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By email: gc18-01@fca.org.uk

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Dear Mark

FCA Guidance Consultation 18/1 on new chapter to the financial crime guide on insider dealing and market manipulation systems and controls

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

We welcome the opportunity of responding to this consultation and discussion. In Guidance Consultation 18/1 the Financial Conduct Authority (the "**FCA**") consults inter alia upon adding a new Chapter 8 to the Financial Crime Guide (the "**FCG**") focussing upon insider dealing and market manipulation. This is the first time that the FCA has sought to address market misconduct crimes through the FCG. Our response relates only to this proposed new Chapter 8. We do not respond to any other aspects of the consultation.

Aside from one important issue relating to the status of the contents of the FCG as "relevant guidance" for the purposes of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the "**Money Laundering Regulations 2017**"), our response relates only to the proposed new chapter 8 and we do not respond to any other aspects of the consultation.

Relevant Guidance under the Money Laundering Regulations (the "MLRs")

Paragraph 1.1.9 in the Introduction to the FCG proposes a highly significant change in the status of the contents of the FCG, namely that whereas previous incarnations of the FCG did not constitute "relevant guidance" under MLRs, this revised version of the FCG will constitute relevant guidance for purposes of the MLRs. This means that a decision maker under the MLRs is required to consider whether a person followed the guidance in the FCG (along with other relevant guidance such as that of the Joint Money Laundering Steering Group) when it is deciding whether that person has breached the regulations. It appears to the Committee that a significant amount of the contents of the FCG, is not in an appropriate form to constitute effective guidance for such a decision maker on matters of breach of the MLRs (we would highlight in particular self assessment questions and examples of good and bad practice). In that respect, in content and development the FCG is a very different document from the JMLSG's highly granular guidance for the regulated sector. In addition some portions of the FCG do not appear to be relevant to potential breaches of the MLRs at all

We would recommend that the FCA should reconsider whether this wholesale change of status is appropriate for the contents of the FCG as a whole or any part of it.

Proposed Chapter 8

Paragraph 1.14 of the introductory remarks in the consultation document highlights what the FCA suggests is a key distinction between a firm's obligations under Article 16(2) of the EU Market Abuse Regulation ("**MAR**") (for those firms where Article 16(2) MAR rather than 16 (1) MAR applies) and the financial crime systems and controls requirements set out in SYSC 6.1.1R: namely:

- Article 16(2) of MAR requires persons professionally arranging or executing transactions "*to **detect and report** potential [civil] market abuse*" (paraphrasing the obligation to establish and maintain effective arrangements, systems and procedures to detect and report suspicious transactions and orders); whereas

- SYSC 6.1.1R "*extends firms' obligations to **counter** the risk of financial crime*".

The FCA states that the guidance in the draft chapter is intended to address ***criminal*** insider dealing and market manipulation and that "*This document does not provide any FCA guidance in relation to MAR article 16".* Nevertheless the FCA is clearly expecting that firms will voluntarily apply the guidance in the draft chapter to all financial instruments that are covered by *both* the criminal and civil regimes because there is explicit recognition that de facto firms typically do not distinguish between the civil and criminal market conduct regimes in the mitigating systems and controls that they deploy. Paragraph 8.1.5 of the draft chapter states "*We recognize that many firms will not distinguish between the criminal or civil regimes for the purposes of conducting surveillance and monitoring of their clients' and employees' activities. As such firms may find it simpler to consider this guidance as applying to all instruments to which both MAR and the criminal regimes….apply*".

Further the draft guidance appears to conflate the word "**counter**" as used in SYSC 6.1.1 with a requirement to "**prevent**" financial crime. The obligation upon firms under SYSC 6.1.1 is not to "prevent" financial crime, it is to "….establish, implement and maintain adequate policies and procedures sufficient….for countering the risk that the firm might be used to further financial crime". We would submit that "counter" within the meaning of SYSC 6.1.1 is requiring firms to have systems and controls to **oppose** or **mitigate** the risk that a firm may be used to further crime, not a requirement that those controls must be sufficient to prevent financial crime ever happening in the first place.

The draft chapter makes a number of references to "prevention". For example, paragraph 8.1.9(1) of the proposed new chapter states that "*appropriate measures for the* ***prevention*** *of financial crime are likely to fall into two distinct categories (1) the identification and* ***prevention*** *of attempted financial crime* ***pre-trade****, and (2) the mitigation of future risks posed by clients who have been identified as having traded suspiciously*". In a similar vein, the guidance on policies and procedures at paragraph 8.2.3 of the draft chapter states firms should ensure that their policies and procedures cover both identifying and **preventing** attempted financial crime **before any trade is executed** and mitigating future risks posed by clients who have already been identified as having traded suspiciously.

Even for those firms falling under the obligation in Article 16(1) of MAR – market operators and investment firms that operate a trading venue – that obligation is not a hard obligation to "prevent" market abuse but is a systems and controls obligation – they "….*shall establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation*….".

The current drafting of Chapter 8, such as the quotes we give above from paragraphs 8.1.5, 8.1.9, 8.2.3, together with paragraph 1.14 of the introductory remarks, could be read as suggesting that the FCA expects firms covered by Article 16 (2) MAR routinely to deploy additional pre trade controls over and above the controls (in particular post trade surveillance) that have been put in place by firms to satisfy the requirements under MAR. The current drafting could be read as the FCA is seeking by this means to extend to all firms a higher "prevent" insider dealing and market manipulation standard whereas MAR explicitly distinguishes market operators and firms operating a trading venue as having the higher obligation in that respect. The draft chapter does not, presently, distinguish between different categories of firms as having different levels of obligation in the way that MAR does.

As a legal matter it is the view of the Committee that SYSC 6.1.1R does not give the FCA legal authority to supersede or gold plate the very specific maximum harmonising regime established under MAR. It would be helpful for regulated firms, therefore, if the FCA could amend the current drafting of Chapter 8 to clarify that the FCA is not expecting an additional level of routine controls and surveillance (including pre trade controls) above those put in place by firms to comply with their obligations MAR Article 16 (2) and its subsidiary instruments.

Instead the FCA could make clear, assuming that this is the FCA's policy intention behind the draft Chapter 8 FCG, that firms' obligations do not end with filing a Suspicious Transaction and Order Report under MAR. Rather, if the firm has that level of suspicion and the behaviour could also constitute criminal insider dealing or market manipulation and could have given rise to proceeds of crime, then firms should also be considering their obligations to file a Suspicious Activity Report under anti money laundering legislation and should also be considering what additional steps are appropriate to mitigate the risks of a repetition of the wrongful behaviour. In other words, for firms covered by the requirements of Article 16(2) MAR, the FCA could make clear that for this population of firms the impact of Chapter 8 FCG is to emphasise that they should mitigate future risks posed by clients (or indeed employees of the firm) **who have already been identified as having traded suspiciously.** These firms are not being asked to put in place additional controls in respect of clients or employees who have not been identified as having traded suspiciously.

In paragraph 8.2.3 it is stated that the FCA expects 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." It is unclear to us whether the FCA intends here to refer only to the risk of a criminal offence relating to inside information or market manipulation being committed or to relevant legal and regulatory requirements generally. It is also unclear what standard of knowledge or suspicion the FCA intends by the words "clear risk" but it appears intended to mean something more than merely "reasonable grounds to suspect".

If this provision is to be retained, we would recommend additional guidance on this point so that firms deciding whether to refuse to execute trades are on firmer ground in face of potential liability to their clients for failing legitimate trades. There is possible risk of detriment of the underlying clients of buy-side firms if the sell-side were to adopt an overly defensive approach and reject trades on the basis of unduly low levels of suspicion. Sell side firms will generally not have a line of sight into the intentions and motivation of their buy-side customers. This is particularly problematic in the area of market manipulation where with behaviours such as suspected spoofing, the broker will typically be looking only at a pattern of orders and trades when deciding whether to submit a STOR and/or SAR and will have no other information from which to deduce the intentions of the buy-side client.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours sincerely

Karen Anderson
Chair, CLLS Regulatory Law Committee

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