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FCA FINES BROKER FOR MARKET ABUSE SYSTEMS AND CONTROLS FAILURES

The FCA has fined Interactive Brokers UK Limited (IBUK) £1,049,412 for failures in its systems and controls relating to market abuse surveillance and monitoring, and for failing to report suspicious transactions. IBUK is an online broker which forms part of the Interactive Brokers Group headquartered in Greenwich, Connecticut.

The Enforcement investigation arose from a review conducted by the FCA's Market Surveillance and Forensics team in late 2014 into CFD and spread bet providers, as part of which the FCA visited IBUK. We highlight three important points below.

1. Market abuse policies must be tailored to the specific risks which arise in the business

The FCA criticised IBUK's market abuse policy because it restated the law without any consideration of IBUK's own market abuse risks and without any guidance as to how to apply the rules relating to reporting suspicious transactions in the specific context of IBUK's business. The FCA also noted that there was no evidence of consideration or challenge by IBUK's Board or senior management as to the extent to which the policy met UK legal and regulatory requirements.

2. Where a UK entity relies on global surveillance systems, these must be properly calibrated to the UK regime and for the UK entity

IBUK had no front office function and five compliance staff. It relied heavily on the Interactive Brokers Group global electronic post-trade surveillance system which was operated by a US sister company IBLLC. The global system generated daily reports identifying those customers who ranked highly on a number of metrics, for example the 40 customers who had made the highest profit over the day, MTD or YTD. The FCA found that these reports were inadequately calibrated because they did not address IBUK specifically. Depending on the levels of activity in other jurisdictions, it was possible for the daily reports not to highlight any transactions relating to IBUK clients at all. IBUK did not provide any input to IBLLC in relation to the calibration or testing of the surveillance systems so as to ensure that it detected suspicious transactions by IBUK clients.

The FCA highlighted two suspicious trades that the surveillance system should have detected, but which were missed:

In the first example a client bought 1.3million shares in a company three days before a positive RNS announcement which led to a 6% increase in share price. The client made a profit of £440,000 which was at least 60% more than the next most profitable trade that the client had made in the previous 12 months.

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In the second example the same client bought CFDs equivalent to approximately 1 million shares in a company in the ten days before a positive RNS announcement which led to a 11% rise in share price. The client made a profit of £870,000 which was three times the profit made by the same client from the next most profitable CFD trading, and more than four times as profitable as the third most profitable CFD trading in relation to any other single stock in the previous 12 months.

Neither of these trades was identified by the post-trade surveillance system because it was calibrated to identify instances of high profits globally and did not include any analysis of trends in client behaviour.

3. Where a firm delegates day-to-day responsibility for monitoring, it must maintain close oversight of the firm to whom this activity is delegated.

IBUK delegated responsibility for reviewing the output of the surveillance systems to staff from IBLLC but failed to provide sufficient oversight. A member of IBUK Compliance sent regulatory updates to an individual within IBLLC Compliance on an ad hoc basis, and then discussed the material on the phone. However, IBUK did not provide training to the IBLLC reviewers and did not undertake any testing or checking of the training conducted by IBLLC. IBUK did not provide sufficient guidance to IBLLC reviewers as to how the results of the post-trade surveillance should be reviewed or the circumstances in which a trade should be escalated and did not effectively monitor the review work being conducted by IBLLC.

Conclusion

Although the case was decided under the old market abuse regime, it emphasises principles which should be well-known and which apply equally under Article 16 of the Market Abuse Regulation. The case builds on recent guidance relating to trade surveillance and offshoring in the WH Ireland case and in Market Watch 50.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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