Financial Conduct Authority

Market Watch

Newsletter on market conduct and transaction reporting Issues

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You can also find issues on our website at: www.fca.org.uk/firms/markets/market-abuse

FCA – Our strategy and 2015/16 Business Plan

On 24 March, we published our Business Plan for 2015/16, setting out the key areas of work we will undertake in the forthcoming financial year, as summarised in our video.

This year's Business Plan follows on from our announcement in December 2014, where we set out details of how we intend to meet the regulatory challenges ahead following a detailed review of our strategy, priorities and ways of working. We have also released details of the two divisions that will undertake our supervisory and authorisations work, with each led by a director who will sit on the Executive Committee. The Investment, Wholesale and Specialists will be led by Tracey McDermott. Linda Woodall will head up the Retail and Authorisations division as acting director.

We thought it would be helpful to explain how the recent changes impact functions carried out by the Market Monitoring Department. The changes announced in the strategy are intended, amongst other things, to enable us to form a more consistent common view on key markets and sectors and to engage with the issues they present in a more strategic way.

Under the new structure we have created a Market Oversight Division, comprised of the FCA's market monitoring functions aimed at combatting market abuse and its UKLA responsibilities. This focussed unit will bring together our responsibilities for the oversight of participants in both primary and secondary markets, enabling us to take a more holistic view of the markets we oversee.

Market Oversight sits alongside Enforcement in a newly created Enforcement and Market Oversight Division. Bringing Market Oversight and Enforcement alongside each other recognises and builds on our credible deterrence agenda in combatting market abuse. By this we mean not just enforcement outcomes in relation to individual breaches but also, importantly, the educational engagement that we strive to achieve by working together with industry and participants to improve the general understanding of and compliance with the rules on market abuse. Our ongoing supervisory and education work will continue to feature strongly in our efforts in this area.

This new structure does not reflect any significant change in regulatory philosophy or approach to our primary or secondary markets activities and does not signal a change in enforcement appetite in relation to market abuse or UKLA matters. More generally, information flows between our enforcement and non-enforcement activities are not anticipated to change as a consequence of the new structure.

Finally, we have created a new Markets Policy and International Division in recognition of the importance of effective engagement internationally, particularly in Europe, for achieving good policy outcomes for markets. This focus will be particularly important in both the primary market space with the current European focus on the Capital Markets Union programme, and in the secondary market with the upcoming implementation of MiFIR/MAR and MiFID II.

Suspicious Transaction Report (STR) data now available

In response to the many requests received for data relating to Suspicious Transaction Report (STR) submission, we now publish these numbers on our website.

We recently published the figures for 2014 and will henceforth update this data annually in February on our STR submission page:

www.fca.org.uk/your-fca/documents/number-of-strs-received-by-the-fca

Last year – 2014 – saw a 24% increase in STRs and we continue to find the submissions we receive are of a generally high quality. As ever, we are committed to ensuring that the quality of referrals, the range of behaviours reported and the range of asset classes reported remain strong.

To this end, our supervisory visit programme continues. We visited 24 firms as part of this work in 2014 and found many firms investing heavily in their post-trade market abuse surveillance.

We additionally launched a supervisory questionnaire programme in 2014. We will send this electronic questionnaire to approximately 50 firms per year who, we believe, form part of the STR regime. The firms are selected based on trading volumes. We will use the results to improve our knowledge of firms' surveillance arrangements and to help us identify firms which would most benefit from a supervisory visit.

We would like to thank those firms involved in both the trial and the first tranche of the survey. We are analysing the results of this work with a view to selecting firms to visit later in 2015.

Market monitoring: reminding MTF operators of their duties under the FCA's Rules

We have carried out a thematic review of the market monitoring arrangements of Multilateral Trading Facility (MTF) trading platform operators. The review focused on the monitoring of cash fixed income products traded electronically on MTFs.

Fixed income markets are vast in size, and highly diverse. A subset of fixed income trading takes place electronically on MTFs, via a variety of trading protocols. Electronic trading is widely expected to become more important in fixed income, and we are aware that trading platforms are positioning their services in this context.

So we see our thematic review of the surveillance arrangements in this area as a timely reminder of the need for trading platforms to operate market monitoring controls that are, and remain, fit for purpose.

Fixed income MTF surveillance is underdeveloped

The overall finding of our thematic review is that the market surveillance arrangements operated by the majority of fixed income MTFs are poor. The fact that we receive relatively few reports under the relevant rule – MAR 5.6.1(1)R – related to fixed income trading may be further evidence of this.

Risk-based monitoring

We were disappointed to see that the monitoring controls of a substantial proportion of MTFs included in our review were underpinned by an inadequate assessment of the risk of market abuse occurring on the MTF.

The assessment of risk was often not specifically tailored to the market abuse risk relevant to either the specific product, or the particular trading protocol. While there was a basic appreciation that a particular type of abuse was more prevalent in relation to some products than others, demonstration of how this was risk-assessed was lacking. When market abuse risk is not assessed in sufficient detail, there is a risk that the surveillance controls become overly generic and will not completely map across to the actual risks relevant to a platform. We observed this risk crystallising on many occasions during our review.

Monitoring basics

Even where the risk assessment was appropriately mapped to the products traded, the processes implemented to identify and control these risks were mainly insufficient.

Under our rules, an MTF operator must give us its full assistance when we investigate and prosecute market abuse occurring on or through the firm's systems (MAR 5.6.1(3)R). But we are concerned that a substantial number of MTF operators lack the resource to do this.

We found that some MTFs included in our review lacked basic elements of effective risk-based monitoring, such as: a monitoring tool that is fit for purpose and reasonably calibrated, suitable surveillance staffing, and a monitoring framework and processes that can ensure surveillance activities achieve a consistently acceptable standard and that monitoring outcomes will not become subject to undue conflicts of interest.

Some firms could not demonstrate adequate record keeping for surveillance matters. We noted the benefits of using an integrated surveillance and case management tool capturing monitoring activity, investigative work and potential referrals, as well as enabling the production of relevant management information such as trends in repeated abnormal behaviour of particular participants, or deviations in alert frequencies that may indicate that alerts are no longer appropriately calibrated.

Fixed income monitoring

A large number of MTF operators in the review could not prove they used a fixed-income specific monitoring methodology that appears relevant to the monitoring of different areas of fixed income: the consideration of yield spreads to highlight movements in individual bonds that are anomalous to the rest of the market.

Another example of a technique we consider highly useful for detecting market abuse in fixed income was monitoring new issues. But unfortunately we found that only a minority of venues used this. New issues can often explain trading activity in other, related, bonds. Keeping an eye on the new issues market can therefore also be relevant to platforms that are not involved in the actual trading of such new issues.

Trading venues must also monitor orderly trading conditions on the platform they operate. Different market models represent different risks, and while we observed that the quality of monitoring was varied, in many cases there appeared to be a heavy reliance on front-office staff to identify issues with a relatively limited systematic approach to orderly market monitoring.

Surveillance roundtable for cash fixed income MTFs

In February this year, we discussed our thematic review, and good and bad practices in cash fixed income surveillance, during a dedicated roundtable for MTF operators active in the fixed income trading space. This was an open and constructive discussion, and we hope it will contribute to improved surveillance practices in fixed income markets.

A significant number of the MTFs that were included in our thematic review will need further improvement to get to an acceptable level of market monitoring. We have taken steps in respect of these MTF operators to ensure that good practices in fixed income surveillance will become the norm.

This article complements our fixed income MTF-specific actions and is intended to increase awareness of regulatory requirements with respect to ensuring market integrity in fixed income. We also consider that the relevance of the general observations included in this article is not restricted to trading venues in fixed income markets.