Introduction
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Stéphane R. Blais is a Director in Deloitte’s FS Risk Advisory Practice. Prior to joining the firm, Stéphane spent 10 years as a financial regulator, at the FSA/FCA. There he assessed Market Abuse and Front Office Controls in Commodities Trading Firms, the results of which are published in the FCA’s Market Watch 49. Stéphane contributed to the development of the FCA’s Wholesale Conduct Strategy and provided technical input to Thematic Advisory Groups (TAGs).

Simon Thorpe
Manager, FS Risk Advisory

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Simon is a Manager in Deloitte’s FS Risk Advisory team and specialises in assisting wholesale firms with the management of conduct of business and compliance risks, with a particular focus on market abuse. Simon has worked with a number of firms to develop their market abuse risk and control frameworks and is currently assisting a number of firms with their MAR implementation programmes.
Agenda

1. Background to MAR
2. Key Developments and Challenges
3. Enforcement Case Studies
4. Market Abuse Control Frameworks
1. Background to MAR
MAR will replace the existing Market Abuse Directive and related FCA rules. The new regime establishes a common regulatory framework on insider dealing, market manipulation and measures to prevent market abuse.

**Purpose & timeline**

**Background to MAR**

- Ensure that regulation keeps pace with market developments
- Strengthening the fight against market abuse across commodity markets
- Reinforcing the investigative and administrative sanctioning powers of regulators
- Harmonising certain key elements e.g. reporting and notification requirements

**Timeline**

- **Proposal October 2011 (Amended July 2012)**
- **Entry into force July 2014**
- **Technical standards issued by ESMA September 2015**
- **Application July 2016**
Overview
MAD I vs. MAR

MAR significantly increases the scope of the existing market abuse regime

<table>
<thead>
<tr>
<th>Instrument Type</th>
<th>MAD I</th>
<th>MAR</th>
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<tbody>
<tr>
<td>Financial instruments admitted to trading on a regulated market</td>
<td>🟢</td>
<td>🟢</td>
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<tr>
<td>Financial instruments admitted to trading on a Multilateral Trading Facility (MTF)</td>
<td></td>
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<tr>
<td>Financial instruments admitted to trading on an Organised Trading Facility (OTF)</td>
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<tr>
<td>Financial instruments, the price of which depends on the price of the instruments referred to above inc. CDS and CfDs.</td>
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<tr>
<td>Behaviour or transactions, including bids, relating to auction markets for emissions allowances</td>
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<tr>
<td>Behaviour in relation to benchmarks</td>
<td>🟢</td>
<td>🟢</td>
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<tr>
<td>Spot commodity contracts excluding wholesale energy products</td>
<td>🟢</td>
<td>🟢</td>
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<tr>
<td>Financial instruments relating to the transfer of credit risk</td>
<td>🟢</td>
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- 🟢: In-scope instruments
- 🟢: Instruments that are only in-scope for the market manipulation prohibition
Key Changes

Overview

**Market Manipulation**
The market manipulation offence has been extended to include attempted manipulation and behaviour in relation to benchmarks.

**Inside Information & Insider Dealing**
Extended scope under MAR including information relating to spot commodity contracts and cancelling or amending an order.

**Suspicious Transaction & Order Reporting**
MAR extends the existing obligation to report suspicious transactions to include suspicious orders.

**Insider Lists & Market Soundings**
More detailed rules on insider lists and a new framework on market soundings to gauge investors’ interest in possible transactions.

**Investment Recommendations**
MAR strengthens the regime that requires persons producing investment recommendations to ensure that information is objectively presented and to disclose potential conflicts.

**Manager’s Transactions**
Persons discharging managerial responsibilities within issuers must notify the issuer and regulator of relevant personal transactions they undertake.
2. Key Trends & Challenges
### Key Developments & Challenges

**Market manipulation & STORs**

#### Key Developments

- **Market Manipulation**
  - Transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark.
  - Spot commodity contracts and auctioned products based on emission allowances.
  - Prohibition on misleading investors on the basis of opening as well as closing prices (MAD referred to only in closing prices).
  - Prohibition on placing or amending orders on a trading venue (i) disrupt or delay the functioning of the trading system; (ii) make it more difficult for other persons to identify genuine orders; or (iii) create false or misleading signals by entering orders to initiate or exacerbate a trend.

- **STORs**
  - Firms are required to report both suspicious transactions and suspicious orders to the competent authority without delay.
  - Firms are required to establish surveillance systems as well as internal procedures to facilitate detection and reporting.

#### Challenges

- Prioritising monitoring activities using a risk-based approach
- Re-calibrating surveillance systems to reflect the increased scope
- Capturing and monitoring orders, particularly voice orders
- Developing pre-trade controls to identify suspicious orders
- The trade-off between automated monitoring systems and human analysis
- The broad definition of what constitutes a benchmark
- The efficiency of processes for making STORs
Key Developments & Challenges
Insider Trading & Market Soundings

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### Key Developments

#### Insider Trading

- The insider dealing offence has been extended to include **cancelling or amending orders** based on inside information.

- The prohibition against recommending that another individual trade on the basis of inside information has been extended to include **inducing individuals** to cancel/amend orders based on inside information.

- **Insider lists** must be in a prescribed format, be maintained for 5 years and firms must make them available to regulators as soon as possible upon request.

#### Market Soundings

- **Disclosing participants** will be required to meet several conditions before disclosing inside information:
  - Assessing whether inside information will be disclosed;
  - Informing the recipient of their obligations;
  - Obtaining consent from the recipient to receive the information; and
  - Maintaining written records both before and after the disclosure.

- The **receiving participant** must assess for itself whether it is in possession of inside information and when it ceases to possess inside information.

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### Challenges

- **Update Compliance monitoring processes to reflect the increased scope**

- **Rolling out training to educate individuals about the new offences**

- **Determine an approach for dealing with HR information within the insider list**

- **Update market sounding procedures**

- **Review existing information barriers to ensure they prevent unlawful dissemination**

- **Ensure that individuals receiving market soundings are captured on the insiders list**
Insider Trading & Market Soundings

Key Developments & Challenges

Key Developments

- **Investment Recommendations**
  - Captures any information which *suggests or recommends and investment strategy* concerning a financial instrument.
  - **MAR extends the scope** beyond individuals who are producing recommendations as part of their day-to-day business to include anyone producing or disseminating a recommendation.
  - Information must be *objectively presented* and firms must *disclose any conflicts of interest* concerning the financial instrument to which the recommendation relates.
  - Firms will be required to *record all investment recommendations made* at the issuer and security level and make 12 months of this data available when making new recommendations.

Challenges

- **IT investment is necessary to record and maintain recommendation histories**
- **Ability to disclose conflicts of interest is dependent on having effective identification processes**
- **Identifying individuals who make recommendations**
- **Changes to business processes required to record information**
- **Despite the increased scope, rules have been written in the context of traditional research recommendations**
3. FCA Enforcement Action
FCA Enforcement Action
Fines

Value of FCA Fines 2014-16

- £601,205,266
- £1,750,144,797

Number of FCA Market Abuse Fines 2014-16

- Manipulative Behaviour: 8
- Inadequate Controls: 1
- Benchmark Manipulation: 5
- FX Manipulation: 6
- Insider Trading: 3

Key Trends

- Recent enforcement action has been focussed on industry-wide issues (LIBOR and FX manipulation).

- The number of market abuse enforcement cases is relatively low in comparison to the FCA’s overall number of fines although the values account for the vast majority of fines.

- The average value of fines against individuals is falling – 21% decrease between 2014 and 2105.

- The FCA is focussing on the effectiveness of firm’s control frameworks as well specific cases of market abuse – this is likely to continue post MAR implementation.
FCA Enforcement Action
Case study

Firm: WH Ireland

Penalty: £1,200,00 fine and restriction on taking on new clients

Key Findings:
The FCA found that WH Ireland failed to take reasonable care to have effective systems and controls to protect against the risk of market abuse. In particular the FCA identified the following issues:

- Weak controls to mitigate the risk of market abuse from inside information, personal account dealing and conflicts of interest;
- Deficient Compliance oversight including monitoring of controls, provision of MI, risk assessment and dealing with suspicious transactions;
- Poor governance including a lack of market abuse MI in Board packs; and
- A lack of a formal process for identifying and recording training that had been given.

The FCA is increasingly focused on the adequacy of control frameworks. As the rules under MAR become more prescriptive this is likely to continue.

Board level oversight of market abuse risks is essential although this will only be effective with suitable MI.

Market abuse risks should be owned by the front office and the business should also operate some controls. However, Compliance still has a key role to play through its own controls and regular “check the checker” monitoring.

Evidencing action taken (e.g. training) is key— if it isn’t documented then it didn’t happen.
4. Market Abuse Control Frameworks
Developing an effective market abuse control framework

Market Abuse Control Frameworks

1. **Training and awareness**
   Conduct periodic industry-specific training, using real-life examples, to ensure understanding of rules is up-to-date.

2. **Control access to inside information**
   Only disclose stock restrictions to individuals who need to know and without disclosing specific information relating to the restriction.

3. **Pre-trade controls**
   Implement proportionate pre-trade controls for example segregated dealing functions, restricted stock blocks and independent review of orders.

4. **Post-trade surveillance**
   Use properly calibrated monitoring of trading patterns to identify potential areas of abuse. Human analysis of alerts should record sufficient information to maintain STOR records.
A firm's market abuse monitoring framework should incorporate a number of different types of monitoring, each with different objectives, approaches and outputs. These different types of monitoring should be conducted in unison to provide the firm with a holistic view of how effective its approach to managing its market abuse risks is. The diagram below sets out the four elements that comprise a holistic monitoring framework.

<table>
<thead>
<tr>
<th>Market Abuse Monitoring</th>
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<tbody>
<tr>
<td><strong>Periodic Testing</strong></td>
</tr>
<tr>
<td>▪ Periodic monitoring consists of routine checks/analysis of key controls or control processes. This covers both periodic monitoring of 1st line controls and independent checking of 2nd line controls.</td>
</tr>
<tr>
<td><strong>Thematic Reviews</strong></td>
</tr>
<tr>
<td>▪ Thematic reviews consist of scheduled, risk-based reviews which assess the overall effectiveness of the front-to-back control framework (including both design and operating effectiveness) for a particular risk or desk.</td>
</tr>
<tr>
<td><strong>Risk Response Reviews</strong></td>
</tr>
<tr>
<td>▪ Risk response reviews consist of tailored reviews which are initiated at short notice in response to internal or external events which may cause a market abuse risk to crystallise or which may lead to the emergence of a new market conduct risk.</td>
</tr>
<tr>
<td><strong>Trade, Comms &amp; Employee Surveillance</strong></td>
</tr>
<tr>
<td>▪ Trade, communications and employee surveillance is conducted using an automated solution which identifies instances of potential market abuse, reviews emails and chats for specific key phrases and identifies changes in the patterns of employee behaviour such as working hours.</td>
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**Risk-based Approach to Monitoring**

In order to ensure efficient use of time and resources, Compliance should adopt a risk-based approach to determining the frequency of monitoring activities. A market conduct risk assessment should be completed and the level of monitoring focus for each risk be determined by the rating for that risk, with higher rated risks being subject to more intensive monitoring.

The following drivers should be used to define the Market Abuse Monitoring Plan and to identify the need for risk response reviews: management input, risk assessment outputs, internal and external events, regulatory focus, regulatory change and previous monitoring activities.
Market Abuse Control Frameworks
Mitigating Risk Across the 3 Lines of Defence

First Line of Defence
- Supervisory Oversight
- Training
- Information Barrier Ownership
- Pre-trade Controls
- Pre-sounding Procedures
- Effective Oversight & Supervision

Second Line of Defence
- Compliance
- Risk Identification
- Risk Identification Oversight
- Training
- Information Barrier Review
- Transaction Review & Approval

Third Line of Defence
- Internal Audit
- Independent Framework Assessment
- Independent Framework Assessment
- Post-trade Monitoring
- Post-Trade Monitoring
- Communications Monitoring
- Communications Monitoring
- Thematic Reviews
Q&A
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