MARKET ABUSE:

FCA TARGETS FIRMS' SURVEILLANCE FAILURES

Tackling market abuse is one of the Financial Conduct Authority's strategic priorities, and recent focus has been on firms' compliance failures. This article will consider the regulatory framework for market abuse offences and steps firms should take to reduce the risk.

What is market abuse?

Market abuse refers to intentional conduct that violates market integrity and market abuse offences can broadly be categorised as civil offences, or criminal offences.

Civil

In the civil context, firms regulated by the Financial Conduct Authority (**FCA**) that operate on the UK financial markets are subject to the Market Abuse Regulation (**UK MAR**) as amended by the Market Abuse Exit Regulations 2019, which sets out the regulatory framework on market abuse and 'aims to increase market integrity and investor protection, enhancing the attractiveness of securities markets for capital raising'.[1]

For breaches of UK MAR offences, the FCA has enforcement powers to impose unlimited fines, order injunctions, or impose prohibitions or suspensions on regulated firms or approved persons.

Criminal

Insider dealing and market manipulation can also constitute criminal offences, under Part V of the Criminal Justice Act 1993 and Sections 89-91 of the Financial Services Act 2012 respectively. Both these criminal offences can warrant a lengthy custodial sentence (see below).

Types of market abuse

The term market abuse encompasses prohibitions on different types of behaviour such as insider dealing[2], unlawful disclosure of inside information[3] and market manipulation[4]. Article 14 of MAR sets out the prohibition on insider dealing and unlawful disclosure of inside information, while Article 15 sets out the prohibition on market manipulation and attempted market manipulation.

More recently, the FCA has turned their attention to the commodities and securities markets and tackling the disruptive trading practices which can occur in this area, often referred to as 'spoofing'.

Spoofing is a type of disruptive trading which can occur in the commodities markets, where a trader will place a bid or offer with an intent to cancel the bid or offer before execution. By doing so, spoofers aim to overload the quotation system of a registered entity, delay another person's execution of trades, to create an appearance of false market depth and/or with intention to create artificial price movements upwards or downwards. This type of behaviour seeks to distort prices and trick others into trading. Forms of spoofing include:

- **Flipping** – where orders or trades are entered for the purpose of causing turns of the market and creating volatility/ instability.
- **Layering** – where trade places a series of non-bona fide orders far from the prevailing best price in the market, thereby creating a false sense of liquidity.
- **Flickering** – occurs commonly with high frequency trading when an order is repeatedly submitted and cancelled (otherwise referred to as 'quote stuffing');
- **Collapsing of layers** – where a trader places a small order on one side of the market and several spoof orders at different prices points at the other side of the market, creating the appearance of a large volume; or
- **Short squeeze** – where a trader takes long positions in futures contracts and then tries to purchase the entire supply of the same commodity

Russia/Ukraine

Russia's invasion of Ukraine has had an unprecedented effect on financial markets, resulting in a tumultuous and variable sanctions landscape. Since March 2022, the sanctions imposed on businesses and individuals alike have had a detrimental effect on Russian securities operating in UK markets. Regulated firms have been taking steps to not only avoid investment in Russia but also have been encouraged to dispose of existing investments where possible; asset managers have written off Russian assets to zero; and trading of Russian securities have been halted and removed from the major equity and bond indices. The UK government's position on Russia could not be clearer and firms are encouraged to cut ties where possible.[5]

Commodities

The commodities market has also been highly affected with Russia being a major supplier of oil, natural gas, wheat, nickel and palladium. On 8 March, nickel trading was halted for over a week by the London Metals Exchange (**LME**) after a price jump to over $100,000 per tonne. When it was reopened, trading of metals was subject to a daily price movement cap of 15%. The LME's handling of this is now being subject to joint review by the FCA and the Bank of England. There is a risk that such volatility can extend to other commodities, such as zinc.

Such volatile conditions make it especially difficult to differentiate between normal trading behaviour and unusual trading behaviour, so market participants should exercise caution not to inadvertently be in breach of their disclosure obligations under MAR.

Later on 25 May, it was announced that Glencore, a commodities trading conglomerate, pleaded guilty to market manipulation and bribery charges in the US and agreed to pay fines of £1.1 billion. The corporate also intends on pleading guilty to further counts of bribery in the UK in relation to the company's oil operations in Africa.

As part of the financial settlement in the US, Glencore agreed to pay penalties of $485 million to resolve the investigation into market manipulation of the benchmark prices for fuel oil, where it was alleged that traders submitted orders to buy and sell fuel oil with the intention of artificially pushing the benchmark price assessment up or down for the purpose of increasing profits and reducing costs on contracts and derivative positions held by Glencore.

Financial Services Act 2021

There have also been amendments to the legislative framework on market abuse with the enactment of the Financial Services Act 2021 (**FS Act**).

1 UK MAR webpage on the FCA website.
2 Article 8, UK Market Abuse Regulation
3 Article 10, UK MAR
4 Article 12, UK MAR
5 FCA response to Chancellor's call to stop investing in Russia | FCA

"There is a broad consensus amongst regulatory bodies across the globe that more needs to be done to increase confidence in the market and reduce financial crime by identifying and prosecuting instances of market abuse."

Section 30 of the FS Act came into force at the end of June 2021, amending the UK MAR to make clear that both issuers and any person acting on their behalf or on their account (such as advisers) are required to maintain their own insider lists (a list which includes details of all persons who have access to inside information and who are working for them under a contract of employment, or advisers, accountants or credit rating agencies) (Article 18 of the UK MAR), as well as amending the timetable as to when issuers are required to disclose transactions by their senior managers to the public (Article 19 of the UK MAR). The deadline will now be two working days after those transactions have been notified to the issuer, rather than three business days after the transaction itself.

Section 31 of the FS Act entered into force sometime later in November 2021, by amending the insider dealing offences (Section 61 of the Criminal Justice Act 1993) and market manipulation offences (Section 92 of the Financial Services Act 2012) to increase the maximum sentence from seven to ten years imprisonment. This was done to reflect the severity of the criminal market abuse offences as well as place criminal market abuse offences on a par with other commensurate economic crimes.

Enforcement

In December 2022 BGC Brokers, GFI Brokers, and GFI Securities were fined a total of £4.77m for failing to ensure they had appropriate systems and controls in place to effectively detect market abuse and specifically failed to implement effective trade surveillance requirements. This most recent enforcement action followed on the heels of a £12.5 million fine for Citigroup Global Markets for the same failure to implement effective trade surveillance.

Commenting on the BGC action the FCA's Mark Steward said: "Oversight of our markets is a regulated partnership between the FCA and market participants and so gaps or holes in a firm's ability to monitor and detect abusive trading poses direct risks to market integrity. This case is another example of the FCA's determination to ensure firms prioritise market integrity and the maintenance of high standards of compliance.

Last year the FCA recently published its approach to dealing with Market disclosing that it undertakes daily monitoring to ensure the timeliness and accuracy of the disclosure of inside information.

In connection with its approach to policing Market Abuse the FCA said *"The aggregate picture is one of increasing intensity, scrutiny and sophisticated action, in which criminal prosecution is one of several concurrent strategies being deployed. We are determined to tackle market abuse and insider dealing wherever there is evidence of it whether this is through the courts or our own powers. Those considering attempting to manipulate our markets should be on notice that we will not hesitate to act."*

What's next

There is a broad consensus amongst regulatory bodies across the globe that more needs to be done to increase confidence in the market and reduce financial crime by identifying and prosecuting instances of market abuse. In the UK, the FCA published their 3-year 2022-2025 Strategic Plan earlier this month. One of its priorities aims to put more resources into its intelligence-gathering capabilities and expanding its data analytical capabilities to better spot and track potentially fraudulent activity at scale, which will include engagement with the National Economic Crime Centre.

We recommend:

1. Risk assessments for market abuse should be comprehensive, accurate and up to date.
2. Trade surveillance is undertaken and that it is calibrated to the underlying assets being traded.

The price movements in some assets can be very different to others and if not properly calibrated it is likely false positives will result.

3. Risk assessments should also be undertaken periodically in order to identify any gaps in trade surveillance.
4. When gaps or deficiencies are identified, it is equally if not more important to show that steps have been taken to remedy such deficiencies
5. Policies and procedures and training should be detailed and up to date. We recommend that policies should include guidance as to what the signs of suspicious activity might include and what information to use and/or consider.
6. If your trade surveillance is outsourced, whether internally or externally or partially or in full, ensure that the firm understands what work is actually being done on its behalf and that it is effective for the UK business (for example appropriately calibrated).
7. Provide regular tailored training for staff to ensure that they understand market abuse and their role in escalating potentially suspicious behaviour.
8. Within the compliance function, there should be clearly designated individuals who are specifically responsible for market abuse surveillance.
9. Monitoring systems should be appropriate relative to the nature, scale and complexity of the business. When assessing the adequacy of such monitoring systems, reference should be made to the six risk behaviours as set out in UK MAR, namely:
    a. Insider dealing
    b. Unlawful disclosure
    c. Misuse of information
    d. Manipulating transactions
    e. Manipulating devices
    f. Dissemination
    g. Distortion and misleading behaviour
10. Boards and committees should pose challenges as to how key risks are addressed.

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