

# Regulatory Update

July 2008



“Get in touch with your MMS RSL consultant to find out how they can help.”

## Market Abuse

As we all know the FSA is placing increasing emphasis on the detection and prevention of Market Abuse and has recently outlined its strategy and key objectives for tackling Market Abuse in a series of speeches and newsletters.

They concluded a series of visits to hedge fund managers (HFMs) in 2007 commenting “some HFMs had a high level of awareness and appropriate controls in place, whilst others were less aware, had fewer controls and demonstrated a complacent attitude to risks”. Their most recent pronouncements include a commitment that “in 2008 our objective is to build on this work, particularly to follow up the initiatives in relation to public takeovers and hedge funds...the main purpose of which is to lead to a strengthening of anti market abuse systems and controls across a wide range of firms.”

Where on the spectrum does your firm sit?

### → Effective systems and controls

As part of their market abuse prevention strategy, the FSA is promoting effective anti-market abuse systems and controls, including training and managing conflicts of interests. The FSA's Market Conduct teams identify current or emerging risk areas and assess all aspects of the market using various methods, and they work with market participants to identify both weaknesses and best practices to enhance their controls.

**How effective are your conflicts controls and training programmes?**

### → Senior management responsibility

The FSA expects firms' senior management to take responsibility for ensuring that they identify the risks and develop appropriate systems and controls to manage those risks. In particular, the FSA addresses the need for conflicts of interests to be properly managed and the need for firms' senior management to report any suspected misconduct by staff to the FSA. In recognition of these efforts, the FSA has given the commitment that, if senior management of firms meet their control expectations, action will not be taken against senior management but only against the individual(s) within the firm who commit Market Abuse. However, if the FSA also believes that a firm is not meeting its standards in maintaining satisfactory systems and controls for the prevention of market abuse, enforcement action will be sought against the firm even if has not necessarily committed market abuse itself.

**Are you as senior managers safe?**

### → Suspicious transaction reports

The FSA expects proactive reporting of suspicious transactions, whether concerning employees, clients or other market participants. The FSA has received over 700 such reports in almost 3 years, mainly in relation to equities, and is encouraging firms to consider all relevant markets and instruments (grey market, OTC (including spread betting) and exchange traded derivatives).

**Do you know how and what to report?**

### → Trade monitoring

Trade monitoring by the FSA continues to have a significant part to play in identifying unusual activity, particularly in relation to M&A, where the FSA has identified an unacceptably high level of price movements ahead of announcements. Moreover, the FSA has observed “very high numbers of insiders” in relation to M&A deals, which increases the potential for leaks. Firms need to train staff to identify and report when they are “inside” and implement appropriate controls and respond accordingly.

**Who maintains your insiders list and are they of sufficient seniority to protect your firm?**

## → SABRE II

The FSA continues to develop its SABRE II system used for detecting and analysing possible insider dealing and market abuse. Further enhancements are planned for 2009.

### Are you keeping up with these extra intrusions?

## → Market rumours

The FSA has made widely publicised statements that it is investigating recent events surrounding share price movements in selected banking shares with regard to the dissemination of false and misleading information. Training is an important control in this area to ensure staff are aware that knowingly disseminating rumours can lead to prosecution. Related concerns include talking to third parties and the press.

### When did you last train your staff and how?

## → The FSA's Investigation powers

The FSA is seeking to add to its armoury of tools available to enable it to mount more effective investigations. The tools currently available include:

- > Interview and document requests
- > Access to bank information
- > Execution of search warrants
- > Obtain telecommunications data under the Regulation of Investigatory Powers Act 2000
- > Civil powers to restrain the proceeds of suspected market abuse

These tools are being supplemented in 3 key ways:

- i) The FSA is seeking to interview traders, under caution, by phone early on in investigations and have commented that they "would be disappointed if firms were to take steps that would get in the way of our ease of access to individuals in urgent enquiries". Firms will need to balance this with their own and their staff's best interests and their need to be certain of who they are talking to before discussing confidential information over the telephone. We recommend firms instruct staff to refer all such queries to their Compliance Officer in the first instance.

### How are you controlling these calls?

- ii) From March 2009 firms will have to record all telephone conversations and electronic communications in relation to client orders in the equity, bond and derivative markets and retain records for six months. While discretionary managers are exempt when dealing with sell side institutions who are required to keep such records, they will need to consider recording when dealing in overseas markets in which they are active.

### Are you planning for these changes?

- iii) The FSA is supplementing common law powers with statutory authority to grant immunity from prosecution to co-operative witnesses. Seeking a US style ability to offer immunity in order to turn those engaged in market abuse against each other and secure convictions. Potentially, this could significantly alter the balance of power in the favour of the regulator.

### How are you providing protection to you and the firm to ensure that disaffected people do not give the FSA unfounded reasons to investigate you?

## → Next steps

### MMS RSL is prepared and ready to help its clients meet the FSA's increased expectations in this area.

**We have developed market abuse procedures** designed for firms to use to assess their market abuse risk profile and tailor appropriate controls to meet their specific requirements. Many firms will contend that they have a low exposure to market abuse risks, but we recommend all firms take the opportunity now to revisit and reassess their risks and document their controls. This will demonstrate that senior management is proactively addressing this area of concern. This is an area where enhancements in control can pay long term dividends by minimising regulatory and reputational risks. Remember, where a firm can demonstrate effective controls, should an employee wilfully breach the firm's controls, it will be the employee and not the firm that faces prosecution.

**We can help by** performing an independent risk audit of these procedures by professionals.

**We also strongly recommend that** our clients perform regular market abuse awareness training. Many will have received training when employed at larger institutions but, given the FSA's focus and expectations; it would be an appropriate time to undertake refresher training in the current environment.

**Your MMS RSL consultant can** advise on the most suitable training available, and can provide training with emphasis on the more practical day to day experiences and not just the letter of the law.

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