FMSB publishes new financial markets misconduct research

London, 27 July 2018 - The FICC Markets Standards Board ("FMSB") today publishes its Behavioural Cluster Analysis ("BCA") study. This is a unique piece of research that has reviewed the behavioural patterns in 390 cases of misconduct in financial markets over an extended period of time (225 years stretching back to 1792) and covering 26 countries and multiple asset classes. This review indicates that the behavioural patterns evident in misconduct events are not unique to each case but that the same 25 behavioural patterns are evident in market misconduct cases and these consistently repeat and recur over time.

The purpose of the work is practical. This work addresses a number of the findings of the Fair and Effective Markets Review 2015 (FEMR). In particular, identifying the root causes and relevant behaviours which underlie market misconduct is an essential step in preventing them recurring and the work leverages the experience of domestic and international markets to do this. The FEMR also called for the provision of real-life case studies in areas detrimental to the effective operation of markets and the need for the industry to reinforce collective memory in these areas.

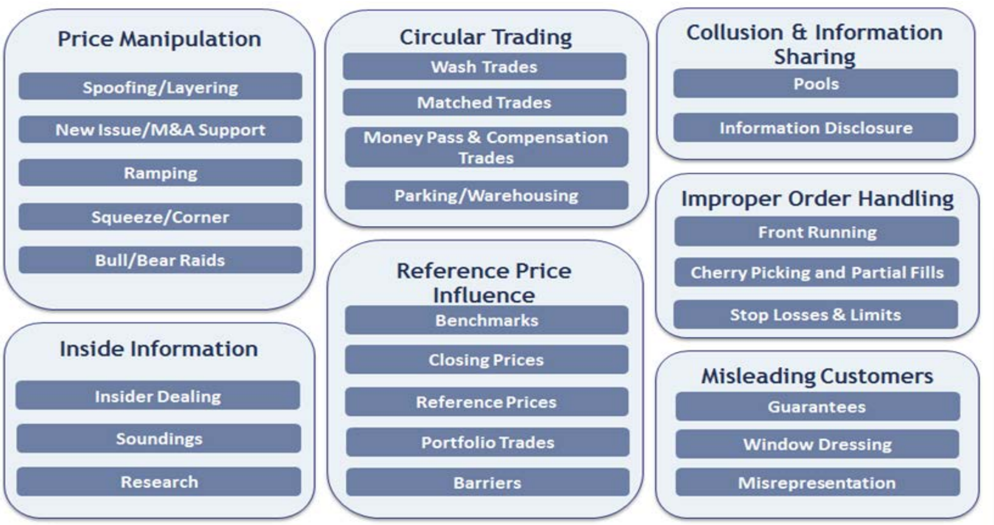
The FEMR said: *"One of the Review's most striking findings has been that, although the specific aspects of individual misconduct may have varied substantially across traders, firms and markets, the underlying behaviours were remarkably similar in many cases and relatively straightforward to describe".*

The work undertaken by FMSB involved researching and analysing information set out in a large body of enforcement cases. The materials were used to illustrate the behaviours in question, so that they can be understood by market participants and factored into systems and controls frameworks.

BCA is an evidence-based methodology based on analysis of the patterns of behaviours in actual market conduct cases brought by regulatory and other enforcement authorities. Using BCA, enforcement cases and similar source materials describing actual adverse conduct are reviewed to ascertain the pattern of behaviour indicated in each case. These are compared with those in other cases in order to determine whether the same behaviours repeat or whether the underlying behaviours are unique in each case. This is the first time that these patterns of behaviour have been collated, analysed and published as a single reference point for market participants.

Findings

The study identified 25 patterns which can be further grouped in to seven broad categories of behaviour as shown in the table below.



The work has also led to four key thematic conclusions:

1. **There are a limited number of behavioural patterns -** The materials show 25 behavioural patterns evident in market misconduct cases, which repeat and recur over time.

2. **The same behavioural patterns occur across different jurisdictions and countries -** These behavioural patterns do not respect national or jurisdictional boundaries but are evident internationally.

3. **The same behavioural patterns also occur across different asset classes -** These behavioural patterns are not specific to particular asset classes. The same patterns are evident in different asset classes.

4. **The behaviours adapt to new technologies and market structures -** Technology is not new – it has been a feature for markets for years and these same behaviours have adapted to new technologies and new forms of communication.

Case Examples

Included below are three examples cases taken from FMSB's database. FMSB has created a searchable database of misconduct cases relating to the behavioural patterns identified in the study.

- **Bull and Bear Raiding**.

  Bull and Bear Raiding (sometimes called spreading "rumours") constitutes taking a position in a security, publishing or disseminating false information in order to move the price of the security and then closing the position.

  Example. An early example is R v. de Berenger 1814 in which a conspiracy was formed between Charles de Berenger, Sir Thomas Cochrane and six others to profit from the publication of false information that Napoleon Bonaparte had been killed. Having accumulated a large position in UK Government Bonds, De Berenger appeared in the port of Dover, Kent, disguised as a Bourbon Officer and calling himself Lieutenant Colonel Du Bourg. He reported that Napoleon had been killed by the Prussians and sent a false letter to that effect to the Port Admiral at Deal for transmission to the Admiralty in London by semaphore telegraph (which was expected to be published in the press).

  Co-conspirators paraded across London Bridge in a post chaise proclaiming an allied victory and handing out handbills to that effect. The price of UK Gilts rose on the news.

  The conspirators then sold the Gilts which they had purchased prior to the bull raid on the London market.

- **Corners and Squeezes.**

  A corner arises where a party attempts to achieve a dominant controlling position in a commodity, security and/or related derivatives to influence the price of the commodity, security or related derivatives and profit from that activity. This can be undertaken to drive prices or to support them.

  A squeeze arises where a party does not seek dominance but attempts to gain control of sufficient amounts of a commodity or security to impact prices.

Example. US 1963. Soybean Oil. In what is known as the Great Salad Oil Swindle, Anthony DeAngelis, owner of the Allied Crude Vegetable Oil Refining Corp., created false warehouse receipts for non-existent soybean oil. He did this through a variety of methods including filling storage tanks with water and covering the water with a thin layer of soybean oil on top. He used the receipts as loan collateral to finance heavy trading of soybeans, soybean oil, and cottonseed oil futures (including a 1962 attempt to corner the soybean market).

Gerry Harvey, CEO of FMSB said: “Behavioural Cluster Analysis is an innovative piece of research. This is the first time that the underlying patterns of misconduct across markets, jurisdictions and asset classes have been collated and analysed over an extended period of time.

The importance of this work was set out in the Fair and Effective Markets Review. This recognised that good regulation and a sound legal framework are necessary pre-conditions for markets to operate fairly and effectively, but more is required to ensure that users of markets receive the best outcomes. As such, the purpose of BCA is a practical one. Identifying the relevant behaviours underlying market misconduct is an essential step to forestalling them.

Furthermore, technology in markets does not remove misconduct as some have suggested – our findings show that misconduct adapts to new technologies and market structures.

(“BCA”) is derived from real cases of market misconduct. By identifying the root causes and relevant behaviours which underlie market misconduct BCA supports and advances the objectives of the FEMR, in particular, in leveraging the experience of other markets and jurisdictions and providing practical examples in one source document.”

Karim Haji, Head of Banking, KPMG UK and member of the FMSB Advisory Council, adds: “The FMSB’s all-encompassing analysis of behaviour and conduct is a game changer for creating better markets.

“Perhaps for the first time, we can say that we have analysed the full range of market manipulation and therefore can more quickly identify any new variants of misconduct that emerge. It is encouraging, and slightly staggering, to think that over two centuries’ worth of market misconduct and manipulation has been boiled down to 25 behavioural patterns we need to combat.

“The Behavioural Conduct Analysis offers practical tools that will help firms instil better conduct outcomes without just writing a longer list of rules.

“The UK’s financial markets form the foundation for our financial services sector, which in turn is a key driver for the UK economy. Markets have to operate effectively, fairly and honestly, the findings of the FMSB’s analysis marks a major step towards this end, we now have a better way to manage misconduct risk, we have to make sure it is used.”

Dan Lavender, Partner, Macfarlanes LLP said: "I am delighted that we have been able to support the FMSB in the development of the Behavioural Cluster Analysis. We think the BCA will be a valuable resource for financial market participants and their advisors. It should prompt firms to think widely about the types of conduct risk they face and design systems to counteract them. It is a practical document and we hope it will become a key reference point for all financial services firms."

All materials published by FMSB are available at www.fmsb.com.

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Notes to Editors

1. The Fixed Income, Currency and Commodities ("FICC") Markets Standards Board ("FMSB") is an independent body set up by market practitioners to improve standards of conduct in wholesale FICC markets. It aims to bring transparency to grey areas in the wholesale FICC markets by identifying emerging vulnerabilities, clarifying and documenting practice and agreeing standards to improve conduct and market behaviour. Ensuring that wholesale FICC markets are transparent, fair and effective is at the heart of the FMSB's mission.

2. Setting up the FMSB was one of the main recommendations to emerge from the Fair and Effective Markets Review ("FEMR"), which was conducted by HM Treasury, the Bank of England and the Financial Conduct Authority.

3. FMSB has a Board drawn from senior executives from across wholesale markets, from corporate clients, asset managers, sell side participants and intermediaries, and infrastructure providers such as exchanges and custodians. Reporting to the Standards Board are standing sub-committees addressing Market Practices, Codes & Standards Convergence and Conduct & Ethics. The Market Practices sub-committees are split into four asset-class specific committees. There is also an Advisory Council representing the interests of member firms.

4. FMSB's members bring together sell-side investment banks, buyside asset managers, market infrastructure providers and exchanges, custodians and users of the market such as corporates. This constitution is unique. The member firms are:

FMSB

ANZ
BAE Systems
Bank of America Merrill Lynch
Bank of New York Mellon
Barclays
BHP
BlackRock
Bloomberg
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BP
Citadel Securities
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