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Making Sense of **MAR**

Developing a Response to the EU's Market Abuse Regulation for the Buy Side

The buy side faces an unprecedented regulatory challenge in the form of the European Union's Market Abuse Regulation (MAR), which came into effect on July 3, 2016. In seeking to enhance and harmonize the EU's market abuse regime, MAR introduces new operational, technology and regulatory requirements for firms operating in the European financial markets.

In order to keep pace with changing financial markets, the regulation has been extended from the previous Market Abuse Directive (MAD), introduced in 2003, to cover more financial instruments, regardless of whether they are traded on regulated markets or not. Transactions involving money-market instruments, credit default swaps (CDSs), contracts for difference (CFDs,) units in collective investment undertakings (UCITS), options, futures, swaps, forwards, commodity derivatives and related spot markets are now covered by the market abuse regime. "One of the most significant changes compared with MAD is the increase in scope in terms of the instruments, venues and behaviors that are captured," says Edwin Schooling Latter, head of markets policy at the Financial Conduct Authority (FCA). "The FCA will work across the range of instruments, venues and behaviors and use our regulatory toolkit, including enforcement action where appropriate, to protect and enhance the integrity of the UK financial system."

The regime expands the scope of the rules to cover the manipulation of benchmarks, and introduces *attempted* market manipulation and insider dealing as new offenses, allowing regulators to impose sanctions even if an attempt to abuse the market is unsuccessful.

MAR also introduces new rules and obligations to comply with the new regime; one of the major operational changes is that buy-side organizations must develop the necessary systems and controls to detect and prevent market abuse, rather than relying on third parties such as brokers for surveillance. While the requirements are new to the buy side, the sell side has experience implementing the necessary systems and controls under MAD. The buy side can certainly learn from the sell side's experience in this area to inform the development of their own compliance response, although there is also a real need for compliance solutions that will address specific buy-side needs. Therefore, all organizations must conduct detailed assessments of their own infrastructure in relation to the new requirements to determine the changes that will be necessary and how to achieve them.

The strengthening of these European market abuse regulations has led to the need for better technology to monitor trading activity, maintain records, and report to regulators as required. But what emphasis have the regulators placed on automation, and are the solutions that are currently available suitable for buy-side market participants? If not, what must been done to develop the right solutions and what should buy-side firms look for in a technology partner?

Understanding the New Regime from a Buy-Side Perspective

MAR "does not represent a fundamental overhaul of the EU market abuse regime," according to the FCA's Schooling Latter, but rather it is about "updating and strengthening the regime that existed under MAD." However, MAR does represent a major change for the buy side, simply because these requirements are new to them. As such, sell-side firms have a significant lead on the buy side when it comes to implementing systems and controls that will capture market abuse.

As Simon Morris, a partner in the financial services and products team at London law firm CMS Cameron McKenna, explains: "There is a massive emphasis on prevention rather than cure under MAR, on having systems and controls in place. There are specific references throughout MAR to the systems that firms are required to have, whether it's for wall crossing, trade reporting or monitoring suspicious transactions. While that is the biggest single change for both the buy side and the sell side, such systems will be more established on the sell side and new to the buy side."

"Previously, the buy side could really allow the sell side to carry out their surveillance for them," adds Jeremy Garland, head of compliance at RIMES Technologies. "But now the expectation from the regulators is that the buy side must monitor their own trading activity to determine if there is any impact in terms of market manipulation or insider trading, for example. That's not a subtle shift, but it has almost taken some firms by surprise because they are used to having their broker take care of surveillance. It's just not as simple as that anymore."

As such, buy-side firms need to emulate the consistent, holistic approach to surveillance that the sell side has already developed under MAD. "The sell side is using highly sophisticated technology and the buy side must effectively have the same quality of detection

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as the large brokers," says Bruno Piers de Raveschoot, COO, regulatory division, at RIMES. "That's a huge challenge because the sell side has been equipped for a number of years and has had time to fine-tune their systems. These organizations have very efficient monitoring controls in place."

Morris adds that while many buy-side organizations take "a rather ad-hoc approach" to handling price-sensitive information at the moment, most sell-side firms have developed a very institutionalized approach with very formal systems. "I believe buy-side firms can learn from the sell side in the field of constant vigilance and the systems and controls required as a result," he says. This is a crucial issue under the updated regime because, as Morris says, the new system controls requirement within MAR allows the FCA to take action against a firm with the controls in place if it believes those controls are sub-optimal. "That is a very important message for the buy side," he says.

Addressing the Specific Needs of Buy-Side Organizations

Attaining the same standards as the sell side is not simply a matter of adopting the same systems, however. The buy side requires new solutions that have been tailored to address their specific circumstances and needs. For example, buy-side technology must be able to detect manipulation at both the order level and at the portfolio level. Morris sees a "fairly clear need" for a technological solution for this part of the market. He adds: "The structural separations of function that you would find in an investment bank, for example, between the brokerage team, the market-making team and the analyst team, simply don't work within an asset management firm. Therefore, buy-side firms will need to introduce more sophisticated systems for monitoring orders and trades."

So how should buy-side organizations go about finding, developing and implementing the necessary compliance infrastructure to comply with MAR and the accompanying regulatory technical standards (RTS) developed by the European Securities and Markets Authority (ESMA)? Garland advises buy-side firms to begin the process of creating the necessary systems and controls under MAR with a "very detailed" risk assessment to develop an understanding of what is traded, how it is traded, and where it is traded. An in-depth examination of current activity and the related risks should provide a solid foundation for the development of a more structured, formal approach to compliance in this area.

Rukshan Permal, a partner in PwC's financial services risk and regulation business, advises buy-side firms to start by considering "proportionality." "That is having the right systems and controls in place to mitigate the risks brought about by MAR," he explains.

"Secondly, the risk assessment is also a core component for the buy side in order to identify, when looking at MAR and the scenarios described within MAR, how relevant it is, given the organization's size, scale and complexity—and, if it is relevant, what might the control framework around that look like?"

Finding the Right Technology Solution

Considering proportionality and conducting a full risk assessment should be top priorities for firms facing MAR, given the emphasis on "systems and controls" within the new regulations. But does this mean that regulators expect all buy-side organizations to implement a fully automated system? "Under MAR, having an automated surveillance system is not a requirement per se," says the FCA's Schooling Latter. "The crux of the Article 16 requirements on detection—which are supplemented at Level 2—is for firms to have *effective* surveillance which is appropriate for, and proportionate to, their individual business."

Therefore, for large firms with high volumes across numerous asset classes, an automated solution "may" be necessary, says Schooling Latter. "For some smaller firms, an automated system may not be the most effective way of detecting suspicious behavior. In all cases, it is important that there is a human element to the process—in the role of front-office staff being appropriately trained and vigilant and escalating suspicions, and also in the analysis of events."

However, as sell-side organizations have already discovered, automation can deliver real advantages in an environment where firms are required to monitor trading activity, maintain records, and report to regulators with efficiency, consistency and accuracy. "With an automated system, an organization can use its staff more efficiently. It's a way to work smarter, not harder—even with a smaller team, an organization can do a lot more with an automated system," Garland explains. He adds that automation also enables firms to develop the necessary audit trails to be able to demonstrate compliance to regulators. "Not only that, it enables systems to address new requirements as they are developed," he says.

At present, buy-side organizations typically employ a combination of manual and automated controls, with the latter increasing in popularity over the last 12 to 18 months, according to PwC's Permal. "Some of our buy-side clients have recently purchased trade surveillance technology designed for specific buy-side scenarios, and we have also seen an uptick in the amount of e-communications that the buy side are monitoring from an automated perspective," he says. "These organizations have certainly shifted this way to enable better coverage of the MAR requirements."

Permal still sees demand for manual controls from some buy-side clients. "Firms that trade in a particular product fairly infrequently would not necessarily want to design an automated test for something that could be done in a relatively straightforward way with manual controls," he says. "Also, manual controls can sometimes be used to bring in other data sources that cannot be viewed through a single, automated system. For example, if a firm is performing a review of its alerts and wants to build a more holistic picture, it may not be possible to do that through technology alone, so they must start with an automated alert through the surveillance system and then bring in other qualitative data aspects manually to build a picture of a trade, a group of trades, or even a group of people associated with a trade."

However, Permal adds that the demand for manual controls from the buy side is likely to decrease over time. "While it's very hard to see how that need is going to go away in the short term, the ambition of many firms that I have spoken with is to have holistic surveillance through the use of big data and technology."

Finding the Right Technology Partner

Technology providers are undoubtedly stepping up to help buy-side organizations meet the new requirements quickly and efficiently by providing a fully compliant surveillance system for a fraction of the cost and effort that it would take to develop one in-house. Garland explains that a cloud-based system from a vendor that can provide the necessary market data will save firms both time and resources. "A solution that is developed by compliance officers can provide ongoing support and keeps abreast of any regulatory changes that are happening to ensure they are reflected in the system," he adds.

There are also data requirements to consider. Buy-side organizations should look for vendors that can address reference data needs, enabling the integration of data from various sources without the need for a repository or warehouse, which is time-consuming to build and expensive and difficult to maintain.

In facing this immense regulatory change, buy-side organizations need access to compliance solutions with the necessary technological and analytical capabilities to enable them to investigate, detect and report any attempted or actual instances of market abuse. In facing a new regime such as this, Piers de Raveschoot says "buy-side firms need a partner that understands the regulation and can guide them through what needs to be done, and how, operationally speaking, it should be implemented."

Finding a technology partner that has the necessary tools, data and experience to create a tailored compliance response is crucial as buy-side organizations assess the risks arising from MAR and develop a regulatory infrastructure to match the new requirements. W