DFSA Dubai Financial Services Authority

THEMATIC SUPERVISION
EMERGING TRENDS
CONG/DFSA OUTREACH
30 May 2016

SUPERVISION OUTREACH – TRADING ROOM CONTROLS THEMATIC REVIEW

30 May 2016

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Agenda

- Overview of principal dealing activities
- Trading Room Controls Thematic Review
  - Expectations
  - Findings
- Common Themes
- Key Take-Aways

Principal Dealing Activities

- Small portion of Authorised Firms in PIB Cat 1, 2, 3A deal in investments as principal

  - OTC
  - On-Exchange

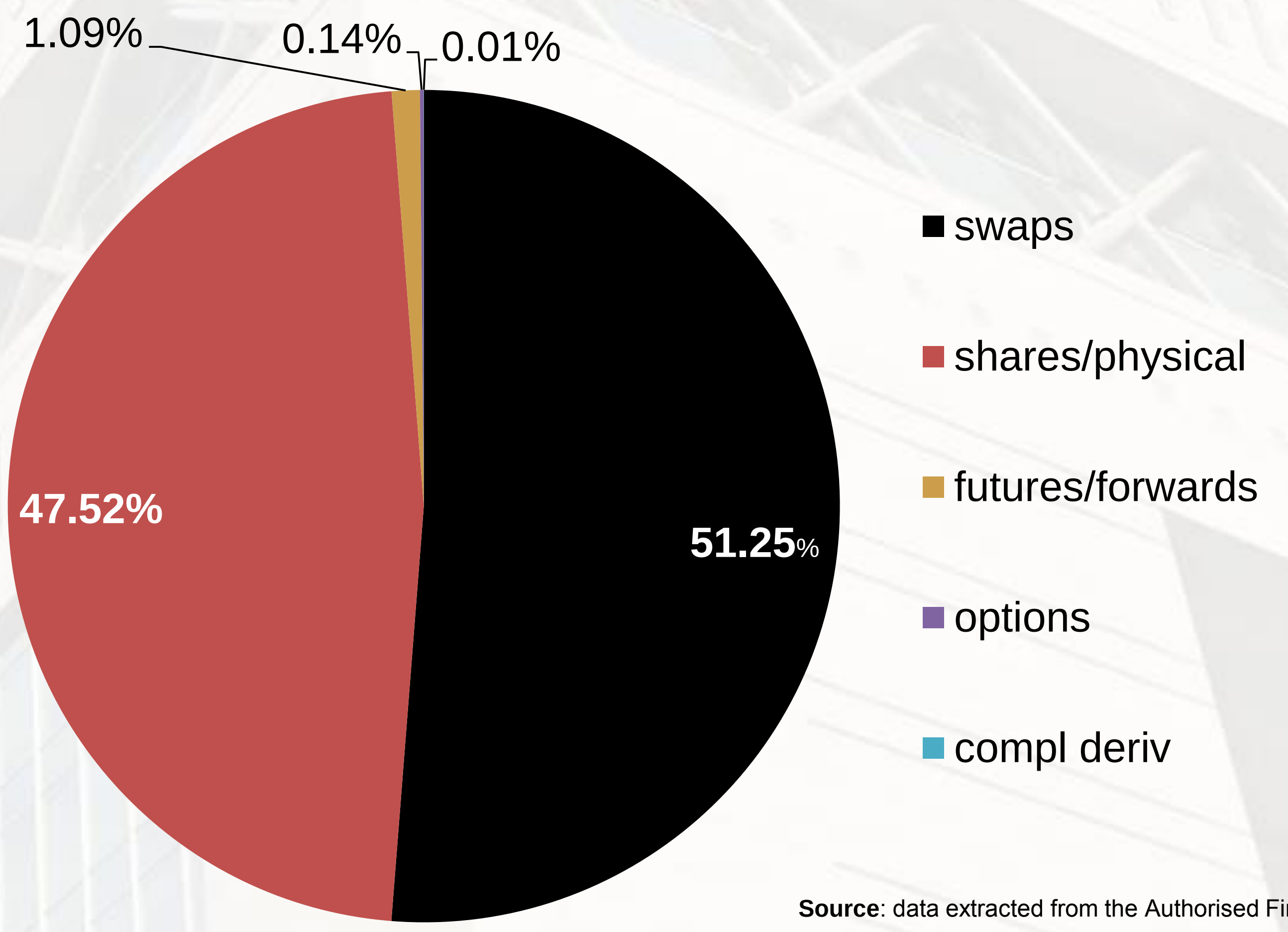
  - Client facilitation
  - Matched Principal
  - Arbitrage
  - Speculation

- Principal dealing < 25% of all dealing activity in DIFC

Source: quarterly EPRS returns

Principal Dealing Activities

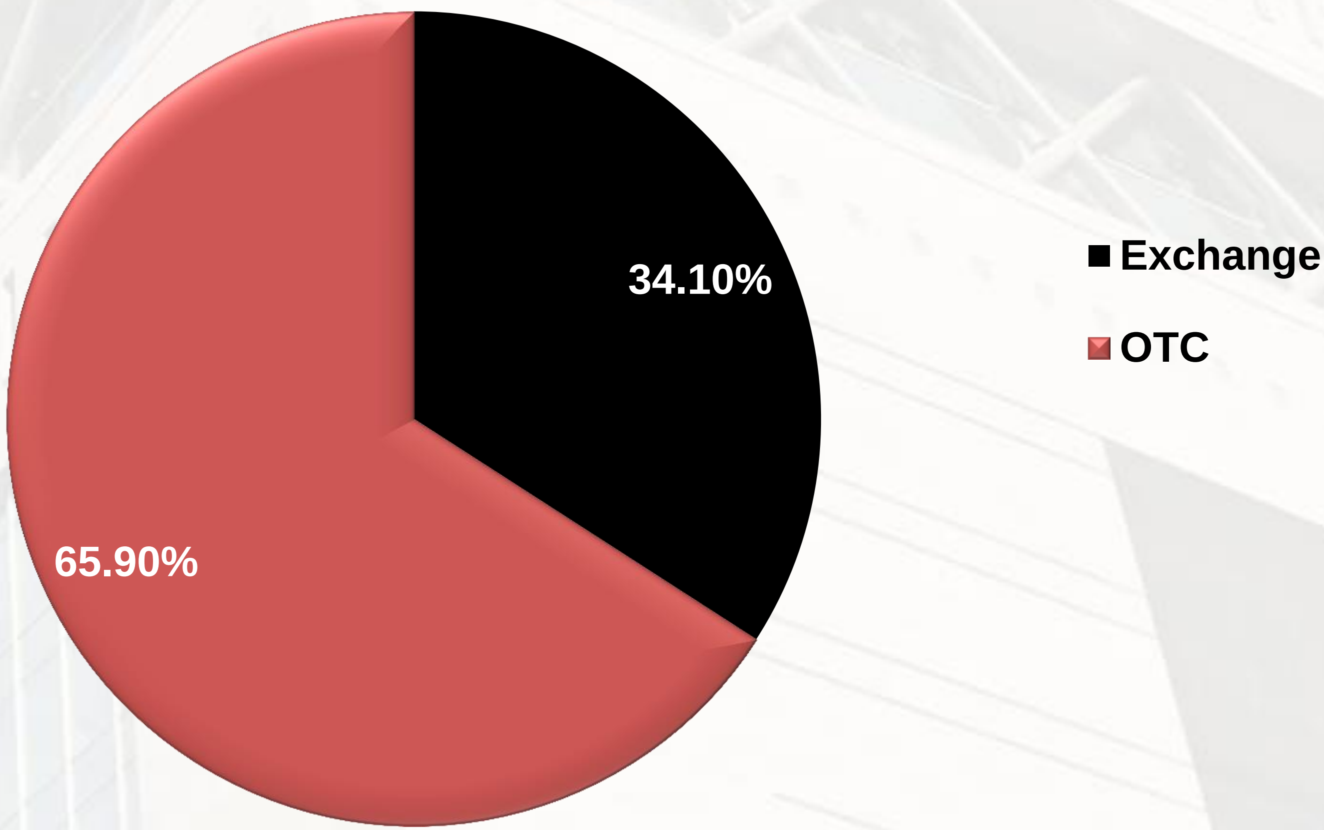
Principal transaction volume by product type



Source: data extracted from the Authorised Firms' quarterly EPRS returns

Principal Dealing Activities

Transaction volume by Venue



Source: data extracted from the Authorised Firms' quarterly EPRS returns

Trading Room Controls Thematic Review

- Predominantly a desk-based review
- High level overview of controls and governance
- Included firms that deal in investments as principal (proprietary trading and client facilitation)
- Focus of Review:
  - Limits
  - Market Risk
  - Error Accounts
  - Cancels and Amends
  - Transaction Surveillance

1. Limits - Expectations

- Effective limit structure (e.g. transaction, position, risk)
- Frequent independent monitoring and senior management reporting
- Limit breach escalation
- Periodic limit review

1. Limits - Findings

- Not all firms have a limit framework
- Common misconception that limits are not needed where:
  - Transactions are done on a Matched Principal basis;
  - Transactions are infrequent and in “low risk” products;
  - Monitoring is done on a transaction by transaction basis.

2. Market Risk - Expectations

- Real-time or near real-time market risk monitoring (equity, interest rate, currency, commodity)
- Independent valuation sources
- Periodic market risk reporting to DIFC entity senior management

2. Market Risk - Findings

- Little to no real-time or intra-day market risk monitoring

3. Error Account - Expectations

- Firms must maintain an error account
- Monitoring and escalation procedures
- Inclusion of DIFC entity senior management in escalations

3. Error Accounts - Findings

- Most Firms lacked formal comprehensive criteria for determining when error activity should be escalated
- Approximately half of the Firms did not maintain an error account

4. Cancels & Amends - Expectations

- Independent identification and review
- Periodic reporting to senior management
- Clearly defined escalation criteria and procedures that include DIFC entity senior management

4. Cancels and Amends - Findings

- Consolidated cancels and amends reports are not generated on a consistent basis

- Most Firms lacked formal comprehensive criteria for determining when cancels and amends activity should be escalated

5. Transactions Surveillance - Expectations

- Firms must establish a framework for the independent surveillance of principal dealing activity
- Periodic reporting and escalation processes must include the DIFC entity senior management

5. Transactions Surveillance - Findings

- Approximately half of the Firms do not perform transaction surveillance

- Common misconception that surveillance is not necessary where transactions are:
    - On recognized exchanges;
    - Executed via straight-through-processing (STP);
    - Individually approved by senior management, ratified by the board, and periodically reviewed by compliance.

Common Theme

- Periodic reporting and escalation chains (e.g. limit and risk breaches, error activity, etc.) did not always include DIFC senior management
  - Generally, this occurred in Firms that book positions in another group entity

Key Take-Aways

- Don’t underestimate your risk. Seemingly safe, low risk dealing activities can present large risks without appropriate controls

- DIFC entity senior management must be included in periodic reporting and escalation chains, regardless of where positions are booked

Dubai Financial Services Authority

DFSA MARKET ABUSE REGIME
THE CODE OF MARKET CONDUCT

Azza Abdel-Bari, Senior Manager–Markets

DIFC Markets Law - Application

- Market Abuse set out in Markets Law DIFC Law No. 1 of 2012 (administered by the DFSA Art 7)

- Part 6 – Chapter 1, Market Abuse Art 54-63

- Markets Law applies to:
  - a person, in the DIFC or elsewhere
  - directly or indirectly
  - act, practice or course of conduct
  - Investment (defined term), related investment

Markets Law

- A person: an entity, regulated or not
- A person: an individual
- In the DIFC or elsewhere i.e. applies to a person that is physically located in another jurisdiction (provided it affects DIFC markets or users of DIFC markets)
- Directly or indirectly

What is an Investment?

- Investment defined by DFSA as a Security or a Derivative
  - Security: Share, Debenture, Warrant, Certificate, Unit or Structured Product
  - Derivative: Future or Option
  - Not limited to Investments admitted to an exchange/market

Therefore it follows that…

The Markets Law applies to

Authorised Firms

In relation to conduct in

Investment

(not just those admitted to trading)

What is Market Abuse?

8 Provisions under the Markets Law

1. Fraud and market manipulation
2. False or misleading statements
3. Use of fictitious devices and other forms of deception
4. False or misleading conduct and distortion
5. Insider dealing
6. Providing Inside Information
7. Inducing Persons to deal
8. Misuse of information

The Code of Market Conduct

- Help determine whether or not conduct is Market Abuse
- Assist Authorised Person to monitor, prevent and report Market Abuse
- Clarify market practices that do not amount to Market Abuse
- Describe factors the DFSA would take into account when making a determination

Status of the Code

- Guidance not Rules
- Not exhaustive
- Conduct may contravene several Articles of the Law

Art 54 – Market manipulation and Fraud

- ...false or misleading impression…supply, demand, price…..
- …create artificial price…..
- …..fraud on a person ……

Conduct that may affect supply and demand….

- Wash trades
- Painting the tape
- Layering
- Momentum ignition
- Quote stuffing

Conduct that may affect price …

- Marking the open/close…
- Transactions by parties acting in collusion to position price….
- Building dominant position in investment or underlying…
- Abusive squeeze
- Colluding in aftermarket of IPO
- Creating a floor/ceiling

Fraud

- …financial accounts
- …Ponzi schemes
- ….misuse of funds raised through offer
- …benchmark manipulation

Examples

- A trader aggressively buys an Investment at the end of the quarter in order to increase the reference price (potentially for a fund manager)
- A trader enters into transactions with a colluding party to secure a dominant position over the supply of an Investment

Art 55 Dissemination of false or misleading information

- ….give false or misleading impression about Investment
- ….media
- ….trading terminal
- …verbal

Examples

- A person posts information on an internet forum/social media/ media which contains false or misleading statements about the takeover of a company

- Misleading disclosure by an issuer about the true impact of a certain issue on its securities

Art 56 Use of Fictitious Devices and other forms of Deceptions

- Transactions or orders to trade which employ fictitious devices and other forms of deception or contrivance
- Transaction or order necessary for contravention (different from Art 54)
- Fictitious devices (not defined)
- Deception or contrivance (not defined)

Examples

- A person enters into a series of transactions which are designed to conceal the ownership of an Investment by holding the Investment in the name of a colluding party.

- Trader takes short position in Investment that begins spreading rumours to drive price down

Art 57 False or Misleading Conduct and Distortion

- conduct not caught by Articles 54, 55, 56
- false or misleading impression supply/demand/price
- distort or like to distort the market in one or more Investments
- Failure to observe standard of behaviour expected by market participants

Art 58 Insider Dealing

- A person who is an Insider shall not,…..
- in the DIFC or elsewhere ….
- directly or indirectly….
- deal or attempt to deal …..
- in Investment, or related Investment
- on the basis of
- Inside information (trading information)

Art 59 Providing Inside Information

- Disclosure of Inside Information to another person ….

  (other than in the necessary course of business)

- Procuring another person to deal in Investments or related Investments in which the Insider has Inside Information

Art 60 Inducing Persons to Deal

- A person shall not, in the DIFC or elsewhere, induce another person to deal in Investments
  - By making or publishing a statement/promise/forecast if the person knows, or is reckless as to whether, the statement is misleading, false or deceptive…
  - By concealment of material facts
  - By recording or storing information that the person knows to be false or misleading …..

Examples

- Boiler room operations that uses high pressure and exaggerated claims about prospects of shares in a company
- Marketing information with exaggerated claims
- Incomplete disclosure to private investors when offering shares in a private company

Art 61 Misuse of information

- A person shall not, in the DIFC or elsewhere …
- engage in any activity or conduct in relation to Investments….
- …by using information which is not generally available to market participants…would be regarded as relevant when deciding the terms on which transactions in Investments should be effected
- ..regarded by market participants as failure by the person concerned to observe the standard of behaviour reasonably expected ….

Defences

- What are defences?
- Market making
- Price stabilisation
- Share buy back

Thank You