Scotiabank (TSX:BNS): Fined $127.5 Million for Price Fixing

Description

Canadian banks are preparing for a rise in credit impairments through 2021. However, one of the Big Five banks received a black eye recently and is paying US$127.5 million in fines. The U.S. Department of Justice (DOJ) and the Commodity Futures Trading Commission (CFTC) charged the bank with market manipulation.

Spoofing activities

Traders in **Bank of Nova Scotia's** (TSX:BNS)(NYSE:BNS) metal trading division were found guilty of performing "spoofing" activities between January 2008 and July 2016. U.S. authorities said four Scotiabank traders placed orders to buy and sell precious metals contracts. However, the intent was to cancel the same orders to manipulate the price.

Spoofing creates a false perception of the supply and demand picture surrounding a commodity. When traders engage in the activity, the purpose is to manipulate or rig metals futures prices to their advantage. Scotiabank was fined US$800,000 for metals spoofing from June 2013 through June 2016.

The CFTC claims the bank made numerous misleading or outright false statements when answering material questions. According to the U.S. DOJ, the involved traders were based in Hong Kong, London, and New York.

Settlement

Scotiabank has agreed to a deferred prosecution agreement (DPA) to settle the criminal investigations into a price manipulation scheme. The bank will pay US$127.5 million to the DOJ and CFTC for failing to detect or prevent its four traders from doing unlawful trading practices.

The total fine includes the US$17 million payment to the CFTC for misleading the regulator during its initial investigation. Henceforth, Scotiabank has to retain the U.S. authorities for three years on orders of the U.S. authorities. It also agreed to continue cooperating in any ongoing investigations and prosecutions related to the underlying misconduct.

Earlier this year, Scotiabank disclosed plans to wind down the metals' division and has allocated US$176 million to cover the wind-down costs and payment for any penalties to U.S. authorities.

Compliance failure

In New York, FBI Assistant Director-in-Charge William F. Sweeney Jr. said Scotiabank has admitted to their role in a massive price manipulation scheme. The bank's traders sought to falsely manufacture the prices of precious metals futures contracts to gain market advantage over other traders.

Because it failed to detect the phantom orders or illegal manipulation of the market, Scotiabank made significant investments in compliance technology and trade-surveillance tools. Aside from almost doubling the annual compliance operating budget, the bank hired more than 200 full-time equivalent compliance positions.

Bank performance

Scotiabank reported a 1% revenue rise in the quarter ended July 31, 2020, albeit with a corresponding 47% drop in adjusted net income versus the same period in 2019. Strong capital and profitability ratios are compensating for the escalating credit loss provisions.

The commodities price manipulation offense could have far-reaching effects on Canada's third-largest bank's image and reputation. It's a Dividend Aristocrat with an outstanding 188-year dividend history. The bank stock is losing 19.6% year to date. For would-be investors, at the current price of $56.37 at writing, the yield is a high 6.34%.

In a statement, management said it would adhere to trading-related regulatory requirements and compliance policies to maintain its stakeholders' trust.

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