The fight against financial crime: insider dealing and market manipulation

The rate of change in the law and its enforcement in financial crime has been dramatic and global in the past few years, resulting in a regulatory minefield for many businesses.

In this series of articles, we focus on different areas of financial crime, taking an incisive look at current regulation and what we can expect over the course of 2018. In this fourth edition we take a look at insider dealing and market manipulation, including the proposed new guidance from the FCA (which is likely to take effect on 01 October 2018) and the increasing level of enforcement in Hong Kong.

The current position

In its 2018/19 business plan published on 09 April 2018, the UK’s FCA identifies financial crime and anti-money laundering as one of its seven cross-sector priorities for the coming year. One of the key areas covered by the FCA in its anti-financial crime agenda is insider dealing and market manipulation.

These come in both civil and criminal forms. On the civil front there have not yet been any enforcement cases in the UK under the Market Abuse Regulation (MAR) since it took effect in July 2016. Recent cases such as that against Tesco plc for making misleading statements to the market as to its results (for more, see here) have been under the previous rules, although the FCA have said that they have plenty of investigations in the pipeline. The next criminal prosecution...
for insider dealing, involving a former bank compliance officer, is also in the offing.

Central to the FCA’s regulatory agenda is prevention, and this goes to firms’ internal arrangements to prevent financial crime as required by the relevant SYSC rules and Principle 3 for Businesses. The FCA fined Interactive Brokers (UK) Ltd just over £1m in January 2018 for failings in this area. When it comes to insider dealing and market manipulation, the FCA is currently consulting on changes to its Financial Crime Guide for firms (the Guide) to provide guidance to firms in this area. The main proposal is to include a new chapter in the Guide addressing insider dealing and market manipulation. Although only applying to the criminal offences, the FCA suggests that firms may find it simpler to consider the guidance in the proposed new chapter as applying to both criminal and civil market abuse.

Meanwhile in Hong Kong, instances of listed companies misleading the market have been in regrettable abundance, either through companies issuing deliberately false financial statements or withholding bad news from the market. The SFC’s stated no.1 enforcement priority is to clamp down on this, and to do so by targeting as many individuals and market participants as it can: listco directors, IPO sponsors (ie banks), reporting accountants, and others. By enforcing collective responsibility on the perpetrators as well as on those who arguably let it happen, the SFC hopes to raise standards and restore the integrity of the Hong Kong market, which has been damaged by too many of these scandals.

**Key issues to think about**

The FCAs proposed new guidance addresses the following areas:

- **Appropriate preventative measures** are likely to fall into two distinct categories
  - identification and prevention of attempted financial crime pre-trade, and
  - mitigation of future risks posed by clients who have been identified as having already traded suspiciously.
- **Senior management** need to take responsibility for the firm’s measures in relation to insider dealing and market manipulation, including understanding the risks to their firm and establishing adequate policies and procedures to counter those risks.
- **An appropriate risk assessment** should be undertaken and kept under review. Risks identified need to be effectively mitigated, for example by:
  - undertaking enhanced order and transaction monitoring on clients
  - setting client specific pre-trade limits, and
  - ultimately declining business or terminating client relationships if appropriate.
- **Firms’ policies and procedures** should include steps to counter the risk of insider dealing and market manipulation occurring through the firm. They should be aligned and refer to the firm's risk assessment. They should link to PA dealing policies.
- **Front office employees** should be aware of the firm’s obligation to counter the risk of financial crime. Senior management will want to make sure that employees have the appropriate training to identify potential insider dealing and market manipulation.
- Firms should regularly take steps to consider whether their **clients** may be conducting insider dealing or market manipulation, such as transaction, order and communications surveillance and, if so, take action including ultimately terminating the client relationship. This links to existing monitoring obligations in order to submit Suspicious Transaction or Order Reports under MAR.

The FCA also makes a number of interesting general observations as regards firms’ obligations in respect of market abuse:
The SYSC obligation to counter the risk of financial crime goes further than the MAR obligation to detect and report suspected market abuse.

Firms’ surveillance function is often separate from their financial crime or MLRO teams. Where this is the case firms need to ensure there is adequate communication between the two so as to counter the risk of criminal insider dealing or market manipulation.

There is an implicit suggestion from the FCA that firms may not have had enough regard specifically to insider dealing and market manipulation when considering their financial crime risk. This may include the need to file Suspicious Activity Reports under the Proceeds of Crime Act 2002 associated with these offences.

What’s next?

In the UK, the consultation periods on the proposed new guidance ends on 28 June 2018. The final feedback will be published in the autumn and adoption of the new guidance is expected to take effect on 01 October 2018. Firms will have little time to implement changes and need both to consider the draft guidance now and to plan for any steps that may need to be taken in the autumn.

In Hong Kong the pendulum may swing back from predominantly civil actions in response to market manipulation towards more criminal enforcement. In recent years High Court actions to obtain redress for affected shareholders have been the SFC’s primary response. But since the arrival in 2016 of Tom Atkinson as Head of Enforcement at the SFC, increased cooperation with the police and the Department of Justice is expected to lead to more criminal prosecutions as well.

This document (and any information accessed through links in this document) is provided for information purposes only and does not constitute legal advice. Professional legal advice should be obtained before taking or refraining from any action as a result of the contents of this document.