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Client Alert

News Flash

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FCA Finalises Changes to its Financial Crime Guide

The FCA has finalised a new chapter on insider dealing and market manipulation.

Key Points:

- Firms should take note of the new guidance, which applies immediately.
- Helpfully, the FCA has clarified that firms do not have an absolute obligation to prevent financial crime.
- The FCA has also clarified further aspects of the new guidance, including regarding situations in which firms would be expected to refuse to execute a trade.

The FCA has published the final version of its updated Financial Crime Guide. The new version comes into effect immediately. The FCA consulted on proposed changes to the Guide in March 2018. The FCA proposed a new Chapter 8, outlining the FCA's observations of good and bad practice regarding firms' systems and controls in relation to the requirement to detect, report, and counter the risk of insider dealing and market manipulation. The FCA also proposed further amendments throughout the Guide to bring it up to date with recent regulatory developments and enforcement cases. See Latham's previous *Client Alert* for more detail on the proposals.

Alongside the updated Guide, the FCA has published a summary of feedback received to the consultation. Respondents raised some interesting points, which have in places led the FCA to amend and clarify its guidance.

Scope of firms' obligations

The FCA reports that some respondents were concerned that the guidance implied that firms have an absolute duty to prevent financial crime. Respondents highlighted that that the inclusion of a requirement to prevent financial crime differs from the obligations in SYSC 6.1.1R. In particular, they emphasised the difference between an obligation to prevent financial crime, and an obligation to implement controls to counter the risk of being used to further financial crime. The FCA has taken this point on board, and has clarified the guidance to remove the suggestion that firms have an obligation to prevent financial crime.

Given the FCA's statements that the guidance is also relevant in relation to MAR (despite technically only applying in relation to criminal insider dealing and market manipulation under the Criminal Justice Act 1993 and the Financial Services Act 2012), some respondents noted that the FCA may be seeking to gold-plate MAR by requiring firms to prevent insider dealing and market manipulation, which is not required under the surveillance and suspicious order and transaction reporting requirements in MAR, as far as they relate to persons professionally arranging and executing transactions (as opposed to trading venues). However, the above clarification should reassure firms that this is not the FCA's intention.

The FCA has also made clear that a firm's risk assessment for the purposes of SYSC 6.1.1R does not need to cover asset classes or instruments that are outside the scope of the criminal regime, and that the term "financial markets" in the context of this guidance means the financial markets to which the criminal offences of insider dealing and market manipulation apply.

Pre-trade obligations

Some respondents requested further clarity about pre-trade obligations, and when a firm would be expected to refuse to execute an order.

The proposed guidance included an expectation that firms' policies should include identifying and preventing attempted financial crime before any trade is executed. It stated 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. Respondents asked for clarity on the circumstances in which firms should refuse to execute a trade, given that no legal test or definition for "clear risk" was proposed. In response to this feedback, the FCA has provided some more detailed guidance about the circumstances in which it would expect firms to refuse to execute a trade. The guidance explains that a firm should refuse to execute a trade when it has information that leads to the conclusion that its client is seeking to trade either manipulatively or based on inside information.

The FCA reports that respondents sought clarity in particular in the context of direct electronic access (DEA) clients, given that firms have little or no interaction with the client pre-trade, making it difficult to detect potential market abuse. The FCA acknowledges that firms providing DEA may be less likely to come across relevant information, but has not changed the guidance as it expects firms to apply the guidance in an appropriate manner, reflecting the nature of their business.

Expected outcomes

According to the FCA, some respondents also raised concerns that firms would risk tipping off a client or employee if they were to take the action suggested in the guidance, such as restricting a client's access, or terminating a client or employee relationship. Some also suggested that there was a disproportionate emphasis on cancelling transactions or terminating relationships, which could lead to an overly conservative approach by firms.

The FCA has little sympathy for the arguments regarding tipping off. The FCA considers that the submission of a STOR or SAR and the need to manage the risk of committing a tipping off offence does not override the firm's obligations to have policies and procedures to counter the risk of being used to further financial crime.

The FCA emphasises that its view is that a firm should not enter into, or maintain a client relationship, if the firm is unable to manage the financial crime risk associated with maintaining that relationship effectively. According to the FCA, this does not mean that firms are required to off-board clients immediately after identifying a single suspicious trade, but should have systems and controls in place to identify, assess and mitigate the risk in a consistent and appropriate manner. The FCA has amended the good and poor practice examples in the guidance to reflect the fact that policies should detail when a firm will consider rejecting a prospective client or terminate a client relationship.

Tailored approach

Some respondents sought clarity as to how the guidance would apply to different business types, requesting more tailored examples of good and poor practice. One respondent also asked for clarity in relation to situations where a firm's client is acting for further underlying clients.

The FCA explains that each firm is required to ensure that its risk framework, and policies and procedures are tailored and appropriate to the nature of its business. The FCA has provided examples of good and poor practice to clarify how the guidance may apply to different types of firm, including in particular how it may apply in relation to employee trading.

The FCA also clarifies that it still expects firms to have policies and procedures in place to counter the risk of financial crime, even where the firm does not know the identity of the underlying client or decision-maker. In the FCA's view, if a relationship is assessed as higher risk from an insider dealing or market manipulation perspective, or the monitoring of transactions identifies potentially unusual or suspicious transactions, it may be appropriate for a firm to seek further information from the client about their business and the underlying clients more generally.

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