Summary of feedback received

December 2018

Consultation title	**GC18/1: Proposed guidance on financial crime systems and controls: insider dealing and market manipulation**
Date of consultation	27 March 2018 – 28 June 2018
Summary of feedback received	We received 8 responses to this consultation, with most from trade associations on behalf of their members, 1 on behalf of a number of legal firms, and 1 independent consultancy. This document provides a summary of the feedback we received and our responses. Overall, respondents were supportive of the guidance, but required clarification and/or amendments to certain areas. **<u>Insider dealing and market manipulation</u>** A number of respondents recognised the need for firms to play a role in combating financial crime, including insider dealing and market manipulation. However, they advised that the Guide should not impose an absolute duty to prevent it. Respondents highlighted the difference between an obligation to prevent financial crime and an obligation to implement controls to counter the risk of being used to further financial crime. Some respondents sought clarity as to how the guidance would apply to different business types, requesting more tailored examples of good and poor practice. Some respondents raised concerns that firms would risk tipping off a client or employee if they were to take any action suggested in the guidance, such as restricting a client's access, or terminating a client or employee relationship. Some respondents requested further clarity about pre-trade obligations and when a firm would be expected to refuse to execute an order.

There were a number of other miscellaneous points, which have been addressed at the bottom of the next section.

Money laundering and general updates

Many of the respondents sought clarification of the change to the Guide to state that it is to be considered relevant guidance for the purposes of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs).

A number of responses pointed to areas where they felt the proposed changes in the Guide did not fully reflect the MLRs. This included how we characterised the FCA's guidance on PEPs and the definition of correspondent banking.

Some respondents provided feedback on other elements of the Guide, in particular the data security chapter. One suggested the bribery and corruption chapter should refer to broader FCA work on inducements. Another questioned whether a new chapter was needed to cover tax evasion.

Two responses to the consultation requested that the Guide make specific references to the Senior Managers and Certification Regime (SM&CR).

One respondent requested the FCA to identify which thematic review findings in FCTR would be helpful for firms' market abuse controls. Another respondent asked us to explicitly state which parts of FCTR remain relevant following the passing of the Money Laundering Regulations 2017.

Response to feedback received	We would like to thank all respondents for taking the time to reply and for the constructive feedback we received. We have considered all responses and revised our guidance where appropriate. We would like to remind firms that the Guide is not binding. Firms can deviate from the Guide depending on the size and nature of the business, or the risks the firm is exposed to. **Insider dealing and market manipulation** Countering the risk of furthering financial crime Five respondents commented that the inclusion of the requirement to prevent financial crime differs from the obligations within SYSC 6.1.1R. These obligations require firms to establish, implement and maintain adequate policies and procedures sufficient for countering the risk that the firm might be used to further financial crime. Some respondents noted that the FCA may be seeking to gold-plate MAR by requiring firms to prevent insider dealing and market manipulation, which is not required in Article 16(2) of MAR. One respondent also highlighted that an obligation to implement controls to counter a risk is not the same as an obligation to counter the risk. One respondent suggested that prevention requirements should not apply to discretionary investment management firms. Some respondents requested clarification of the FCA's expectations regarding pre-trade controls. The proposed guidance included an expectation that firms' policies should include identifying and preventing attempted financial crime before any trade is executed. It stated that market participants should refuse to execute any trade where there is a clear risk that the trade is in breach of relevant legal or regulatory requirements. Respondents asked for clarity on the circumstances in which firms should refuse to execute a trade, given there was no legal test or definition for 'clear risk'. Respondents particularly sought clarity in the context of direct electronic access (DEA) clients, where firms have little or no interaction with the client pre-trade, and market manipulation, where firms may be monitoring patterns of orders and trades when attempting to identify suspicious behaviour. A respondent suggested that it is unreasonable for buy-side firms, given the nature of the business, to have procedures to identify and prevent financial crime before a trade is executed. Another respondent highlighted the risk of detriment to underlying clients of buy-side firms if the sell-side were to adopt an overly defensive approach. **Our response**: We broadly agree with respondents' comments about the difference between preventing financial crime and establishing systems and controls to counter the risk of being used to

further financial crime. We have clarified the guidance to reflect this.

With respect to pre-trade controls, we acknowledge the need for clarity. We have sought to provide more detailed guidance about the circumstances in which we would expect firms to refuse to execute a trade. We have removed reference to 'clear risk', and explained that a firm should refuse to execute a trade where it has information which leads to the conclusion that its client is seeking to trade either manipulatively or based on inside information.

To be clear, the FCA is seeking to minimise the risk of a client being able to trade a financial instrument having communicated to their broker that, for example, they hold inside information on the instrument, or that their strategy is to manipulate a market. We recognise that this scenario may be less likely to occur for DEA providers and the risk may therefore be categorised as low. However, we have not specifically amended the guidance, as firms should use it in an appropriate manner for their business.

Ensuring the guidance is suitable for all business types

Two respondents sought clarity on how the guidance applies to different types of firms, and commented that there should be proportionality in what is expected from different categories of firm.

One respondent commented that some of the self-assessment questions are helpful to discretionary investment managers, but requested a specific provision to distinguish the measures suitable for discretionary investment managers.

One respondent required clarity where a firm's client is not the individual or entity making the decision to trade. The most obvious example of this is where an investment bank/wholesale broker has a retail broker as its client, and that retail broker has multiple underlying clients itself. In this instance, the firm investment bank/wholesale broker may be unable to identify the underlying retail client, and it was suggested that it would be disproportionate to expect firms to exit their relationship with the client.

Our response:

The Guide is not intended to be differentially prescriptive to every business model type. Indeed, no other chapter attempts to draw out sub-chapters or headers which are appropriate to particular parts of industry.

Regarding firms' policies and procedures to counter the risk of being used to further financial crime, each firm is required to ensure that its risk framework, and policies and procedures are tailored and appropriate to the nature of its business, for example, client type(s) (if applicable), product type(s), means of order transmission and execution, risk posed by employees. We maintain that the systems and controls referred to throughout the Guide should also manage the risk created by a firm's employees. So, the guidance, where applicable, applies to discretionary managers.

We also expect firms to have policies and procedures to counter the risk of being used to further financial crime where the firm does not know the identity of the underlying client or decision maker of transactions. If a relationship is assessed as higher risk from an insider dealing or market manipulation perspective, or the monitoring of transactions identifies potentially unusual or suspicious transactions, it may be appropriate to seek further information from the client about their business and the underlying clients more generally. For specific transactions, firms may seek further information from their client about the underlying client.

We believe the guidance applies to different types of firms, and have not changed the scope of its application. We agree that different types of firm should design systems and controls that are appropriate for their circumstances, as well as being proportionate and effective.

We have, however, added some text, amended some of the language and provided examples of good and poor practice to clarify how the guidance may apply to different types of firm, including how it may relate to employee trading.

<u>Tipping off</u>

Three respondents raised concerns that refusing to execute a trade or terminating a client relationship could be akin to 'tipping off' the client. One respondent suggested that refusal to execute a trade would be visible to the client and would, in turn, disclose the notification of attempted insider dealing or market manipulation. They requested the removal of this suggested action within the guidance. Another respondent suggested that the client is unlikely to accept restrictive measures without enquiring further. The respondent suggested that these measures should only be used where proceeds of crime have not yet been generated, or where the individual has been notified that they are under investigation by the competent authorities.

Our response:

MAR requires firms to have procedures to ensure that the subject of a Suspicious Transaction and Order Report (STOR) is not informed of the report, including by asking the client for information needed to complete certain fields in the form. We presume this is what firms are referring to regarding concerns of tipping off under MAR. Provided there is no disclosure of the

STORs to be submitted, there is no conflict between a firm's MAR obligations and its obligations under SYSC.

Under Section 333A of POCA, it may be an offence to reveal that a Suspicious Activity Report (SAR) has been filed, or that an investigation is being contemplated, or is being carried out. Providing the firm does not communicate that it has filed a SAR and does not elude to the fact that the client may be, or is being, investigated by law enforcement, we do not consider that action carried out to fulfil the firm's obligations under SYSC is likely to constitute tipping off. To enable them to articulate their intention to not tip the client off, firms may wish to record the rationale, decision making and communications for any actions taken against their client.

We expect firms to refuse to execute trades when they believe that their client is seeking to trade either manipulatively or based on inside information.

In practice, we expect firms to exercise careful consideration when communicating with their clients or employees, and to consider the risks of tipping off under POCA on a case by case basis, seeking legal advice if necessary. While firms need to consider these obligations, the submission of a STOR or SAR and the need to manage the risk of committing a tipping off offence does not override the firm's obligations to have policies and procedures to counter the risk of being used to further financial crime. So, we have not amended the guidance to remove the suggested actions or limit the circumstances in which they may be appropriate. Firms should seek to have policies and procedures to counter the risk of being used to facilitate insider dealing and market manipulation, as they would other types of financial crime.

<u>Perceived emphasis on terminating client relationships</u>

One respondent suggested that the Guide appears disproportionately weighted towards the outcome of cancelling transactions pre-trade and exiting a client relationship. They highlighted that it risks adding to the existing problems around de-risking, and may drive clients towards less compliant service providers, ultimately reducing regulators' oversight of such clients. The respondent also stated that the guidance envisages inflexible requirements in relation to the need to terminate a client relationship. They commented that it would be difficult for a policy to detail the circumstances in which this action is appropriate, as it will depend on the outcome of the firm's monitoring and extent and nature of any suspicious activity identified. The respondent suggested a requirement to consider the position following a SAR /STOR would appear more workable.

Two respondents commented that a suspicion does not create certainty that a client is engaging in criminal behaviour. One commented that the text appears to create an expectation on firms to take measures over and above the submission of a STOR. Another commented that it is not necessarily unreasonable for firms to maintain a client relationship following submission of one of more SARs/STORs, unless or until the firm has sufficient data to conclude that termination is appropriate.

Our Response:

While the Guide refers to terminating client relationships and to refusing trades, we do not believe that it is unduly weighted towards these measures. These measures are included among the examples firms may choose to take. The FCA does not prescribe the circumstances that dictate which steps are appropriate, or when they should be taken. However, we believe that a firm should not enter into, or maintain a client relationship if it is unable to effectively manage the financial crime risk associated with maintaining that relationship.

This does not mean that firms are required to off-board clients immediately after identifying a single suspicious trade. Rather, firms should have systems and controls in place to identify, assess and mitigate the risk in a consistent and appropriate manner.

We agree that suspicion does not constitute proof of criminal activity. However, firms are obliged to manage the risk that they are being used to facilitate financial crime. This may on occasion involve taking measures over and above submission of a STOR.

It may sometimes be difficult to articulate when a firm should terminate a client relationship, and there may be scenarios where this is not appropriate. We have altered the good and poor practice examples to reflect that policies should detail when a firm will consider rejecting a prospective client or terminate a client relationship.

We appreciate the concerns raised about clients moving to less compliant service providers. However, we would not expect this to be considered as a factor when firms are considering their obligations to counter the risk of being used to further financial crime.

<u>MLRO and Surveillance</u>

Two respondents suggested that flexibility be allowed regarding the relationship between the MLRO and Surveillance function, and discouraged the FCA from introducing specific expectations of the relationship.

Our response:

We have not mandated how firms should operate, simply that firms ensure appropriate expertise is used and information is shared when appropriate. The text is not, in our opinion, inflexible, but offers good practice around information sharing between the functions.

Miscellaneous amendments

We have made a number of further amendments to the document, in response to more specific feedback received:

- We have made clear that a firm's risk assessment (for the purposes of SYSC 6.1.1R) does not need to cover asset classes/instruments which are outside the scope of the criminal regime.
- We have made clear that the 'financial markets' in question are the financial markets to which the criminal offence of insider dealing and market manipulation apply, respectively.
- We have acknowledged that potential financial crime concerns may be raised by a function other than Compliance.
- We have made clear that attempted insider dealing or market manipulation is reportable as STORs, and not necessarily SARs.
- We have changed 'the firm should comply with its obligations to report those suspicions via a STOR and/or SAR, and review the options available to counter **the** risk of financial crime posed by its ongoing relationship with that client', to counter '...**any** risk…'.

Money Laundering and general updates

Status of Financial Crime Guide guidance

The proposed amendment in paragraph 1.1.9 of FCG was intended to reflect the wording of the Money Laundering Regulations. We understand the concerns that the industry has raised about the potential tensions this may create between the FCA's guide and the guidance produced by the Joint Money Laundering Steering Group (JMLSG). We have reflected on this and the helpful suggestions received from the industry and have amended the draft to clarify that JMLSG remains the only guidance that is approved by the Treasury under the MLRs.

SM&CR

We have updated the guide to clarify a decision taken by the FCA, and disseminated to the industry via trade bodies. If firms have a Money Laundering Reporting Office (MLRO- CF11/SMF 17 function) - that could satisfy the requirement in Regulation 21(1)(a) of the MLRs to have a senior manager responsible for the relevant person's compliance with the MLRs.

We have included a link to FCA's guidance on the SM&CR within the Guide, which will future proof the Guide.

Changes to reflect the MLRs

We have reflected on points where raised in the consultation responses. We will be making changes in paragraph 3.2.7 'Handling higher risk situations' to ensure this reflects the law and industry guidance:

- Delete reference to 'fake or stolen identity documents' - this was included in the draft but not the final version of the MLRs.
- Change the 'correspondent relationships' bullet point to avoid a perception that correspondent trading relationships should be treated as high risk and instead clarify that firms should adopt a risk based approach to management of these relationships, in line with JMLSG Guidance.
- References in the Guide will refer to the FCA's guidance on the treatment of PEPs and will reflect that the MLRs state that firms may follow this guidance.

We will also make changes:

- In paragraph 3.2.11 on Record Keeping, to make sure it replicates the wording of Regulation 40 of the MLRs.
- In paragraph 3.2.1, the examples of good and poor practice for group wide systems and controls will instead make a direct reference to the requirement in Regulation 20(1)-(5).

One respondent pointed out a challenge that changes to the MLRs make for those storing records electronically. As this is a change made in law, we have not accepted this but will feed it in to future Government consultations on the MLRs.

Other changes to the Guide

- The Guide represents the findings of FCA thematic work and covers our thematic work going back to 2008. We will keep older information under review and update it with any future supervisory findings. This includes any markets specific information or findings from the diagnostic work on money laundering through the capital markets, which we announced in the FCA's Business Plan.
- We do not propose to insert a new chapter to cover providing guidance on the corporate criminal offence of facilitation tax evasion. While tax evasion is a predicate crime for money laundering, this is more a matter for HMRC as the tax authority. We will, however, include in the sources of information section a link to the HMRC and UK Finance guidance on compliance with this requirement.

	• We do not plan to reference broader work on inducements in the bribery and corruption chapter. The findings from our inducements work were specific to those sectors that were probed, and the existing guidance remains current. • A respondent asked that we include all the sanctions regimes in the EU within Chapter 7. The changes to this chapter are intended to avoid references to specific regimes, so as to future proof the Guide from often fast paced changes in sanctions requirements. We are retaining that approach. • Some responses pointed out that they believed the FCA should review all of the information in FCTR to see what is relevant under the new MLRs. We have considered this but think it important that we keep FCTR as it stands. As with all examples, firms must consider whether it is relevant to their business and appropriate in light of all circumstances. • We are also making minor changes to the Glossary to delete references to 'FATF Special Recommendations' and updating the glossary item 'Consent' to refer to a 'Defence Against Money Laundering'.
Changes made to the guidance as a result of feedback received	Changes made to the guidance can be found in the above section.

You can access the full text of the guidance consulted on here