

Managing market abuse in the new norm

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Speakers



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Market Abuse top of FCA agenda

- Enforcement cases on market manipulation
- Significant increase in FCA's requests for information on systems and controls framework
- Market Watch publications:
 - **MW63** - controls around working from home arrangements
 - **MW66** - recording obligations under SYCS Rules
 - **MW67** - importance of correct transaction reporting and STOR submission

POLL

Adrian Geoffrey Horn – wash trading

- Horn – an experienced market maker and ex-broker – executed 129 wash trades in McKay shares in the LSE to ensure that a minimum volume of 13,000 were traded each day
- Horn thought that by helping McKay to remain in the FTSE All Share Index he would benefit the relationship between his employer Stifel Nicolaus Europe Limited and its client, McKay
- Orders were split between a third-party broker via a Smart Order Router (SOR) and his own company direct access system to the LSE
- FCA fined Horn £52,500 for market abuse and prohibited him from performing any functions in relation to regulated activity

Adrian Geoffrey Horn – key lessons

- Motivation for market misconduct can be wider, or more difficult to discern, than just direct personal financial gain
- Relatively simple abusive strategies can be executed in a complex manner eg. use of smart order routing, mixture of execution methodologies



Corrado Abbatista – spoofing

- Abbatista – formerly CIO at dissolved Fenician Capital Management LLP – fined by FCA for spoofing in CFDs and prohibited from performing functions related to regulated activity.
- Most CFD orders placed through a Direct Market Access system to replicate orders placed to buy or sell the security itself. Some orders also placed by phone to brokers
- Spoofing behaviour was initially identified through FCA's in house surveillance system

Corrado Abbatista – key lessons

- Sophistication of FCA's detection mechanisms increasing – transaction reporting data being actively used
- Link between derivatives and the securities they reference can be exploited. Risk has often been downplayed or overlooked by firms



TFS-ICAP – printing

- TFS-ICAP – major interdealer broker – fined £3.44m for printing behaviour carried out by staff in the FX Options broking desk occurring openly over a prolonged period
- Printing is the disclosure of fictitious trades to the market to entice other participants to transact, often at an artificial price level
- Deficiencies also identified in oversight and compliance monitoring.
- Warning signs overlooked by senior management

TFS-ICAP – key lessons

- **Culture** – desk heads were aware of the behaviour, and reportedly engaged themselves
- **Remuneration** – staff were remunerated based on volumes – incentivising printing behaviour
- **Governance** – Board met only once a year, did not discuss compliance
- **Compliance** – no pro-active monitoring plan, seen as ‘tick-box’



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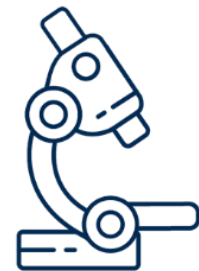
FCA supervisory focus

Large number of visits in last 18 months

- Firms primarily wealth managers and brokers, small number of proprietary traders
- Focus on market abuse risk assessment and surveillance system calibration

Consequences can be significant:

- Time consuming follow up questions and discussions
- Independent 'skilled person' review often over £100k
- Fines or regulatory censure
(eg. Interactive Brokers >£1m, Tullet Prebon £15.4m)



FCA supervisory focus – systems and controls

Market abuse risk assessment (MARA)

- Design is not comprehensive
eg. mapping of prohibitions, consideration of inherent risk
- Little or no input from front office
- Poor description of how risks may occur
(eg. relating to products offered, type of clients, or from PA deals)
- Mapping of controls is too generic

FCA supervisory focus – systems and controls

Policies and procedures

- Generic – not tailored to the business
- Not providing clear steps on how to investigate and manage cases
- No clear escalation of STOR policies
- No consideration of prevention obligations under the financial crime guide



First line of defence obligations

- Front office lack knowledge and understanding of prevention and detection obligations
- Training does not emphasise front office obligations

FCA supervisory focus – systems and controls

Surveillance arrangements

- Using generic off-the-shelf systems
- Not assessing if system is adequate for firms needs
- Calibration and effectiveness reviews not carried out regularly
- No communication surveillance policy or assessment of gaps in controls with the introduction of new technologies or working from home arrangements

Governance and culture

- Little involvement of senior management in establishment/on-going assessment of controls framework
- None or inadequate quality of MI received by senior management

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Market Watch – controls during Covid

Assess whether controls are as effective as in an office environment and compliant with SYSC rules.

Market Watch 63

- **Review MARA** to identify new and emerging risk in Covid
- **Review procedures** around market soundings; controls for working from home
- **Review IT controls** – access to files on ‘need to know basis’
- **Training** – repeat training to include risk from work arrangements and PA dealing
- **Review PA dealing framework** – ensure policies mitigate potential abuse and pre- and post controls are in place
- **Review surveillance arrangements** – market may react differently; systems may need re-assessing

Market Watch – controls during Covid

Market Watch 66

- **Assess control gaps and ways to mitigate risks** – in-scope activities should be carried out in recorded auditable devices
- **Update policies and procedures around recording of information and PA dealing** – to include consequences for breaching the policies
- **Provide training** – not only covering market abuse prohibitions but when new or amended policies introduced or new technologies are used
- **Set out adequate governance arrangements** – clear framework for approval and use of new technology and any fulfilment of the recording obligations
- **Embed the right culture** – setting the example and promoting the right message from the top

Market Watch – FCA's inhouse surveillance

Market watch 67

- Overview of FCA's in-house surveillance capabilities
- Reiterates importance of transaction reporting and STORs in surveillance process
- Use of different routes to enforcement outcomes to tackle market abuse
- Intention to share more case studies including non-enforcement ones



Staying up to date with FCA expectations

- ✓ Regularly review effectiveness of your control framework (MARA, policies, procedures, surveillance arrangements, etc)
- ✓ Ensure 1st line understand obligations and are proactively escalating suspicious activity
- ✓ Ensure you can evidence that control framework is effective (MI, STORs, Record keeping, audit trail, etc.)
- ✓ Seek appropriate expertise where necessary
- ✓ Keep a close eye on FCA publications, speeches, and enforcement decisions

Questions



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