

FCA Proposes New Guidance on Financial Crime Systems and Controls

The FCA is proposing to add a new chapter on insider dealing and market manipulation to its Financial Crime Guide.

Key Points:

- The FCA proposes to add a new Chapter 8 to Part 1 of its Financial Crime Guide, outlining the FCA's observations of good and bad practice regarding firms' systems and controls in relation to the requirement to detect, report, and counter the risk of insider dealing and market manipulation.
- The FCA is also proposing to make amendments throughout the Guide to bring it up to date with recent regulatory developments and enforcement cases.
- Comments are requested by 28 June 2018, and the FCA proposes that the new guidance will come into effect on 1 October 2018.

What is the purpose of the new guidance?

The proposed guidance (set out in [Guidance Consultation GC18/1](#)) expands upon firms' obligations under SYSC 6.1.1R — "*A firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime.*" — as it relates to insider dealing and market manipulation. At present, the Guide does not offer firms any guidance specific to countering the risk of these offences taking place.

The guidance itself focuses on criminal 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). This is because the FCA does not have the competence to make guidance in relation to MAR, as this is reserved to the European Securities and Markets Authority (ESMA). However, the FCA acknowledges that, in practice, firms often will not distinguish between the civil and criminal regimes for the purposes of their internal systems and controls, and so suggests that firms might want to treat the guidance as equally relevant to both regimes. This is a neat way for the FCA to sidestep ESMA's role.

The FCA also makes another important point about the difference between the two regimes. The FCA stresses that, although Article 16 of MAR requires firms and individuals professionally arranging or

executing transactions to establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions, SYSC 6.1.1R goes further than this by requiring firms to have in place systems and controls to **counter** the risk of financial crime. As such, appropriate measures under SYSC 6.1.1R will include both the identification and prevention of attempted financial crime pre-trade, and the mitigation of future risks posed by clients who have already been identified as having undertaken suspicious trades.

On the webpage for GC18/1, the FCA also states that although it recognises that some firms separate their surveillance function from their financial crime teams, such firms must ensure that there is adequate communication between the two areas such that the firm can effectively counter the risk of insider dealing and market manipulation.

Substance of the guidance

The guidance itself is split into four key themes: governance, risk assessment, policies and procedures, and ongoing monitoring. Each section sets out FCA expectations, a list of self-assessment questions for firms to ask themselves, and examples of good and poor practice.

Governance

Senior management should take note that the FCA expects them to take responsibility for the firm's measures to counter insider dealing and market manipulation. In particular, this means understanding the risks to which the firm is exposed (including understanding the legal definitions of insider dealing and market manipulation, and the ways in which the firm may be exposed), and establishing adequate policies and procedures.

Once again, the FCA is setting a high bar in terms of its expectations of senior managers, which is particularly pertinent in the context of its Senior Managers and Certification Regime.

Risk assessment

The FCA expects firms to assess and regularly review the risk that they may be used to facilitate insider dealing or market manipulation. A variety of factors are listed, which should be taken into account for the purposes of this assessment. Firms should then take appropriate action to mitigate the risks identified.

Key aspects for firms to note include ensuring that someone with sufficient expertise carries out the risk assessment, that the risk assessment is actually put to use in deciding what business to accept (and this is not influenced by other factors such as profitability), and that the risk assessment interacts appropriately with the firm's anti-money laundering risk framework.

Policies and procedures

Policies and procedures should refer back to the firm's risk assessment, and need to focus on both identifying attempted financial crime and mitigating future risks. Front office staff need to be made aware of the policies and procedures, and must be clear that they should refuse to execute a trade when there is a clear risk of financial crime. Policies and procedures need to be communicated and embedded throughout the firm.

The FCA also highlights that firms' personal account dealing policies need to ensure that conflicts of interest that might result in employees not escalating suspicious activity are avoided (the FCA provides the example that, if employees are allowed to copy clients' trades on their own accounts, they may be less inclined to escalate financial crime concerns that only become apparent post-trade).

Some warning signs of poor practice include documents that are not updated to reflect legal or regulatory changes, or that are generic and do not consider risks specific to the firm. These are common failings for firms to make, and so are important to get right.

Ongoing monitoring

The FCA suggests that firms may consider it appropriate to use the results of their surveillance for the purposes of MAR in relation to countering criminal insider dealing and market manipulation too. However, the FCA stresses the difference in the scope of the two regimes (the UK criminal regime being broader than MAR in terms of the markets and instruments to which it applies) and that consequently relying only on their arrangements under MAR may not be adequate.

The FCA emphasises the need for firms to consider regularly whether their clients may be engaging in insider dealing or market manipulation, and to consider the appropriate response when risks become apparent. This includes identifying patterns of behaviour as well as individual incidents. There is a particular emphasis on firms doing more than just reporting the suspicious activity — they need to consider what other measures they should take, such as undertaking enhanced monitoring of the client or ultimately considering the suitability of retaining the relationship. Firms also need to consider how this monitoring interacts with the client on-boarding process and the firm's anti-money laundering framework.

Link with money laundering

In the paper, the FCA highlights to firms the link between financial crime (including insider dealing and market manipulation) and money laundering. This is an important point, as whenever a firm suspects that a criminal offence has been committed, it needs to think about potential proceeds of crime and relevant reporting obligations under the Proceeds of Crime Act 2002. Therefore, firms need to check that their frameworks interact, and that suspicions relating to financial crime are escalated to anti-money laundering teams.

Next steps

Comments on GC18/1 are requested by 28 June 2018. The FCA proposes that the new guidance will come into effect on 1 October 2018. In the meantime, firms should review FCA expectations and benchmark themselves using the self-assessment questions and examples of good and poor practice in the draft guidance.

There is a clear link back to the Julia Hoggett speech of last November (see Latham's related [Client Alert](#)), in which the FCA warned that if a firm has repeated concerns about the trading behaviour of a client, then it is legitimate for the FCA to ask whether the firm has properly considered its regulatory obligations to counter the risk of financial crime. There are also echoes of a [recent enforcement case](#) that related to systems and controls failings around the detection of potential market abuse.

Given the FCA's current focus on financial crime and market abuse from an enforcement perspective, firms should make sure they review the FCA's expectations in this area with care.

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