

# MANAGING CONDUCT RISK AND PROTECTING AGAINST MARKET ABUSE DURING THE COVID-19 CRISIS - WEBINAR

26 May 2020

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Conduct Risk has been a defining theme of the Financial Conduct Authority and whilst Conduct Risks might be blindingly obvious once in front of you, they may be difficult to spot in advance. It is therefore essential for businesses to understand what conduct Risk means, identify the risks and drivers to protect themselves and ensure markets remain clean.

Equally, firms must make clear to employees conduct expectations and highlight good conduct, employing a strong and robust Conduct Risk Framework to meet regulatory expectations and ensure compliance with regulations.

With all the present changes brought about by the COVID-19 pandemic, regulators expect firms to take responsibility and ensure business continuity while continuing to meet key regulatory requirements and ensuring employees understand the higher risks and consequences of poor behaviour. The risks of Market Abuse are heightened during the pandemic and regulators across the globe are working together to ensure the markets maintain the highest standards of integrity, with firms expected to do their part on that.

## Discussing Conduct Risk and Market Abuse mitigation during COVID-19

Gowling WLG Partner and Head of UK Financial Services Regulation and Joint Head of UK Financial Services Sector Ian Mason, and UK Financial Services Regulation Principal Associate Sushil Kuner joined MyComplianceOffice (MCO) for a discussion of crucial aspects of Conduct Risk and Market Abuse mitigation, exploring:

- What does Conduct Risk mean?
- [FCA's 5 Conduct Risk Questions Programme](#)

- What are Conduct Risk Drivers?
- What should a good Conduct Risk Framework include?
- The impact of COVID-19 on Conduct Risk
- What is market abuse and why does it matter?
- The heightened risks of market abuse arising from COVID-19
- The FCA toolkit for market abuse
- Current Enforcement trends

Watch the webinar: 'Managing Conduct Risk and protecting against Market Abuse during the COVID-19 Crisis'.

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## Transcript

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**John Noonan:** Hello everyone. This is John Noonan from My Compliance Office. Welcome to the webinar Managing Conduct Risk and Protecting against Market abuse during the COVID-19 crisis. Presenters Sushil Kuner and Ian Mason from Gowling WLG.

I would like to kick things off by welcoming Sushil - principal associate at Gowling WLG. Sushil, over to you.

**Sushil Kuner:** Thanks John and hello everyone. Ian Mason and I are very pleased to be presenting to you all today and just to mention that we are former regulators ourselves.

Ian was the head of wholesale enforcement investigations at the FSA and I joined Gowling WLG almost two years ago now, having spent eight years working across a number of roles in the supervision and enforcement divisions of the FCA.

Today I will start off by discussing conduct risk, which has been a defining theme of the FCA - understanding what it means for firms, what good conduct risk frameworks should consider and what the impact of COVID-19 has been on conduct risk. As we will see later, one of the risks arising from the current pandemic, is the increased potential for market abuse, which Ian will be talking about in the second half of this presentation explaining what market abuse is, how COVID-19 can heighten the risks of market abuse and how the FCA tackles market abuse.

Ian will then finish off by discussing some current enforcement trends.

So, what is conduct risk? Conduct risk is not a defined term and the FCA has expressly stated that it is not suggesting that there is a single regulatory approved conduct risk framework that will suit every organisation. Rather, firms must develop their own conduct risk definition and strategies and put in place a tailored conduct risk framework to address the specific risks that they are exposed to and the needs of their organisation.

Having said that, it is generally accepted that at a high level, conduct risk means any action of a firm or individual that has the potential to cause consumer harm or harm to market integrity. It is the risk that divisions and behaviours across a firm lead to detrimental or poor outcomes for consumers and the risks that the firm fails to maintain high standards of market integrity and behaviour.

Conduct risk therefore touches on all parts of an enterprise framework. The FCA has, in recent years, been adopting a more outcomes focussed approach. In its 2020/21 business plan, the FCA stated "a regulatory approach which focusses on outcomes will allow us to be clearer at a time when market dynamics, innovation, societal and legislative changes are all transforming the financial landscape.

We want all firms to take the end-out for consumers and markets into greater accounts when they design and deliver services. The FCA has also been making clear its view that firms culture shapes the outcomes for consumers and markets. Which is why its supervisory work aims to assess and address the drivers of culture. This includes looking at firms leadership, purpose, governance and approach to managing and rewarding their employees.

Andrew Bailey, in his role as chief executive of the FCA, said in his speech in 2018 that

"there is no single right culture. It depends on circumstances and there are certainly cultural characteristics which are highly suggestive of good outcomes." We will come onto explore this a bit later.

An important point to note is that conduct risk is not only a retail issue. Poor conduct and wholesale markets poses a risk to the FCA's objectives through the way in which it threatens the soundness, stability and resilience of financial markets and transparency of the price formation process.

In 2015, the FCA set out five key questions that it expects financial services firms to ask themselves and to be able to answer to the regulator. These questions inter-probe how organisations embed long-term good business practice or how the organisation considers good conduct in its training and induction programme. When assessing conduct risk, the FCA considers the firms approach to these questions and whether the board is engaged with these issues.

So, let us just look at these questions then. What proactive steps do you take as a firm to identify the conduct risk inherent within your business? How do you encourage the individuals who work in front, middle and back office control and support functions to feel and be responsible for managing the conduct of their business? What support does the firm put in place to enable those who work for it to improve the conduct of their business or function? How does the board and ExCo gain oversight of the conduct of business within their organisation and equally importantly, how does the board or ExCo consider the conduct implications of the strategic decisions they make.

And finally, has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Since their introduction, financial services firms in the UK have invested substantial efforts in change programs related to conduct and culture in order to be able to satisfactorily address these questions. The starting point for any firm is to understand the drivers of conduct risk within their business and what good conduct of business looks like.

This slide sets out some examples of conduct risk drivers stemming from firms' structures and behaviours and which could create a risk of harm to consumers or market integrity. Firms that understand the drivers of conduct risk can better understand whether their conduct risk frameworks are robust enough to mitigate against the risk of harm.

Taking governance first. A firm which has poor governance cannot effectively identify and mitigate risk to the firm caused by their business activities. For larger firms with more

product lines, it becomes even more difficult. In my previous role as an FCA enforcement investigator, I often investigated root causes of long-running failings in some of the largest institutions and a common theme that we kept identifying was that there were layers of management and committees with similar and often over-lapping objectives with similar MI going up the chain, in varying different forms with no-one really keeping a close eye on whether, and to what extent, issues were being addressed and by whom.

The introduction of the senior managers and certification regime, should go some way to addressing this, but it is a long-running theme which the FCA pays close attention to. Similarly, a firm which is inadequate systems and controls, cannot effectively identify a risk of harm caused by its activities. Management information or MI is a key form of control and if not designed properly, can lead to risks not being properly identified.

Going back to my enforcement days this was another recurring theme when investigating root cause of failings. In some instances, findings from quality assurance work conducted within the business or by the second line of defence, highlighted significant risks.

However, due to the design of MI, these findings were often lost, for example by amalgamating negative results with more positive results, in high level reports to the board which overall gave green RAG statuses. This is a great example of why firms should be adopting both a top-down and bottom-up approach in identifying risk.

The SMCR tries to hold individuals within a firm to account where failings are identified and it should be noted that where MI is found to be deficient, it is not generally a good excuse to say that MI pre-dated an individual's role. MI should be kept under review to ensure that senior management is receiving the right information at all times.

Next. Conflicts of interest. Do you routinely review a business models and assess whether there are any potential conflicts of interest that may be present? For example, do you have a vertically integrated business model? Do you manufacture and distribute products? Is the way in which you incentivise your employees creating conflicts of interest?

Culture in financial services is widely accepted as a key root cause of the major conduct failings that have occurred within the industry in recent history. Given its impact, firm's culture is a priority for the FCA and it expects firms to foster cultures which support the spirit of regulation in preventing harm to consumers and markets.

Things to think about when trying to ascertain your firm's culture include: What's the tone from the top like? Does senior management act in accordance with policies and procedures of the firm? Do they still reward bad behaviour through remuneration, for

example because the employee is hitting their targets?

Is there a blame culture within your organisation when things go wrong? This often discourages people from speaking up and admitting they have made a mistake. Thereby preventing problems from being rectified. Do people turn a blind eye to misconduct in the workplace for fear of speaking up?

Where you may have great speaking up initiatives, are these truly embedded within your organisation? And is there an element of indecision within your organisation? Do difficult decisions tend to be put off? This could lead to long-running failings at the firm, not being addressed through prompt decisive action.

A firm's business model is a potential driver for conduct risk. For example, product design and complexity. Here I point to the classic example of consumer searching for yield in a low interest rate environment and firms reacting by designing increasingly complex products to meet this demand. Then there is technological advancement in pursuit of lowering costs and gaining efficiencies, more firms are investing in newer technologies and moving more of their offering online.

With this come additional risks, such as operation of resilience and cyber-security and these can have a detrimental impact on both customers and markets if not deployed correctly. And then we have individual behaviour. For example, insider dealing which is difficult to prevent, but through systems and controls can be detected.

As I mentioned earlier, the FCA expects firms to have in place conduct risk frameworks which are tailored to the needs of their business, based on size, business model and geographic reach. The framework should take into account both its short and long-term goals and should be robust enough to manage the conduct risk associated with that business.

The most successful programs often have regular board level reviews and challenge programs in place. Whilst there is 'one size fits all' program, we have highlighted in these slides the key considerations when trying to create your conduct risk framework. Now, I am not going to go into these in detail as we have already explored key conduct risk drivers and things to consider, but just to emphasise again that as a first step, firms should be defining what conduct risk means for them and establish a clear relationship between conduct risk and business strategy.

Clear lines of responsibility and accountability of conduct risk should be established and responsibility of the overall culture of the firm should sit with senior management who

should set out the tone of how their staff behave.

Firms should be making an assessment of all of the conduct risk that the firm is exposed to, for example insider trading, conflicts of interest, mis-selling and so on and the ensuring that these are mitigated as far as possible through appropriate controls. Finally, conduct risks should be monitored and appropriate metrics and management information be designed.

I wanted to highlight an interesting development from the FCA, who have indicated that diversity within senior management can be a conduct risk mitigator. As such, the FCA is treating diversity as a key supervisory issue and will be asking firms in its supervisory oversight role, about their gender diversity policies.

I'm going to read out an interesting quote from Megan Butler, executive director of supervision in wholesale investments and specialist supervision on this issue. "We need to call out the fact that diversity is fundamental to business success and to the production of failure".

Firms that promote gender diversity also significantly lower their conduct risk and this is where the FCA's interest comes in. Firms with mono-cultures suffer 24% more governance related issues than their peers, so our supervisors may ask directly about gender diversity policies. Are you recruiting an even split of female and male graduates? Are those female graduates rising through the ranks in equal numbers and if not, do you understand why? Does equal pay and the pay gap get attention in your firm? And can your business do more to prevent environments that appeal to women and give them confidence.

It is important to note that this is not just a viewpoint being shared by the FCA. It is actually based on studies that they have conducted. The FCA often carry out thematic reviews and in a population of similar firms, they often find a mix of firms who adopt a good or poor practices. They compare the board composition of those firms implementing what they perceive to be good practices with those that were adopting poor practices and identified that there was greater female representation on the boards of firms adopting good practices.

However, although the FCA will be more intrusive about a firm's gender diversity policies, it is more interested in firms being able to demonstrate that they have diversity of thought at senior leadership levels, rather than expecting all firms to have X amount of females or ethnic minorities etc. on the board. They do not want this to be a tick box exercise for firms.

To highlight this point, we thought it would be fun to have a quick interactive game. So, without thinking about it, I would like you to choose a colour that appeals to you the most and select that colour in the poll that is just coming up. So, the poll is up. If you would like to make your selection please.

Oh, I think we are having a technical glitch at the moment. Apologies for that. Okay I think we are going to have to do without the poll. Unfortunately but I can talk you through it anyway. I can play this with Ian, just for demonstrative purposes. So, if we could just close that poll please. Okay, so Ian I am going to ask you instead then. What is your favourite colour? What appealed to you the most?

Blue is my favourite colour, so I would choose blue.

Okay. Thanks for that. Okay, for full disclosure purposes. I will go for red. Oh, trying to get onto the next slide here.

Okay so apologies for that. Okay so according to various personality tests that I found on Google, experts have determined that there are four basic personality types. So if you are a red like me, you like challenge, you are persistent, decisive, like to take charge, confident and if you are a blue, like Ian - you are orderly, conscientious, diplomatic, analytical, disciplined.

So if you chose yellow, yellows tend to be optimistic, enthusiastic, entertaining, like to help others and they are verbally articulate and then greens - supportive, loyal, consistent, controlled and good listeners.

That sounds great, right? Well each personality trait also has certain weaknesses which I am trying to get onto the next page again.[Ah, there you go] With reds tending to be known as the dominating personalities - they are said to be impatient, demanding and resent restrictions. And it appears that Ian may be a bit pessimistic who does not like to try new things and can be sensitive to criticism. Yellows, whilst having very sunny personalities, may appear unable to take anything seriously and act impulsively whereas greens apparently are procrastinators, who hold grudges and are often indecisive.

So what is the point of all of this? Well it goes to the FCA's point that effective boards who adopt good conduct risk practices often have a diverse board with the right blend of personalities. If your firm has a mono-culture, then there is more of a risk that certain practices or decisions are not challenged appropriately at the board.

Just a quick note on other FCA hot topics right now. Gender pay gap. Are you disincentivising women to enter the industry or get to senior leadership positions and thereby

reducing the talent pool or not having a diverse enough senior leadership team. Fear versus psychological safety. Is there a fear of speaking up, despite whistle-blowing initiatives? Healthy corporate cultures we have already discussed and then non-financial misconduct.

The FCA is showing more interest in this area. It has made clear that although it is not the morality police, it will be taking an interest where there are allegations of non-financial misconduct against senior management or allegations that senior management are not treating allegations of non-financial misconduct seriously. Allegations of non-financial misconduct to call into account individuals' integrity and both questions over whether those individuals are fit and proper to perform their roles.

And then, finally mental health. Is your firm treating mental health seriously? Pressures on staff and mental health issues can impact on individual behaviours who should feel supported by the business.

Turning now then to COVID-19. I do not need to tell you that it has had an unprecedented impact on businesses and global markets. All UK financial services firms are expected to implement measures to protect and support their staff from being exposed to, or contracting COVID-19 and observe the relevant UK government policy implemented from time to time. For example, on social distancing.

The government indicated at the outset that financial services was considered to be a critical sector and at the same time, the FCA, Bank of England and Her Majesty's Treasury all made clear their expectations of financial services firms to have effective contingency plans in place, to enable them to continue operating effectively while meeting their regulatory obligations.

COVID-19 can create a number of conduct risks which, if not mitigated through adequate contingency planning, could result in harm to consumers and market integrity. It is not inconceivable that COVID-19 could, for example, impact on the health of senior management teams and the board. Firms should therefore ensure that they have a robust crisis-management policy in place and identify all personnel who carry out key governance functions to ensure continuity of day-to-day decision-making.

They should also consider the possibility of senior managers approved under the senior managers' regime being unable to carry out their roles and any temporary arrangements which may be required. Cyber-resilience is also another key consideration. The European Central Bank warned banks early on to prepare for an increase in cyber-attacks as cyber-criminals sought to take advantage of potential chaos caused by COVID-19.

Firms should ensure that potential mass staff shortages do not impact on their cyber-resilience and ability to withstand malicious attacks. There have also been press reports of a significant rise in the number of phishing emails, in which cyber-criminals take advantage of fears over COVID-19. Firms should ensure they are taking all reasonable steps to shield their customers from such practices.

In terms of operational resilience, if large volumes of workers are working remotely from home, how are you going to mitigate key regulatory risks during these temporary working arrangements? [Sorry, I've moved back one]. For example, if there are requirements for telephone call recording, how are you going to adhere to those requirements?

How are you going to monitor employees working from home? How do you ensure employees continue to meet high regulatory standards from an informal home setting? Regulated firms which outsource services in particular, critical important services, should be monitoring their outsourcing agreements closely.

The regulated firm remains responsible to the regulator for the activities being conducted by outsourced providers. In the event that the operations of the outsource provider are impacted by COVID-19 to the extent that it can no longer meet its obligations under the outsourcing agreement, the regulated firm should take swift action to ensure continuity of business.

Firms should be ensuring that their online services are able to cope with increased demand from consumers who may now be utilising more online services for everyday financial needs. Talking about consumers, the FCA has gone to great lengths to issue guidance for firms on how they treat their customers fairly in the current environment.

For example, mortgage lenders and consumer credit firms who have been told to offer customers a payment holiday for three months if they are facing financial difficulties as a result of COVID-19. Lenders have been encouraged to relax rules and credit within these assessments, but SME's who need access to the government's business interruption loan and bounce-back loan schemes and so firms really need to be understanding what the regulatory expectations are for the sector that they operate in.

The FCA has also issued guidance for firms providing services to retail investors, including how to conduct identity checks remotely as part of their obligations under the anti-money laundering regime.

While the FCA expects firms to honour their core regulatory obligations, they are showing some flexibility to firms in the current pandemic, wherever possible. Finally, it is worth

noting that COVID-19 has had an unprecedented impact on financial markets, causing billions to be wiped off stock markets worldwide.

It is crucial for the orderly and proper functioning of the markets that all financial market participants adhere to their regulatory obligations when deploying their business continuity measures during this pandemic.

In particular, issuers should disclose, as soon as possible, any relevant significant information concerning the impacts of COVID-19 on the fundamentals, prospects or financial situation in accordance with their transparency obligations under the market abuse regime.

I will now hand over to Ian, who can now talk more about this.

**Ian Mason**: So, what is market abuse? Well, it falls into three categories. Insider dealing - which you will be familiar with, which is obviously where a person provides insider information and uses that information to trade, so for example you know that company is planning an acquisition and you deal ahead of that acquisition using that inside information.

Secondly, unlawful disclosure of inside information. Which is where a person discloses inside information to any other person, except where the disclosure is made in their normal exercise of their employment professional duties. So there is a little bit of a get-out there.

So you cannot discuss inside information with friends, family or colleagues unless it is connected with your role and I wanted to emphasise here that it is the act of disclosure itself that is unlawful, not where the recipient acts on that information or makes a profit. So once you have passed on that information, it is out of your control and you do not know what the recipient will do with the information.

And then thirdly, market manipulation. Now this is broadly defined but includes placing an order or trading in a way which gives forceful misleading signals in relation to the supply or demand for the price of a financial instrument. And as I will come onto later, the FCA is actually investigating a much higher proportion of market manipulation cases than it used to.

And why does it matter? Well, if you get it wrong, there are significant fines and sanctions and both companies and individuals can be fined. The levels of fines in this slide are the figures in the market abuse regulation itself, but it is possible for financial authorities to go above these levels and in fact in the UK, the FCA can impose unlimited fines and as well as civil market abuse regime, there is also the separate criminal regime for insider dealing.

And really preventing market abuse is a high FCA priority. Under the criminal regime, the FCA has obtained 36 convictions for insider dealing and it has a particular focus on market abuse in six institutions, whether against directors or advisers such as accountants or lawyers, what a former FCA director enforcement calls "cook crooks in pin stripes".

And to give you one example of this - a fairly recent example, it is a case the FCA announced in June 2019, where a senior compliance officer at the investment bank UBS in London used her position to identify inside information, which she then passed onto her family friend who was an experienced day trader in securities and they were using pay as you go mobile phones and the family friend made a profit of about £1.4 million from the trading, was subject to the five charges and the UBS officer was sentenced to three years imprisonment and the family friend received three years imprisonment in relation to five offences of insider dealing. So that shows you the FCA does take these cases seriously.

We are now going to look at the definition of inside information under the market abuse regulation. So, what is inside information? Well it has to be information of a precise nature. Now there are some grey areas in terms of what is precise. And that is a judgment on a case-by-case basis. For example, how detailed are the terms or structure of the potential deal?

It has to not have been made public. So, the classic example of this, is if you are on a train - in the days when we could all go in public transport - and you saw a factory burning down, the factory is owned by this company. Obviously in that situation, that would be public information, so in theory you could actually - having seen that - go ahead and deal with the new company shares that owns that factory because you have seen that public instance occurring.

And then the significant effect in terms of whether it has been made public or not would it be likely to have a similar effect on the share price and there is no fixed percentage here. It really depends on the liquidity of the stock and the nature of the information. So that is just on a case-by-case basis.

I wanted to look now at market soundings. So, the basic position as I have explained is that the unlawful disclosure of inside information is a breach of the market abuse regulation and the markets soundings regime provides a safe harbour for the communication of that information provided procedural requirements are followed. What is a market sounding?

Well, basically it is the communication of information that falls prior to the announcement of transaction in order to gauge the interest of potential investors in a possible transaction

- that is a market sounding.

Those of you with longer memories may recall the practice of being - what was known as being taken over the wall? The market sounding regime really replaces that. What we have now, is a much more prescriptive and formal regime with detailed record-keeping requirements.

And what are those procedural requirements? Well the recipient must consent to receiving the inside information. So they may say, well actually I do not want to receive the inside information, in which case the person passing the information must stop at that point. The recipient must be notified when the information ceases to be inside information and the disclosing party must keep a record of all that information disclosed to the recipient and the date and time of disclosure, and those records must be kept for five years.

Those procedural requirements must be followed to comply with the market soundings regime and get the benefit of that safe harbour. Turning now to market abuse in the COVID-19 crisis. Well, I think as we know, in times of crisis such as war time and economic depressions, these create increased opportunities for illicit activities - black market goods and the Corona virus pandemic is no different and it has been reported that scams - both face to face and online, cyber-fraud and similar activities are on the increase with criminals taking advantage of a captive audience working from home, as many of us are.

And the Corona virus emergency has created conditions for market abuse. So the FCA's announcement of two month's temporary relief for listed companies to complete their audited financial statements may result in companies sitting on potentially inside information, which they would otherwise have disclosed sooner.

And with most office based people working from home, normal controls around the protection of inside information will also be weaker so there is a higher risk that confidential documents are left lying around the home or not disposed of securely. And in fact, some firms, some financial institutions prohibit the printing of work related documents at home.

Also, the current volatility of financial markets makes suspicious patterns of trading or transactions harder to spot. It is not really clear what is, if you like, normal in the current markets. So firms will need to consider what the new normal is, in relation to the perimeters previously set for price changes or profits generated.

While it is important to bear in mind and to be clear that despite the current challenges,

the FCA has made clear that there is no relaxation or amnesty on the market abuse regulation and I have included in the slide here, a quote in terms of what they currently say and really emphasising that companies still have to fulfil their market abuse obligations in relation to inside information.

Now, the FCA has an impressive toolkit for tackling market abuse. Some individuals may also be tempted to take advantage of the current fertile conditions in market abuse - while the FCA is focussed on dealing with the COVID-19 crisis and may be distracted, I think this would be unwise. The FCA has a much larger detection net as a result of the increased reporting - transaction reporting implemented by MiFID II.

In 2019, the FCA received 9.8 billion MiFID II transaction reports. An increase in 17% on 2018. And the FCA also ingests approximately 300 order book which generated around 150 million order reports a day. And the FCA systems can now consolidate the order book, so that it can look across and aggregate orders in the same stock across different platforms.

It receives around 6,000 suspicious transactions in order reports each year. Now that is a lot of data. As a part of the suite of measures designed to help financial services firms weather the impact of COVID-19, the FCA has stated that for market trading and reporting, "as firms are moving to alternative sites and working from home arrangements they must consider a broader controlled environment in these new circumstances". So the FCA have said that firms should continue to record calls but we accept that some scenarios may emerge where this is not possible.

Firms should make us aware if they are unable to meet these requirements. We expect firms to consider what steps they could take to mitigate outstanding risks if they are unable to comply with their obligations to record work communications. This could include enhanced monitoring or retrospective review whilst the situation has been resolved.

They also say, firms may experience difficulties in submitting their regulatory data, in which case we expect them to maintain appropriate records during this period and submit the data as soon as possible. Firms should not unnecessarily delay these submissions, if firms have concerns, they should contact us, as soon as possible.

Problem issue here - if you have got a problem, do not sit on it. Let the FCA know first. If you are discussing it and do not report the matter to the FCA.

When the current crisis is over, my expectation is that the FCA will look back at any suspicious trading patterns over the period, except it is not doing so now and of course,

as I have said, it will still be receiving real-time transaction information.

Now, that does not mean they are going to commence an immediate enforcement investigation but that investigation can always be started later on. So looking at what has changed since market abuse regulation was introduced. Well, as I have said, the procedures for handling and the scourge of inside information have really heightened up.

And we have the market soundings regime. But I also wanted to emphasise that social media has really increased the risk of market abuse. And the informed disclosure inside information is a particular risk. So the use of bulletin boards and Twitter may be used to give a false misleading impression of prices to mitigate the market.

So, electronic media have really increased the scope here of the risk which may arise. One of the other changes is the early detection of market abuse. And I have already mentioned the bigger net available to the FCA through increased transaction reporting. And the FCA is also - as Sushil mentioned - placed increased emphasis on whistleblowing and self-reporting by firms through suspicious transaction report.

The FCA has fined some firms not having adequate regulatory controls in place to report suspicious transactions or orders relating to market abuse. There is also greater collaboration with other law enforcement authorities and regulators. For example, the FCA worked closely with the SCC, the DOG and the European authorities in their investigations in enforcement action relating to the liable cases.

There has also been a step-change in the FCA's approach to opening investigations. The trigger for opening investigations is lower than it was. Basically, whenever there is a suspicion of serious misconduct, rather than just straightforward cases that the FCA expected to win, although in my view no case is that easy to win if you have good lawyers on the other side. So there are more investigations being opened. There are 96 enforcement cases open involving suspected insider dealing and 33 cases suspecting market manipulation, as of March 2019. More cases involving market manipulation.

As I mentioned earlier, the FCA has both regulatory powers under the market abuse regime and criminal powers to prosecute insider dealing and market manipulation. So the FCA will not typically know at the beginning of the investigation whether it is going to be going down the regulatory route, or the criminal route so the investigation will be dual-track with strict rules relating to criminal elements gathering being applied.

Of course, being faced with an investigation is stressful for any individual, but even more stressful when there is the prospect of criminal sanctions. How successful has the FCA

been in tackling market abuse?

In February 2020, Mark Steward who is the FCA's executive director of enforcement and market oversight revisited the market cleanliness metric that the FCA uses as a proxy for potential insider dealing ahead of takeovers. Now, for those of you with long memories, this metric was first published in 2008 when it found approximately 30% of takeovers showed abnormal price movements two days before an announcement and the latest figure, published in 2019 is currently at its lowest score at around 10% and the FCA has also developed a new measure, abnormal trading volume ratio which has produced a lower figure of 6.4%.

Now, Mark Steward has suggested some possible reasons for these lower scores. A higher level of enforcement activity, more investigations that is - is an obvious driver. And Mr Steward also indicated that decisions will be made shortly on some key market abuse investigations connected with evidence stripping, tax avoidance. These are complex investigations involving a number of European jurisdictions, as well as the U.S. and these will be significant cases when published.

But Mark Steward also highlighted a more strategic approach. What he calls, dynamic interaction involving created collaboration between enforcement and supervision teams at the FCA and also ensuring that market participants, that is the firms, play their role in detecting and reporting market abuse and the FCA are taking robust action against them, where they do not do that.

Mark Steward also highlighted a step change in market manipulation cases. So in previous years, the majority of market abuse investigations undertaken by the FCA involved insider dealing, those tended to be easier cases to prove compared with market manipulation.

Now the FCA has made a strategic decision really facilitated by its access to enhanced data, when equity trading in the order book - as I mentioned earlier - investigate more manipulation cases and in fact these now comprise 40% of market abuse investigations.

Now I think that is a big and quite brave call by the FCA because market manipulation cases are typically highly complex, they are resource heavy in terms of data and staff required. They take longer, they are difficult to prove evidentially. They are hard cases.

But the FCA - I think must be - and must be seen to be, active in tackling market manipulation as well as insider dealing. So that completes my section on market abuse, I will now hand over to John who is going to talk about My Compliance.

**John:** Thanks Ian and thanks Sushil - that was very very interesting. Can I just remind

everybody to please send questions that they have on this session. Just enter the questions in the chat box at the bottom of the screen.

Just while we are waiting for questions to come in, I would like to tell you a little bit about MCO. How we might help you manage conduct risk and protect your firms against market abuse.

At a core, we are software serviced based technology vendor that helps firms mitigate conflict or interest to an employee firm and third party activities. Ease of use is paramount for us. For firms that have not yet automated their employee activities, or perhaps those firms looking to switch providers, we recognise that the last comment you, as compliance officer, want to hear after purchasing the software is that the software is difficult to use.

When this happens, employee adoption rates go way down, you have an unused product on your hands and a lot of unhappy people. Therefore we designed our system to be extremely easy to use from both the supervisor and as well as the employee perspective.

We did not design this in a vacuum. We received lots of inputs from various sources, such as clients and consultants which has really paid off as everyone has reacted very positively to our newer interface.

The system is also designed to meet the toughest compliance regulations today. As important, the system is broad enough to meet your policies in any code of ethics and business requirements that you may have.

We were founded in 2008 as a spin-out of Fidelity. We now have over 400 customers worldwide using our products. About our solution suite, I think our platform hosts all the products and platforms that you can see in the diagram. At the heart of our solution is a compliance program manager - or CPM. This is the core engine where all functionality and modules originate from.

It is really a suite of tools that allow us to build and apply new applications on top of it. For example, this is where the rules engine, the task management, workflow and emails reside which is then shared across all of our modules.

Our PTM module manages the trades and the personal trading of your employees and the tracking of that activity. Complementing PTM's are our ability to connect with brokers such as Fidelity, Schwab and VanGuard. OBA - our outside business activities module, allows you to capture and apply the outside business activities and affiliations.

Gem - our gifts and entertainment module. This is a solution for monitoring employee gifts,

meals, types of entertainment, travel activities - you name it. You can program business rules based on dollar thresholds and easily aggregate by people or by companies.

Political Contributions Manager monitors all employee political contributions at both the federal as well as state level as well as state level. The Forms Manager allows you to create any form of pre-claim submission screens that can be linked to the rules engine. The systems comes with standard templates for modules such as OBAs and gifts. However you can create any form that your company needs, such as - for example, the permission to speak when expert network or the permission to speak at an industry trade show, or a conference.

The Attestations Manager allows compliance to configure and distribute any number of questionnaires for employees to complete. This can be done periodically such as monthly, quarterly, semi-annually or annually. KYT - or know your transaction provides a suite of complete transactions surveillance module.

The Trade Surveillance modules have been monitored, security trading and accounts and portfolios and in funds. Those are examples of different modules. The suitability manager compares investment activities across client objectives to ensure that brokers are not placing clients and securities outside of those stated investment objectives.

I know this module is a control room suite as you can see in the circle. I am not going through the older modules within the control room, but what may be of interested in today is an MNPI - an insider information module. This MNPI module tracks the receipt of MNPIs associated with an investment banking deal or a private investment. Examples of MNPI include a pending purchase or the sale of a company.

A known example is a pending raking change to a security. Compliance officers can create insider lists here and then add them individual to expose the inside information including the timeframes when they are eventually able to access this information. Interestingly enough, many compliance professionals today still use Excel to manually track this information.

The third product in our conduct suite is 'Know your Third Party' or what we call, KYTP. Our third party management tracks the risks that your third party such as your vendors, your customers, your suppliers, bring to your specific business. Clients use this module to track third parties during the on-boarding process as well to track them on an ongoing basis.

The product does have a risk rating capability where you can score and assign a risk

classification to any third party. The client lifestyle manager is a newer MCO offering - similar to our third party manager, that tracks the conflicts between your third parties and employee activities. That is all about MCO today. If you want to know more information, please send a - do not hesitate to contact us. We will bring up the contact details for both MCO and Gowling WLG shortly.

Now let us go to the questions.

And we have got one question. We have a few questions in actually. Let me start off with the first question that we have here. For Sushil or Ian.

Could COVID-19 have an impact on your non-financial misconduct?

**Sushil:** Yes. Thanks for that John, I can pick that one up. Yes. It might have an impact on non-financial misconduct. So when we talk about non-financial misconduct, here what we are thinking about is sexual harassment in the workplace, workplace bullying, that sort of issue, which given the fact that we are now - the majority of us are working from home in informal atmospheres, informal environments, using Zoom and online chat facilities, there is a risk that standards could drop? And that people that are not working in that more formal, structured office environment might make comments that may be inappropriate, start behaving in a manner that they may not, in the workplace.

So, it is again, I think the emphasis would be on firms in terms of that conduct risk training. Ensuring that while employees are working from home, they are making adjustments because of temporary working arrangements that they still understand their duties to their employers as well as under the regulatory system, to act appropriately.

**John:** Okay. Thanks very much. Next question. Is the FCA being more reliant towards firms in the current environment or can they expect enforcement action for breaches of rules in the current pandemic?

**Sushil:** Yeah, I think again if I just pick this up and maybe Ian can discuss it from a market abuse angle again, but from a general risk perspective it really depends on the seriousness of the breach that we are talking about.

I think the FCA will appreciate that the firms are under a significant amount of pressure at the moment, so if for example what you are facing is a technical breach where there is not much of an impact on - it does not have much of a customer harm, did not really lead to any harm to markets or market integrity, the FCA may show more leniency to those sorts of examples.

However if it has actually been on the forefront and putting out a lot of timely communications to firms in terms of its expectations when firms are responding to COVID-19 and if firms go against the various guidance or do not adhere to those properly, then there is a risk that the FCA could come down quite hard on them.

For example here we are talking about protectionist measures that the FCA has deployed, where they are asking firms to pay attention to the government's agenda at the moment. Help businesses such as SMEs in terms of getting access to loans quite quickly therefore maybe relaxing some of the credit worthiness assessments and similarly affording more time to consumers and giving them payment holidays when it comes to their mortgages and payment holidays.

Now, if firms do not heed that guidance, there is a chance that the FCA could take that very seriously and end up in enforcement for those sorts of actions and then Ian, you have mentioned market abuse, so do you want to talk about that as well?

**Ian:** Yeah, sure. As I said in my session, I think the FCA has said, basically no leniency as far as market abuse is concerned. Having said that, of course they will look at the seriousness of misconduct and there may be some sympathy towards firms who have done their best to try and get things right.

But I do think particularly for individuals, who have say committed insider dealing or market abuse and is really trying to take advantage of these very difficult conditions at the moment during COVID-19, my expectation would be they will be very less sympathetic in that situation, so possibly a little leniency towards firms, but as I have said, market abuse is a strong FCA priority. I would think very little leniency towards the individuals who committed criminal or quasi-criminal misconduct.

**John:** Okay. Thanks. Next question. Is it legitimate for the FCA as a regulator to be intervening in areas such as diversity and inclusion and non-financial misconduct?

**Sushil:** Yeah, again I touched on this earlier. They are being more intrusive in terms of looking at areas that they had not necessarily focussed on in the past. But you can see why they are doing that. They are more focussed now on cultures within firms and behaviours and that is the thing that they are wanting to tackle the most.

They think that by focussing on issues such as diversity and inclusion and non-financial misconduct they can get firms to pay attention to their cultural behaviours, how they operate and avoiding that mono-cultural state which they see impacts on board decision-making. I think they are trying to get firms to seriously consider their approaches to non-

financial misconduct which is an indicator for cultural behaviours within firms.

**John:** Okay. We have two more questions. How realistic is it to expect the FCA to undertake market abuse investigations in the current crisis.

**Ian:** Yeah, I will pick that one up. Obviously given current conditions, FCA investigations involve practical situations like analysing lots of data and also carrying out face to face interviews in recorded situations. It is going to be quite hard to arrange - well I mean face-to-face interviews at the moment are going to be very difficult obviously with social distancing. It may be possible, of course, to arrange interviews by Zoom or similar media like we are using.

**Ian:** Obviously it is not perfect investigation conditions for the FCA but that does not mean that they cannot kick off investigations by, for example, serving notices of investigations of firms' individuals and follow that up with a request for information which is a paper-based exercise and then when that information comes in, start analysing it.

So clearly it is not ideal investigation conditions for the FCA, it will slow things down. I think it has been reported some other investigation agencies have had problems, but my understanding is the FCA are actually going quite well practically in the current situation so I think that is where we are on that one.

**John:** Okay, it is likely related to the final question. Why do FCA investigations take so long?

**Ian:** Yeah. Well this is a question that I was asked when I was at the FCA/FSA and also now I am on this side of the fence, often asked by firms' individuals under investigation by the FCA. I mean, the problem is that obviously investigations are legal processes. They require lots of data to be collected and analysed that takes time. Interviews, those take time and analysis of interviews.

**Ian:** It is quite a time-consuming process. Having said that, I think there is a fair amount of concern at the moment, anecdotally that investigations do seem to be taking longer than before. The FCA are quite resourced challenged in terms of having enough people to actually tackle these cases and as I explained earlier, when you are actually having a high volume of your cases and you have got fewer people to do it, well the end result is going to be, unless you do things very efficiently, the investigations will take longer.

**Ian:** The FCA does try to mitigate this by updating firms' individuals on the progress investigations, but that is not usually a very detailed feedback on that, so you may just be told, well we have not reached a decision yet or the next stage may not be some months.

I do understand. I have seen both sides of the fence of this, both as a regulator and enforcement and on this side of the fence on the defence side.

**Ian:** Obviously with more investigations the idea was basically the FCA would have short-sharp investigations, take a quick view, open investigation, close them quickly but they still have to undertake a certain amount of work before you can actually reach a view. So that, I think is proving quite difficult as well. I think it is a difficult one that, and investigations will continue to take a long time for the foreseeable future and I think the current crisis probably will not help that, unfortunately.

**John:** Sure, thanks Ian. We are just coming up to the hour, so I think that is all the questions we will take for today. Thanks Ian and thanks Sushil. So we would like to thank everybody for attending today. For more information about Gowling WLG, visit [gowlingwlg.com](http://gowlingwlg.com) and for more information about MCO Solutions, please visit [mycomplianceoffice.com](http://mycomplianceoffice.com). We will send you a link to the slides and recording, along with answers to any additional questions in the next few days.

Thank you again for your time and have a great day.

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## Author(s)

### Sushil Kuner

Principal Associate - UK Financial  
Services Regulation, London

 Email

[sushil.kuner@gowlingwlg.com](mailto:sushil.kuner@gowlingwlg.com)

 Phone

+44 (0)20 7759 6542

 vCard

Sushil Kuner

**Ian Mason**

Partner - Head of UK Financial Services  
Regulation and Joint Head of UK  
Financial Services Sector, London

 Email

ian.mason@gowlingwlg.com

 Phone

+44 (0)20 7759 6685

 vCard

Ian Mason