

Insight

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FSA gives clear market abuse warning to hedge fund managers

One of the FSA's stated long-term priorities is combating market abuse. The FSA has given hedge fund managers a clear warning that they must have in place appropriate systems and controls to deal with market abuse risk.

The FSA will be carrying out checks formally to assess anti-abuse controls and procedures: falling short of the required standards is not an option as it could lead to costly intervention by the regulator and, in serious cases, enforcement action.

Key points to note

- Review key control areas and, where necessary, implement new systems and controls without delay.
- The FSA has indicated some of the key areas of control and these should be at the top of the list when reviewing anti-abuse controls and procedures (see below).
- Staff training must be regular and detailed and must relate to the firm's business, highlighting particular risk areas relevant to that business.
- Senior managers are primarily responsible for the firm's systems and controls and must implement measures to create a culture of compliance: they must not rely purely on static policies and procedures. Over reliance on the compliance department should be avoided.

- Hedge fund managers must ensure that advice and assistance received from external advisors is of the required high quality.
- Banks in particular should look to the information they provide to hedge fund managers in the course of discussions about industry trends and developments. This is considered to be a risk area in relation to which the FSA will look for formalised procedures in the future.

The FSA's warning

The warning to hedge fund managers set out in the FSA's Market Watch newsletter issued on 29 October 2007 is stark: market abuse systems and controls in some of the firms reviewed are inadequate and must be improved. In particular, the FSA is clear that it will hold a firm's senior management directly responsible for failure to comply with the market abuse regime. This means that senior management must work at developing a compliance-focussed culture within their firm, as well as ensuring all appropriate controls are in place. Complete delegation of responsibility for systems and controls to the compliance function or to compliance consultants is not satisfactory.



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Specific areas of control

The FSA have focussed on some specific areas of control that can be of particular use in managing market abuse risk:

- In-built computer controls which will restrict or identify market abuse;
- Independent monitoring of market abuse controls and procedures;
- Maintenance of restricted lists and stop lists covering all listed securities;
- Robust procedures for the operation of "Chinese Walls" where appropriate;
- Policies concerning the treatment of confidential information;
- Implementation of long-term remuneration structures based on firm performance;
- Taping telephone lines of appropriate individuals;
- Retrospective review of the Personal Account dealing of staff;
- Regular staff training tailored to the type of business undertaken by the firm.

These control areas are not new to businesses and the FSA will expect all firms to have considered what controls are appropriate to their business activities, including those highlighted above, and for those controls to be effectively implemented and operational. Where firms use external advisors to support their compliance function, they must ensure the advice they receive is of good quality.

Control of inside information

Insider dealing is a particular area of focus for the FSA and there is concern regarding the information flow from companies and banks to the hedge fund managers in the course of meetings and discussions. In particular, the FSA has noted that it is increasingly common for public-side investors, including hedge fund managers, to discuss industry trends and developments with banks and this is specifically identified as a market abuse risk area. The FSA has invited banks to propose formalised procedures to manage their relationships with public-side investors in order to reduce this market abuse risk.

We're here to help

Our expert financial services regulatory team can assist you with all aspects of regulatory risk management and will tailor our advice to meet your specific needs.

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