Reuters benchmark or any other benchmark rate.

(3) RBC did not have a sufficient system of controls and supervision in place in relation to its FX Trading business during the Material Time

26. During the Material Time, RBC did not have a sufficient system of controls and supervision over its global FX Trading business concerning the disclosure of confidential customer information.
27. RBC operated a “three lines of defence” model to manage risk of FX Trading during the Material Time. RBC’s front office (the first line of defence) had primary responsibility for identification of conduct risks and they were expected to escalate concerns to Compliance or a supervisor. In addition, the front office and Compliance functions participated in risk assessments, which could also result in escalation of issues for further review by Compliance or Risk (the second line of defence) or Internal Audit (the third line of defence).
28. During the Material Time, there were deficiencies in the first and second lines of defence as outlined below:

- a) In 2011, RBC's Capital Markets Compliance Canada appeared to recognize the risk that the FX Trading business posed to customers and RBC from a regulatory perspective (insider dealing/market abuse) and market integrity. On October 18, 2011, a "Compliance Bulletin - Foreign Exchange Markets" was prepared by RBC's Capital Markets Compliance Canada that alerted employees to these risks and required, among other things, compliance with the ACI Model Code. The ACI Model Code provided specific guidance on the prohibited nature of disclosing confidential information. However, this appears to have been a Canada-only initiative and it does not appear that the message was effectively implemented. Consequently, the global head of the business was not advised of the bulletin or provided with a copy and the ACI Model Code was not reflected in policies and procedures.
- b) RBC's policies and procedures during the Material Time did not provide sufficient guidance to FX traders. While, as noted above, the policies prohibited disclosing confidential customer information, they were high-level in nature and applied to RBC or RBC Capital Markets as a whole. The policies did not specifically address the use of chatrooms or the practical issues FX traders faced daily. For instance, the policies did not provide sufficient guidance on the differences between sharing confidential information, which was prohibited, and sharing acceptable "market colour".
- c) During the Material Time, RBC appeared to rely primarily on its front office FX Trading supervisors and their delegates, who were responsible for the first line of defence, to identify, assess and manage risks concerning the disclosure of confidential customer information. The front office did not effectively do so. FX traders were not provided with sufficient guidance on what was or was not acceptable in chatrooms. The front office did not effectively supervise chatroom discussions. Even heads of regional desks, who were supposed to be supervising conduct, participated in the disclosure of confidential customer information in chatrooms.
- d) Compliance, the second line of defence, failed to sufficiently address the risk posed by the chatrooms. For example, while correctly identifying the risk in October 2011, it failed to ensure the guidance was distributed and to coordinate training in conjunction with other

departments. For much of the Material Time, Compliance's role in monitoring the FX Trading business was primarily focused on developing FX trade surveillance and performing electronic communications surveillance—the limitations of which are noted below.

- e) Although there was widespread media and regulatory attention since the middle of 2012 concerning the risks associated with the use of chatrooms, RBC did not formally prohibit multi-dealer chats until March 2014 (with a FX-specific chat ban being implemented in October/November 2013) despite:
- i. RBC Managing Director A being aware of Bloomberg-related FX issues as early as April 2012; and
 - ii. FX traders and heads of desk discussing potential chatroom shutdowns as early as August 2012.

In a chat dated April 24, 2012, RBC Managing Director A advised a head of desk, RBC Trader C:

RBC Managing Director A: hihi

RBC Trader C: Hi mate

RBC Managing Director A: Lets be careful about chats discussing fixing orders that we have with other banks BOE made special mention of these at our meeting yesterday

RBC Trader C: understood

RBC Trader C: To be honest we see so few I think we should be out of the focus by will make good note

RBC Managing Director A: well less and less clients wanting to execute for that time as they feel its manipulated

RBC Managing Director A: where's there's smoke there['s] fire

While the subject of chatrooms was specifically discussed at an FX operating committee meeting in September 2012, RBC's FX front office decided against banning or restricting chatrooms. Some banks, however, did prohibit Multi-Dealer Chatrooms. These prohibitions were discussed in chatrooms involving RBC FX employees in August 2012 and April 2013. RBC Managing Director A eventually banned chatrooms in the FX

business globally, but this was only in October/November 2013—more than a year after specifically contemplating and rejecting any action on chatrooms.

- f) As a regular monitoring, supervision or control practice, Compliance relied in part on an inadequate electronic-communications “e-comms” (including email and other messaging platforms) review based on lexicon “hotword” lists and random sampling.

29. A market participant that identifies a problem in respect of its systems of internal control or any other inappropriate activity that has affected (or may affect) investors or compromises the integrity of Ontario’s capital markets, should promptly and fully self-report. RBC failed to establish a sufficient compliance system to monitor its FX Trading business. As such, the lack of sufficient controls meant that misconduct went undetected, and RBC was unable to remediate, self-report and escalate concerns.

30. There was insufficient training and guidance during the Material Time on how RBC’s general policies on confidentiality should be applied specifically to the FX Trading business. The general, high-level training that was provided did not provide sufficient guidance to FX traders about FX compliance issues, including how the Code of Conduct applies to their trading behaviour.

31. In chats, FX traders expressed concerns about the sufficiency of guidance from Compliance. Perhaps because of the lack of guidance from both the front office and Compliance, it appears that traders relied on those around them. However, some of those individuals were engaged in problematic conduct themselves.

32. The insufficient training and guidance about the application of general policies to the FX Trading business increased the risk that confidential customer information could be disclosed.

C. CONDUCT CONTRARY TO THE PUBLIC INTEREST

Enforcement Staff alleges that the following conduct was contrary to the public interest:

- 33. During the Material Time, RBC:

- a) Shared confidential customer information with FX traders at other firms in electronic chatrooms; and
- b) Failed to establish and maintain an adequate compliance system that addressed inappropriate information sharing and thus provided reasonable assurance that RBC:
 - (i) complied with securities legislation, and in particular the market manipulation and fraud prohibitions in the Act; and
 - (ii) did not undermine confidence in the integrity of the FX markets.

34. As a result, RBC failed to meet the high standards of conduct expected of a market participant, which potentially put its customers at risk.

D. ORDER SOUGHT

35. Enforcement Staff request that the Commission make an order pursuant to subsection 127(1) and section 127.1 of the Act to approve the settlement agreement dated August 23, 2019 between RBC and Enforcement Staff.

36. Staff reserve the right to amend these allegations and to make such further and other allegations as Staff deems fit and the Commission may permit.

DATED this 26th day of August 2019.

ONTARIO SECURITIES COMMISSION
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Cullen Price
cprice@osc.gov.on.ca
Tel: 416-204-8959

Alexandra Matushenko
amatushenko@osc.gov.on.ca
Tel: 416-597-8287

Kai Olson

kolson@osc.gov.on.ca

Tel: 416-597-7242

Ryan Lapensee

rlapensee@osc.gov.on.ca

Tel: 416-579-7218

Staff of the Enforcement Branch