

## Thematic review on the arrangement of supervision by investment service providers for suspicious transactions and orders

### Contents

1 Summary .....	1
2 Objectives of the thematic review.....	2
3 Arrangement of controls for suspicious transactions and orders .....	2
3.1 Arrangements, systems and procedures to detect suspicious transactions and orders .....	2
3.1.1 Regulation.....	2
3.1.2 Responses by the firms.....	3
3.1.3 General assessment and actions recommended by the FIN-FSA .....	3
3.2 Internal guidance and training of staff processing transactions .....	4
3.2.1 Regulation.....	4
3.2.2 Responses by the firms.....	4
3.2.3 General assessment and actions recommended by the FIN-FSA .....	5
3.3 Reporting of detected suspicious transactions or orders to the FIN-FSA.....	5
3.3.1 Regulation.....	5
3.3.2 Responses by the firms.....	5
3.3.3 General assessment and actions recommended by the FIN-FSA .....	6
4 Conclusion .....	6
5 For further information, please contact:.....	6

### 1 Summary

The Financial Supervisory Authority (FIN-FSA) has assessed the arrangement of supervision by investment service providers for suspicious transactions and orders (suspected market abuse). The comprehensive and high-quality arrangement of supervision is paramount to prevent and detect market abuse, such as insider dealing and market manipulation, or attempts thereof. The objective of regulation is that notifications submitted to competent authorities (STOR<sup>1</sup> reports) are meaningful, comprehensive and useful. The STORs from investment service providers play a key role in the supervision of market abuse conducted by the FIN-FSA. The topic has also been one of the focus areas for the European Securities and Markets Authority (ESMA).

According to the findings of the thematic review, in most cases, investment service providers have an automatic trading surveillance system in place, either developed by a third-party provider or internally by the firm.

As a rule, the entire staff had been provided basic-level training on the detection of suspected market abuse, for example, as part of the initiation of new employees or as an online course to be completed annually. More thorough training had been organised for employees participating in the processing or monitoring of transactions and orders.

Investment service providers assess the nature of a suspicious transaction or order relative to the descriptions of the abuse of inside information and market manipulation provided in the Market

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<sup>1</sup> Suspicious Transactions and Orders Report.

16 December 2019

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Abuse Regulation. The Compliance function of the investment service providers makes the final decision about whether to report a suspected market abuse to the FIN-FSA or not.

The FIN-FSA considers the supervision of suspected market abuse to have been arranged by investment service providers primarily in compliance with regulation.

## 2 Objectives of the thematic review

For the purposes of the thematic review, the FIN-FSA requested information from investment service providers on the arrangement of supervision for suspicious transactions and orders. The survey was addressed to 12 investment service providers, which transmit and execute orders on behalf of customers. No investment service providers were met in connection with the thematic review, as the assessment was made on written material. The thematic review focused on the arrangement of supervision for market abuse rather than the content of individual reports.

The thematic review covered the following subject areas:

- How the arrangements, systems and procedures to detect suspicious transactions and orders and report on them to competent authorities had been established in the firm.
- How the training of staff on the detection and reporting of suspicious transactions and orders had been organised by the firm.
- How the firm assesses whether to report a suspected market abuse detected by it to the FIN-FSA.

The objective was to find out how investment service providers comply with requirements concerning the prevention and detection of market abuse and how they had arranged supervision for trading. Particular attention was paid on ascertaining whether the arrangements and systems established by investment service providers for supervising suspected market abuse are proportionate to the scale, size and nature of their business activity.

Particular attention was also paid on how comprehensively and regularly staff had been instructed and trained in detecting and reporting suspected market abuse.

The arrangement of supervision by investment service providers for suspicious transactions and orders is regulated by Article 16 of the Market Abuse Regulation (EU) (596/2014) ("MAR") and Commission Delegated Regulation (EU) 2016/957 ("Delegated Regulation")

## 3 Arrangement of controls for suspicious transactions and orders

### 3.1 Arrangements, systems and procedures to detect suspicious transactions and orders

#### 3.1.1 Regulation

Article 16(2) of MAR requires that any person professionally arranging or executing transactions shall establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions.

The Delegated Regulation provides more detailed requirements for these appropriate systems. Article 2 of the Delegated Regulation provides that persons professionally arranging or executing transactions shall establish and maintain arrangements, systems and procedures that ensure ef-

16 December 2019

Markets

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fective and ongoing monitoring of all orders received and all transactions executed, for the purposes of detecting and identifying suspected market abuse. The systems shall be appropriate and proportionate to the scale, size and nature of the business of the investment service provider.

Article 3 of the Delegated Regulation provides that the systems:

- shall allow for the analysis, individually and comparatively, of each and every transaction executed and order placed, modified, cancelled or rejected;
- produce alerts indicating activities requiring further analysis for the purposes of detecting potential insider dealing or market manipulation or attempted insider dealing or market manipulation;
- cover the full range of trading activities undertaken by the persons concerned.

### 3.1.2 Responses by the firms

Investment service providers were requested to provide a description of the abovementioned systems, arrangements and procedures. The majority of respondents stated they had an automatic trading surveillance system in place, either developed by a third-party provider or internally by the firm. Some of the respondents had an automated trading surveillance system outsourced to an external service provider.

As regards the automatic surveillance system, the responses described the general operation of the system and various alerts produced by the system allowing one to detect abnormal trading activity. In addition, the responses described practical routines applied in the monitoring of suspicious trading.

Some of the respondents did not have an automatic trading surveillance system to detect suspected market abuse, if any, but supervision for orders and transactions had been arranged in other ways. These responses highlighted that the scope and nature of the investment service provider concerned do not necessitate an automatic surveillance system. For example, the justifications provided included a low number of transactions transmitted and executed by the investment service provider.

In addition, the responses explained how the investment service provider was able to ensure compliance with regulatory requirements without an automatic system through other arrangements and procedures. Such arrangements and procedures included, for example, regularly produced reports on trading and real-time notifications on abnormal orders sent to the staff involved in the monitoring of suspected market abuse. Reports and notifications are reviewed to detect suspicious trading transactions.

Investment service providers highlighted their guidance for relevant personnel on the monitoring and detection of suspicious trading. The responses also emphasised the experience and expertise of the staff and its obligation to monitor trading and report detected suspicious activities.

### 3.1.3 General assessment and actions recommended by the FIN-FSA

As assessed by the FIN-FSA, based on the responses to the thematic review, the ongoing surveillance of trading by investment service providers is mainly at a level consistent with regulatory requirements.

The FIN-FSA calls the attention of investment service providers to the following considerations in order to ensure the coverage and quality of supervision of suspicious transactions and orders.

All investment service providers must meet regulatory requirements concerning the effective and comprehensive monitoring and detection of market abuse regardless of whether they have an automatic trading surveillance system in place or not. In the FIN-FSA's view, compliance with the requirements of Article 3 of the Delegated Regulation can be achieved in practice without an automatic trading surveillance system primarily only in special circumstances. Such circumstances include, for example, cases where the number of orders and transactions is low. Hence, investment service providers that lack an automatic trading surveillance system are advised to consider the need to implement one as part of the regular assessment under Article 2(5)(b) of the Delegated Regulation.

The monitoring of trading must extend to all customers of the investment service provider, regardless of whether they are private persons or professional investors. Therefore, the supervision of suspicious orders and transactions must cover orders received and transmitted from private persons, institutional customers and group internal units, as well as all executed transactions.

It is possible to outsource the surveillance of trading to a third party, but the investment service provider itself is always responsible also for outsourced activities. If the automatic surveillance of trading has been outsourced to a third party, the quality of the outsourced surveillance must be assessed on a regular basis and ensure that the investment service provider has the requisite resources and expertise for that purpose.

The supervision of trading must cover all orders received and transmitted and all transactions executed, irrespective of the financial instrument. The requirement concerns, in addition to equities and derivatives, also other instruments, such as bonds, and OTC trading on the abovementioned instruments.

The FIN-FSA reminds that an internal assessment of the systems, arrangements and procedures in place must be conducted at least on an annual basis, and it must be documented.

### **3.2 Internal guidance and training of staff processing transactions**

#### **3.2.1 Regulation**

In accordance with Article 4 of the Delegated Regulation, persons professionally arranging or executing transactions and market operators and investment firms operating a trading venue shall organise and provide effective and comprehensive training. Such training must be arranged to the staff involved in the monitoring, detection and identification of orders and transactions that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, including the staff involved in the processing of orders and transactions. The training shall take place on a regular basis and shall be appropriate and proportionate to the scale, size and nature of the business

#### **3.2.2 Responses by the firms**

The responses were requested to describe the abovementioned training during the period of validity of the Market Abuse Regulation. Most respondents had arranged basic-level training on the detection of suspected market abuse for their entire staff, for example, as part of the initiation of new employees or as an online course to be completed annually. More thorough training had been organised for employees participating in the processing or monitoring of orders. In addition, the responses described how training had been integrated as part of the overall process of the supervision of misconduct.

16 December 2019

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The responses were mixed in terms of the coverage of the documentation of the training provided to the staff and the issues discussed, as well as which personnel groups had been trained and how frequently.

The responses also indicated that various online courses had become increasingly popular as a form of training. The responses of the investment service providers included the firms' internal instructions on the detection of suspected market abuse and how reporting them to the competent authority.

### **3.2.3 General assessment and actions recommended by the FIN-FSA**

In the FIN-FSA's opinion, on the basis of the responses given to the thematic review, investment service providers' internal guidance and training provided to the staff on the detection and reporting of suspected market abuse were mainly at the level required by regulation.

The FIN-FSA recommends investment service providers to pay attention to ensuring that the internal processes of detecting and reporting suspicious transactions and orders are defined as precisely and clearly as possible, also at a practical level. In addition, internal guidance should be reviewed on a regular basis and updated where necessary.

Training on regulations concerning market abuse and internal instructions should be arranged as part of the initiation of new employees participating in the processing or monitoring of trading orders or transactions. Training should be arranged to the staff on a regular basis and whenever there are material changes in regulation.

The FIN-FSA reminds that, in practice, the expertise of staff plays a key role in ensuring the effectiveness and coverage of controls for misconduct in compliance with regulation. The maintenance of expertise is supported by adequate and regular training.

## **3.3 Reporting of detected suspicious transactions or orders to the FIN-FSA**

### **3.3.1 Regulation**

Article 16 (2) of MAR requires that where there is a reasonable suspicion that an order or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation or attempt thereof, the competent authority shall be notified without delay.

### **3.3.2 Responses by the firms**

The thematic review inquired, among other things, the criteria applied by investment service providers to determine whether to report a detected suspicious transaction or order to the FIN-FSA or not. The responses indicated that investment service providers mainly assess the nature of a suspicious transaction or order relative to the descriptions of the insider dealing and market manipulation provided in the Market Abuse Regulation.

The internal processes for the assessment of the threshold for the reporting obligation were very similar across the respondents. Based on the responses, the staff had been trained and instructed to detect and report suspected market abuse to the Compliance function. The investment service providers' internal guidance described the process of monitoring, detecting and reporting sus-

16 December 2019

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pected market abuse. The guidance included examples of insider dealing and of market manipulation. The Compliance function of the investment service providers makes the final decision about whether to report a suspected market abuse to the FIN-FSA or not.

### 3.3.3 General assessment and actions recommended by the FIN-FSA

As assessed by the FIN-FSA, based on the responses to the review and the internal guidance attached to the responses, the practices concerning the reporting of detected suspicious transactions and orders appear to be mainly at a level required by regulation.

Although the thematic review did not particularly focus on the content of isolated STOR reports, observations made by the FIN-FSA indicate that there are differences in the number and quality of STORs submitted by different firms.

In assessing the threshold for reporting suspected market abuse and the content of the STOR, the FIN-FSA advises investment service providers to pay attention, among other things, to the following considerations.

- Factors affecting the reporting threshold
  - Extraordinary nature of the suspected trading in comparison with the normal trading patterns of the suspected party and/or normal trading on the security concerned
  - Financial gain achieved through the suspected trading
  - Potential link of the suspected party to the issuer of the security and/or inside information
  - As a rule, suspected insider dealing is related to inside information disclosed in a stock exchange release or company announcement. If suspected insider dealing is related to information disclosed for example in a press release, it is advisable to state in the report the grounds on which the press release is considered inside information as defined in MAR article 7.
- Content of the STOR
  - The justifications for a STOR must always be laid out clearly in the report.
  - The report must include all documentation relevant to the inspection of the case, such as order records, recordings of telephone conversations, and e-mail correspondence.

## 4 Conclusion

As part of ongoing supervision, the FIN-FSA will continue to pay attention to the arrangement of supervision within investment service providers and to the content, quality and number of STORs submitted by investment service providers to the FIN-FSA. In addition, based on the thematic review, the FIN-FSA will review the need for potential more targeted measures.

Where necessary, the FIN-FSA will provide further information to investment service providers regarding the reporting of suspicious transactions and transactions.

## 5 For further information, please contact:

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