



“Cum-Ex” trades – implications for financial institutions in the UK

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On 18 March 2020, following its interim ruling that Cum-Ex trading was per se illegal, a German court found two former London-based investment bankers guilty of tax evasion offences in the first criminal trial related to Cum-Ex trades in a landmark ruling which could lead to hundreds more cases. As a consequence of their cooperation with the prosecutors, which included providing detailed information regarding the transactions under consideration, the defendants received suspended sentences totalling 34 months with a requirement to repay several million Euros of benefit from the Cum-Ex transactions. This should not be seen as the likely sentence for those who do not co-operate with prosecutors and we would anticipate a higher sentence being imposed in the UK.

Because the complex practice required the interplay of many characters, the case led to a closer examination of the wider industry. Both defendants provided significant assistance, which helped identify crucial details of the strategy.

The court also made a ruling against the main lender involved in providing liquidity to the Cum-Ex trades, MM Warburg Group, which was ordered to repay €176m, which was the profit the lender made from deals.

Surprisingly, given that much of the trading occurred in London, there has been little UK media coverage of the trial.

What is a Cum-Ex trade?

Cum-Ex transactions involve multiple reclaims for a single payment of dividend withholding tax. In certain European countries, most notably Germany, withholding tax certificates for tax deducted at source on share dividend payments were issued by either the company paying the dividend or the bank in which the shares were deposited. The withholding tax certificates could be used to offset an income tax liability.

Shortly before the dividend was issued, the shares would be traded rapidly and deposited into multiple banks obscuring the identity of the true owner; the buyer or the seller. The dividend would be issued, less the withholding tax, which, due to confusion around the ownership of the shares, would create uncertainty as to which person would be considered to have “paid” the withholding tax. The result being withholding tax certificates would be issued to multiple persons in respect of a single dividend.

The overall tax loss has been estimated to be in the region of €55bn, with Germany being the hardest hit.

What are the implications for individuals and financial institutions in the UK?

Although the UK tax authorities have not been impacted by Cum-Ex transactions (the UK does not impose a dividend withholding tax), many financial institutions in London were engaged in tax-related equities trading at the relevant time. Some financial institutions will have been involved in ancillary transactions, for example, providing liquidity or hedging for transactions.

It is perhaps not surprising therefore that a number of UK financial institutions are being investigated by European tax authorities and further prosecutions are likely. German prosecutors have stated that they will pursue around 400 more suspects arising out of 56 investigations.

In addition to European tax authorities conducting investigations, the FCA has confirmed that it is carrying out investigations. In February 2020, Mark Steward, the FCA’s Director of Enforcement and Market Oversight, confirmed that in the FCA’s view, Cum-Ex trading was abusive and the FCA was working closely with European authorities

who were investigating dividend stripping tax avoidance schemes. Mr Steward also confirmed that the FCA has been investigating suspected abusive share trading in London's markets that have allegedly supported these transactions and these investigations are close to conclusion and decisions about action are imminent¹.

What action should you take?

If you were involved in European dividend arbitrage in the period up to 2012, you may become the subject of investigation and you should consider whether it is appropriate to:

- begin interrogating your internal records to ensure that material which could demonstrate that you were not

involved in any dishonest wrong-doing is retained and is readily accessible (some data retention policies can result in records being archived or deleted)

- conduct a comprehensive internal investigation (conducted with the assistance of legal counsel to ensure that any enquiries made are properly protected by privilege)
- make a Suspicious Activity Report for money laundering suspicions to the NCA, or report trading related matters to the FCA
- strengthen compliance policies/procedures (this is likely to only become evident following an internal investigation).

Any UK financial institution and its senior personnel who were involved in Cum-Ex trading during the relevant period would be well advised to take all necessary steps to protect their interests, both in respect of any potential proceedings in Europe, but also in respect of potential intervention in the UK.

Notes

- <https://www.fca.org.uk/news/speeches/market-integrity-and-strategic-approach>, Practising Law Institute's 19th Annual Institute on Securities Regulation in Europe, London 6 February 2020.

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