

MARKET ABUSE SYSTEMS AND CONTROLS MUST GO BEYOND MAR

On 27 March the UK Financial Conduct Authority ("FCA") published draft amendments to its Financial Crime Guide making clear that systems and controls relating to market abuse need to go beyond the requirements of the Market Abuse Regulation ("MAR"). Authorised firms must ensure that their systems and controls are sufficient to counter market abuse, not just to detect and report it. The FCA emphasises the need for senior management understanding of the law relating to market abuse and the ways in which it may occur.

BACKGROUND

The FCA rules relating to Senior Management Arrangements, Systems and Controls ("SYSC") include rules relating to financial crime. SYSC 6.1.1R requires firms to have systems and controls for countering the risk that the firm might be used to further financial crime.

In the past both the FCA and firms have tended to treat SYSC 6.1.1 as applicable to money laundering.

Financial crime for these purposes, however, does not just mean money laundering, it includes any offence involving (i) fraud or dishonesty; (ii) misconduct in, or misuse of information relating to, a financial market, (iii) handling the proceeds of crime; or (iv) the financial of terrorism (section 1H Financial Services and Markets Act 2000 ("FSMA")). It therefore includes criminal market manipulation and insider dealing.

In recent months the FCA has sought to emphasise in public statements the breadth of the definition of financial crime. Now, in GC 18/1, the FCA is consulting on a proposed new chapter for the Financial Crime Guide addressing how the obligations in SYSC 6.1.1R apply to market abuse.

In the consultation the FCA explains:

there is a key distinction between the obligations under Article 16(2) of MAR and the requirements in SYSC 6.1.1R. Article 16(2) of MAR requires firms to detect and report potential market abuse, whereas SYSC 6.1.1R extends firms' obligations to counter the risk of financial crime.

Accordingly, in the FCA's view it is not sufficient for firms to have systems and controls for detecting and reporting market abuse as required under the Market Abuse Regulation ("MAR"). Systems and controls must also address how the firm will prevent and/or reduce the risk of market abuse.

Key issues

- SYSC 6.1.1 requires firms to have systems and controls to counter the risk of financial crime.
- Financial crime in this context includes criminal market abuse.
- In the FCA's view SYSC 6 requirements are more onerous than those under MAR as SYSC 6 requires firms to prevent market abuse, not just to detect and report it.
- Compliance with SYSC 6.1.1 requires focus on pre-trade controls and high risk clients.
- FCA emphasises the need for senior management understanding of criminal market abuse law and risks.

DRAFT GUIDANCE

The draft guidance explains that appropriate measures for the prevention of market abuse are likely to fall into two distinct categories:

- (1) the identification and prevention of attempted financial crime pre-trade, and
- (2) the mitigation of future risks posed by clients who have been identified as having already traded suspiciously.

Firms must also ensure appropriate interaction between systems and controls for preventing market abuse and systems and controls for preventing money laundering, including by considering making suspicious activity reports ("SARs") to the National Crime Agency where market abuse is suspected.

The draft guidance sets out examples of good and bad practices under the heads of (i) governance; (ii) risk assessment; (iii) policies and procedures and (iv) ongoing monitoring, to which firms should have careful regard.

The guidance focuses heavily on senior management awareness and involvement, in particular under governance, and includes the following noteworthy self-assessment questions:

- Does the firm's senior management team understand the legal definitions of insider dealing and market manipulation, and the ways in which the firm may be exposed to the risk of these crimes?
- Does the firm's senior management team regularly receive management information in relation to suspected insider dealing or market manipulation?
- How does senior management make sure that the firm's systems and controls for detecting insider dealing and market manipulation are robust? How do they set the tone from the top?
- How does the firm's MLRO interact with the individual/departments responsible for order and trade surveillance/monitoring?
- How does senior management make decisions in relation to concerns about potential financial crime raised to them by Compliance? Do they act appropriately to mitigate these risks? How does senior management make sure that its employees have the appropriate training to identify potential insider dealing and market manipulation?
- Do front office staff understand how insider dealing and market manipulation might be committed through the firm, to escalate potentially suspicious activity when appropriate, and challenge client orders if they believe the activity will amount to financial crime? Does the firm have effective whistleblowing arrangements in place to support appropriate financial crime detection and reporting?

Whilst SYSC 6.1.1 applies only to criminal market abuse, the FCA states that firms may wish to treat it as applicable to civil market abuse given the overlap between the two regimes.

ANALYSIS

In the past both the FCA and firms have tended to focus on the application of SYSC 6 to money laundering rather than market abuse. The FCA now intends to broaden the way it applies SYSC 6 through a close reading of the definition of financial crime. This is in keeping with the FCA's stated intention to use the

full range of powers available to it under FSMA and the Handbook, and to focus on combatting money laundering and market abuse.

Firms will already seek to comply with many of the examples of good practice set out in the draft guidance as part of compliance with MAR and the High Level Principles. However, in reviewing the draft guidance firms should consider, in particular, whether existing systems do enough to address the FCA's focus on (i) pre-trade controls; (ii) treatment of high risk customers; (iii) SAR reporting (in addition to STOR reporting); and (iv) senior management understanding and awareness.

As to senior management, the self-assessment questions are likely to give some indication of the FCA's expectation of what will constitute "reasonable steps" for senior management function holders with responsibility for compliance with SYSC 6. In this regard it is clear that the FCA expects senior management to have a good understanding of the relevant law.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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