Financial Conduct Authority

August 2025 update:
This review is historical. See What we publish for more information and current views.

Asset management firms and the risk of market abuse

February 2015

Thematic Review

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Contents

1. Executive summary

Overview

This paper presents our findings from the thematic review of how asset management firms control the risk of committing market abuse. The review considered how firms control the risks of insider dealing, improper disclosure and market manipulation, with a primary focus on equities and insider dealing.

Market abuse damages market integrity and undermines confidence in financial markets. At a firm level, association with market abuse causes reputational damage and can lead to substantial financial loss. Our regime requires firms to have effective processes to identify, monitor and manage the risk of market abuse.

Key messages

Our overall finding was that firms had put in place some practices and procedures to control the risk of market abuse. However, these are only comprehensive in a small number of firms. In many firms further work is required to ensure these operate effectively and cover all material risks. In particular, firms need to pay more attention to the possibility of receiving inside information through all aspects of the investment process and take steps to manage this risk. Firms generally also need to improve the effectiveness of post-trade surveillance. Only a minority of firms had appropriate controls for these matters.

An effective market abuse control framework

Our review focused on the key aspects of an effective framework to manage market abuse risk. This includes ways to:

- minimise the risk of receiving but not identifying inside information
- control access to inside information when it has been received
- use pre-trade controls to reduce the risk of market manipulation and insider dealing
- conduct post-trade surveillance to monitor and investigate potentially suspicious trades
- control personal account dealing, and
- train staff to ensure awareness of market abuse issues

Findings

1. **Managing the risk that inside information could be received but not identified.** Firms generally had effective policies to identify and control inside information in clear situations, e.g. from a wall crossing where an investment bank explicitly shares inside information when seeking views on a prospective corporate action. Practices to avoid inside information or identify its receipt when it is not expected to be received (e.g. preventing fund manager meetings with consultants who are likely to have inside information or ensuring these meetings are documented) were often informal and inconsistently applied.

2. **Controlling access to inside information and managing the risk of improper disclosure.** All firms had a policy to limit the sharing of inside information to those who need to know it. However, only a minority of firms monitored the effectiveness of this policy.

3. **Pre-trade controls to prevent market manipulation and insider dealing.** Firms generally had good pre-trade controls to reduce the risk of market abuse. In most firms a segregated dealing function conducted a review to flag potentially manipulative transactions prior to execution. All except two firms used a block or warning prompt to prevent trading of securities that had been restricted due to the possession of inside information.

4. **Post-trade surveillance.** Only two firms in our sample demonstrated post-trade surveillance that effectively highlighted and properly investigated potentially suspicious trades. In a number of firms effective investigation of potentially suspicious transactions was difficult due to a lack of documentation (e.g. where there was no easily retrievable record of external meetings) and poor awareness of front office research activity.

5. **Personal account dealing policies.** All of the firms in our review had a personal account dealing policy with procedures to reduce the risk of market abuse.

6. **Training.** All except for one firm conducted training to ensure employees' understanding of market abuse rules was up to date and to discuss recent market abuse cases.

Next steps

We will shortly be writing to all the firms in our thematic sample to provide individual feedback. Where firms did not effectively manage the risk of market abuse, we expect them to make improvements to their practices.

Senior management of asset management firms need to satisfy themselves that their firm's practices to manage the risk of market abuse are appropriate. This should take into account the findings of our work. For convenience we have separated some of our findings into examples tending towards good and poor practice. We will follow up on this work through our routine supervision.

2.
Our approach to combatting market abuse

This review of controls in asset managers is one aspect of our work to promote effective management of market abuse risk by firms. We also assess how firms control this risk through our routine firm supervision. This work is complemented by market surveillance and enforcement, which acts as an important identifier and deterrent. Our work to combat market abuse is directly linked to the FCA's objective to protect and enhance the integrity of the financial system.

This thematic review primarily involved equity fund managers and is separate to the ongoing Fair and Effective Markets Review (FEMR). The FEMR is a joint review by HM Treasury, the Bank of England and the FCA into the way wholesale financial markets operate; it is focused on the fixed income, currency and commodity markets.

What we did in this review

The review covered 19 asset management firms including long-only asset managers, hedge fund managers and an occupational pension scheme. We reviewed the market abuse policies of all firms and visited 17 of them. The sample included both small and large firms, with global assets under management ranging from approximately £200m to over £100bn.

3.
Our findings in more detail

Managing the risk that inside information could be received but not identified

Wall crossings

Firms generally had effective policies to identify and capture inside information that is intentionally received through wall crossings by investment banks (this occurs when an investment bank shares non-public information to obtain fund managers' views about a prospective corporate action). However, most firms did not have effective policies for when inside information is unintentionally received from a conversation about a proposed wall crossing (a sounding) when that wall crossing is not taken up; for example, if enough detail is given for the fund manager to deduce the company and nature of the event. Firms should review their practices in this area.

Good practice

Five firms had an initial point of contact for soundings that was independent of the fund managers. In some cases this enabled soundings to be rejected without sharing any information with fund managers; for example, when the subject of the wall crossing was in a geographical area that was outside a fund manager's mandate. In other cases, where the fund manager was consulted and decided not to take up a wall crossing, there was an independent assessment of any information received to verify that it did not constitute inside information. Three of these firms had contacted all investment banking counterparties to ensure they were aware of this policy and complained if a fund manager was directly approached about a wall crossing.

Another firm required fund managers to make a documented assessment of whether inside information had been received following any declined soundings. This reduced the risk that the receipt of inside information could go undetected.

Poor practice

Where firms do not require fund managers to confirm whether inside information has been received following a sounding, the risk of insider dealing is increased. In one firm we found that a fund manager had been told the name of the company that was planning a corporate action during a sounding but took no further information. The fund manager recognised this was potentially inside information and decided not to trade any of the company's shares. However, the company was not added to the restricted list and the compliance function was unaware of this situation. This created the risk of another fund manager trading while inside information was held in the firm.

Company-specific research

All firms had practices to avoid the unnecessary receipt of inside information when conducting company-specific research. However, these were typically informal and inconsistently applied. In one firm, interaction with independent industry consultants was not controlled in the same way as interaction with consultants who were part of a formal expert network. This is despite the risk being similar in both situations. In other firms, some fund managers had decided not to meet any investee companies in the period immediately before results announcements to avoid the risk of receiving inside information, but compliance were not included in this decision and there was not a consistent firm-wide approach.

Practices to identify inside information, in situations other than wall crossings from investment banks, were mixed. Two firms had practices that frequently reminded staff to be alert to the risk that inside information could be received in unexpected situations. A further seven firms could give examples of situations where staff had raised concerns about whether inside information had been unintentionally received, some of which had resulted in restrictions on trading. Other firms could not give examples of situations where staff had been concerned about the possible receipt of inside information. Firms should encourage staff to discuss any concerns about whether inside information might have been received with a designated point of contact and consider whether the nature and volume of such discussions is appropriate given their investment activities.

If firms receive inside information but it is not identified as such, there is a significant risk that this information is acted on in breach of market abuse rules. Firms should consider the benefit relative to the risk of attending meetings where there is a significant possibility that inside information might be inadvertently received (for example, meeting with a consultant who is likely to possess inside information). Where firms choose to attend such meetings, they must consider additional practices to promote the identification of any inside information that could be received.

Good practice

Fund managers at one firm reduced the risk of receiving inside information from investee companies by avoiding any meetings with them during close periods[1] (a period of time before a company publishes results) other than in exceptional circumstances and following pre-clearance from compliance. This is one way of reducing the risk of unintentionally receiving inside information.

We also observed a number of practices to reduce the risk of receiving inside information from meetings between fund managers and industry consultants. One firm prevented fund managers from meeting with consultants who had recently worked for a listed company because of the possibility they could be in possession of inside information. Another firm required consultants to confirm they would not disclose inside information before meeting with a fund manager. To increase the chance of identifying any inside information received and to provide an audit trail for any post-trade surveillance, one firm required fund managers to document topics discussed following meetings with industry consultants. This increases the likelihood that any inside information received will be identified.

One of the larger firms used a 'material non-public information hotline' to encourage vigilance about whether inside information could have been received in the research process. This hotline was used frequently with a significant proportion of cases leading to a restriction on trading and it appeared to be an effective control.

In a smaller firm, the most senior fund manager regularly asked more junior staff about the content of meetings and whether there was any concern that inside information could have been received. In one instance this led to a complaint to a research counterparty that had disclosed information the firm considered inappropriate. This is a good example of how awareness and ownership of risks by senior management can reduce the likelihood of receiving but not identifying inside information.

1 Close period is defined in the listing rules http://fshandbook.info/FS/html/handbook/LR/9/Annex1#D59

Poor practice

At one firm that did not have a consistent approach to meeting companies during close periods, fund managers had met with the management of a large listed company less than a week before it published results. Shares in the company were sold following the meeting and before the announcement of disappointing results that caused a significant share price decline. There was no centrally logged documentation related to this meeting and the firm had not identified this situation before our review. A subsequent investigation by the firm found no evidence of insider dealing but documentation was found to be lacking. Processes have now been enhanced with investment teams required to justify why close period meetings are necessary and to document what is discussed during the meeting.

In one firm, the compliance function was unaware that an investment team was using an alpha capture system (this enabled sell-side firms to submit trading ideas electronically through a dummy portfolio and to be allocated commission based on the returns of the dummy portfolio). The potential market abuse risks had not been appropriately considered and the firm had no checks or controls around this system; for example, to confirm it was not receiving input from sell-side firms front running analyst recommendation changes.

At two firms, fund managers viewed it as the responsibility of the management of listed companies, investment banks and other research providers to assess whether any information provided could be inside information. This approach created the risk that information received is not appropriately considered, increasing the risk that inside information could be received but not identified.

Controlling access to inside information and managing the risk of improper disclosure

All except one firm used a restricted list to document the receipt of inside information. Most firms considered all employees to be restricted when inside information had been received by the firm and did not rely on the ability to restrict knowledge of inside information to particular individuals. All firms, however, had a policy to limit the sharing of inside information to those who needed to know. In some firms, the 'need to know' policy was monitored by keeping a list of who knew what inside information.

Limiting the number of people who have knowledge of inside information to those who need to know manages the risk of improper disclosure and reduces the risk of insider dealing. Firms should consider how they can reduce these risks, which may include keeping documentation of who knows what inside information, particularly in sensitive cases.

Good practice
One firm we visited kept a detailed log of who knew inside information. Knowledge of the information was not shared beyond the person wall-crossed, other team members who needed the information to fulfil professional responsibilities (e.g. a fund manager who might participate in a proposed placing), and compliance. Senior management and traders were unaware of the information or the restriction, unless they attempted to trade the stock. Even then they were only informed of the restriction, rather than receiving the inside information. Limiting the sharing of inside information to those who need to know is appropriate and the documentation of who knows what is one way of monitoring whether this policy is working effectively.

Poor practice
One firm notified all traders when inside information had been received as an interim control to prevent trading until a system block was in place (we consider system blocks and pre-trade controls in more detail below). In addition to being notified of the company name, the traders also received the detail of the inside information. This unnecessary dissemination of inside information was contrary to the firm's need-to-know policy and increased the risk of market abuse.

Pre-trade controls to prevent market manipulation

All except three firms had segregated equity dealing functions, including some of the smaller firms in our review. In most of these firms the dealers had a reporting line that was independent of the fund managers. The dealing function queried any suspicious or anomalous trades to understand the reasoning behind them; for example, a large order to be executed towards the end of the day, on a fund valuation date, which could be an indicator of market manipulation. An independent check is a good control to reduce the likelihood of trading errors and market manipulation.

Good practice
In one firm, management considered the volume of trades to be too small to merit a segregated equity dealing function, but required all fund managers' orders to be signed off by an independent colleague. This provided an opportunity to review any concerns prior to execution.

Poor practice
One firm with a large number of employees had no independent check prior to an order being placed. In another firm there was a segregated, independent, equity dealing function for all except one of the fund management teams. The exception was established because the fund manager thought trading would be improved by having a dealer within his team. No other compensating controls were put in place and this reduced the effectiveness of market abuse controls.

Pre-trade controls to prevent insider dealing

All except two firms used system-based pre-trade controls to prevent trading in the financial securities of companies that had been restircted due to the possession of inside information. In most firms the order management system prevented an order being placed until the company was removed from the restricted list (a hard block). Three firms used a warning prompt that had to be overridden to trade a restricted stock, combined with a post-trade check to highlight if this had occurred. Both approaches appeared to successfully prevent trading restricted securities but a hard block reduces the risk of human error.

The majority of firms recorded the fixed telephone lines of staff directly involved in the investment process with a minority also recording mobile phones. Recording telephones provides an audit trail of activity should one be required for post-trade surveillance or enquiries.

The majority of firms had a practice to document the rationale for investment decisions before trading though this was not always mandated. The documentation was primarily used to monitor investment decision-making but also enabled more effective post-trade surveillance or enquiries.

Firms should ensure they have effective controls to prevent trading when it is known that a portfolio manager has access to inside information about the security to be traded. Pre-trade documentation of investment rationale can enhance the monitoring of market abuse risk.

Good practice
In some firms, the trading function was situated in a segregated, secure area. Where a fund manager has placed a large trade relative to the volume of the security being traded, knowledge of this trade could be inside information for other fund managers; a physically segregated dealing function reduces the risk of other fund managers coming into contact with this information.

Poor practice
One firm did not implement system-based trade restrictions on a timely basis following the receipt of inside information: this took several hours in some cases. To prevent trading in the relevant security prior to the system being updated, the firm notified all dealers when inside information had been received and instructed that trading should be barred. This firm had the capability to use system-based pre-trade controls so the reliance on manual intervention was unnecessary and increased the risk of market abuse due to human error.

Post-trade surveillance

Only two firms in our review had a post-trade surveillance programme that was effective in identifying market abuse. These firms also used a systematic process to identify and assess potentially suspicious trades. This included trades preceding price-moving corporate announcements and also any trading patterns that could be indicative of market manipulation (in case these were not identified by pre-trade controls). In addition to reviewing individual trades, these firms also periodically considered whether there were any patterns in the trades highlighted, for example, was there an unusually high number of trades from the same person.

Post-trade surveillance has a key role to play in both detecting and deterring market abuse. We expect senior management to have processes to satisfy themselves that controls to identify and manage the risk of market abuse are working effectively. The suitability of different post-trade surveillance activities will vary according to a firm's size and activities; however, our work indicates that improvements may be required in many firms.

Good practice (relating to insider dealing surveillance)
One firm we visited used statistical analysis to identify post-trade price movements outside a set probability range to trigger surveillance follow up. This price-move trigger was varied by market according to that market's volatility.

Post-trade surveillance at one firm highlighted a pattern of successful trading by a fund manager prior to non-routine company announcements. This was investigated thoroughly, including reviewing all communications and an interview with the fund manager. There was no evidence that any inside information had been received but this trading pattern differed from the core long-term investment strategy and management felt it increased the risk of market abuse. This was communicated to the fund manager who reverted to the core investment strategy.

One firm conducted regular monitoring of the recorded telephone lines of fund managers and traders, listening to a sample of conversations. Monitoring lines will not be practical for all firms, but it increases the likelihood of detecting market abuse as well as incentivising staff to escalate any concerns that inside information might have been received.

Poor practice (relating to insider dealing surveillance)
One firm used the same percentage price change in all markets when identifying trades to follow up on. In more volatile emerging markets, this approach highlighted an unmanageable number of irrelevant trades, making trades genuinely worthy of investigation harder to spot.

Another firm had no documentation of the research process and could not verify the trade rationale or what information had been used to inform the trading. This made it difficult to independently assess any trades highlighted by post-trade surveillance.

All firms had post-trade surveillance practices that would help detect market manipulation but the effectiveness of these practices was mixed.

Good practice (relating to market manipulation surveillance)
One firm had post-trade reviews covering both manipulating transactions (which give a false impression of supply or demand or directly manipulate the price of a security) and where deception or misleading statements are used prior to trading. This included a media search to check for any activity that could be false or misleading; for example, if a fund manager gives a positive media interview about an investee company to generate demand shortly before selling the holding.

Poor practice (relating to market manipulation surveillance)
A minority of firms relied on quarterly analysis of investment performance as a post-trade check to detect market manipulation. This is not as effective as trade-level analysis and may not be sufficiently frequent to detect market manipulation on a timely basis.

Personal account dealing policies

All of the firms in our review had a personal account (PA) dealing policy. Generally, these policies included measures to reduce the risk of front running[2] and insider dealing; for example, a pre-trade check against the restricted list and a minimum holding period.

Our rules require firms to have a PA dealing policy. This offers protection to the firm and to individuals. This is particularly relevant when trading is being undertaken externally and is not caught by other controls within the firm.

Firms should consider their PA dealing policies and ensure that the requirements under COBS 11.7 are met, including adequate arrangements aimed at preventing market abuse.

2 Front running is defined in MAR 1.3.2 http://fshandbook.info/FS/html/handbook/MAR/1/3

Good practice
All except for one firm required pre-trade approval for PA dealing and, in the majority of firms, there was a post-trade review to monitor for any suspicious activity.

Poor practice
Three firms did not effectively manage the risk of a fund manager trading ahead of a fund. Two of these firms had no requirement about what time would be required between a PA trade and a fund trade. Another firm only required that fund managers did not PA trade within one hour of a fund trade. This was unlikely to be sufficient to prevent market abuse through front running, given the firm had many holdings in less liquid equities and had the capacity to influence these share prices through its trading activities.

Training

All except one of the firms in our review conducted training on market abuse. Most firms included market abuse training as part of the new joiner process and had annual training that covered market abuse for all employees. Market abuse training serves to bring employees' understanding of market abuse rules up to date and allows discussion of recent cases. It also gives senior management the opportunity to reinforce the company approach to market abuse risk.

Firms should consider the frequency and quality of training on market abuse and, where appropriate, make improvements to ensure staff knowledge is sufficiently current for the firm to effectively identify, manage and monitor the risk of market abuse.

Good practice
Approximately half the firms had face-to-face training to complement on-line training. This encouraged debate of real-life scenarios and a full understanding of how market abuse rules apply in practice. Three firms used examples in training from their own experiences of fund managers and analysts inadvertently receiving inside information, to promote awareness of this risk.

Poor practice

Where there is a reliance on online training, it should be effective. At one firm, which relied solely on online training for market abuse, the training log showed a number of staff had completed the market abuse module in less than half the stipulated time. There had been no follow up to understand why this was the case or whether the staff had understood the material. Where staff do not have an up-to-date understanding of market abuse issues, related risks are significantly increased.

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