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# Insider dealing and manipulation

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## What impact will the new chapter of the FCA's Financial Crime Guide have on your firm?

In March 2018, the Financial Conduct Authority (FCA) published a draft new chapter on insider dealing and market manipulation to its Financial Crime: a Guide for Firms (GC18/1) which is set to be published in final form in early October 2018. The draft guidance outlines the FCA's observations of good and bad market practice around a firm's requirements to detect, report and counter the risk that a firm is being used to facilitate financial crime as it relates to insider dealing and market manipulation. It is particularly relevant for firms who arrange or execute transactions in financial markets.

The draft guidance focuses on the criminal offences of insider dealing and market manipulation under the Criminal Justice Act 1993 and the Financial Services Act 2012, rather than the civil offences under the Market Abuse Regulation (MAR).

### So, what's new?

- **Governance:** Pertinent in the context of the FCA's Senior Managers and Certification Regime (SMR) is that senior management should take responsibility for understanding the risks posed by insider dealing and market manipulation and establish adequate policies and controls to counter those risks.
- **Risk assessment:** The FCA expects that a firm regularly reviews and assesses the risks posed by insider dealing and market manipulation in the same way as other financial crime risks through a risk assessment. This will include considering the ways in which insider dealing and market manipulation could occur across its products and services and what mitigation can be put in place. It expects, *inter alia,* the risk assessment to be aligned with AML risk assessments and to inform surveillance models.
- **Policies and procedures:** Policies and procedures should be up to date, reflecting legal and regulatory changes, addressing the specific risks to firms and be clearly communicated, embedded and applied within firms.
- **Ongoing monitoring:** Firms are already subject to the requirement to detect and report suspicious behaviour under MAR in the form of a suspicious transaction and order report (STOR). The draft guidance rightly reminds firms that they must consider their reporting obligations under POCA (i.e. filing suspicious activity reports (SAR)) where there is also a criminal offence: namely insider dealing, creating a misleading impression and making a misleading statement (the market and benchmark manipulation offences).
- **General:** it suggests that appropriate measures are likely to fall into two distinct categories: (i) the identification and prevention of attempted financial crime pre-trade (including refusing to execute a trade where there is a 'clear risk' it is in breach of law or regulation) and (ii) the mitigation of risk posed by a client who has already been identified as trading suspiciously.

### Analysis - Pre-trade prevention

In general, the Guidance contains few surprises and reflects financial crime best practice. However the suggestion that firms should be identifying and preventing financial crime pre-trade (and where a clear risk exists, refusing to execute a trade) is likely to cause concern for firms. Currently SYSC requires firms to establish controls to counter the risk that they may be used to facilitate financial crime. In fact, the Guidance makes several references to the word "prevent" rather than "counter the risk of" financial crime, which goes further than the regulation itself.

Whilst good on-boarding and risk classification controls should flag higher risk clients and new controls required under MIFID II may also prove useful in identifying some problematic behaviour, without a holistic view of a client's trading activity, even identifying financial crime pre-trade is not straightforward.

In addition, prevention is likely to prove extremely tricky in all but a few circumstances. In insider dealing, the trade is likely to occur just ahead of a price movement, normally caused by a public announcement. Until such point, it is difficult to see how one could prevent such trades occurring. In other cases, the lack of contact provided by direct market access platforms and the use of multiple brokers would mean it would be very difficult to spot suspicious trading activity before it happens.

In addition, trade surveillance and Anti-Money Laundering transaction monitoring models currently operate to alert post-event: pre-trade monitoring is almost impossible to achieve. Humans are still required to investigate those alerts which, when done properly, is time consuming. As such, firms may be left to ponder what pre-trade identification and prevention would look like in practice, and in particular what a clear risk looks like,  and whether it would require greater investment in resource and analytics to comply with the guidance.

### STOR v SAR: 1 for 1?

The FCA suggested in a speech towards the end of 2017 that where a firm had reasonable suspicion of insider dealing under MAR (and thus filed a STOR with the FCA), in almost all circumstances, this would equate to reasonable suspicion of the criminal offence of insider dealing. One may infer from this an expectation by the FCA that firms should be filing SARs under the Proceeds of Crime Act 2002 (POCA) on a one for one basis. The reality is more nuanced and complex and depends on a number of factors.

1. POCA obliges firms to report suspicions of money laundering, thus unexecuted orders or attempts to trade cannot be reported as no money laundering has taken place.

2. the threshold for suspicion is set down in case law and may differ slightly from the reasonable suspicion threshold under MAR for STOR reporting. In addition, the FCA has encouraged STOR reporting, whereas the NCA discourages defensive SAR reporting, which also may lead to a difference in expectation.

3. Third, a regulated entity is not required to file a SAR where the identity of the money launderer or the whereabouts of the criminal property is not known, which may well be the case where omnibus trading accounts are used and/or brokers are acting on behalf of one or more clients. This equally applies to exit procedures, e.g. multiple STORs or SARs in respect of a client who is a broker may be more to do with the client's own AML controls rather than evidence of its own criminality.

4. Finally, it depends on the quality of the STOR/SAR investigation process: whether the investigator has obtained as much information as possible and has the requisite markets experience to negate or crystallise the suspicion. Where separate teams investigate the STOR and SAR elements, differences in approach or quality may exacerbate this.

What is clear however is that firms should have robust investigation procedures in place which address both STOR and SAR reporting requirements. Where STORs and SARs are investigated separately, collaboration and clear hand-offs between the relevant teams are key. As ever, documenting the rationale not to file is as important as the STOR or SAR itself.

It will be interesting to see how the above is addressed in the final guidance which is due imminently. Firms should take this as an indication of the FCA's increased focus on tackling both the perpetrators and the facilitators (witting or unwitting) of these offences.

### What can you be doing right now?

Here at KPMG, our Financial Services Investigations team includes financial crime experts with a range of backgrounds in forensic accounting, trading and data analytics, as well as former Nominated Officers, to help strengthen your control framework and your investigation processes.  Our experience of working with regulators such as the FCA and regulated firms gives us insight into expectations and best practice.  For more information, please contact us on the details below.

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